Joint Committee on Pensions

2023 Interim Report

Annapolis, Maryland
January 2024

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THE MARYLAND GENERAL ASSEMBLY
ANNAPOLIS, MARYLAND 21401-1991

JOINT COMMITTEE ON PENSIONS

December 14, 2023

The Honorable Bill Ferguson, Co-Chair
The Honorable Adrienne A. Jones, Co-Chair
Members of the Legislative Policy Committee

Dear President Ferguson, Speaker Jones, and Members:

During the 2023 interim, the Joint Committee on Pensions met three times. The joint committee addressed legislative proposals requested by the Board of Trustees for the State Retirement and Pension System. The joint committee made recommendations on these items at its final meeting for the 2023 interim, voting to sponsor seven legislative proposals. The joint committee also had briefings on the actuarial valuation of the system and the system's investments. In addition, the joint committee had a briefing from the Maryland Teachers and State Employees Supplemental Retirement Plans, which provided an overview of the plan and information on an automatic enrollment study. A complete report of the joint committee's 2023 interim activities and legislative recommendations will be published in January 2024.

We thank the joint committee members for their diligence and attention to the work of the committee. Also, on behalf of the committee members, we thank Phillip S. Anthony, Joe Gutberlet, and Katylee Cannon of the Department of Legislative Services, and the staff of the Maryland State Retirement Agency for their assistance.

Sincerely,

Cathi Forbes

Michael A. Jackson
Senate Chair

Catherine M. Forbes
House Chair

MAJ:CMF/PSA:JG/kmc

cc: Victoria L. Gruber
Ryan Bishop
Jeremy Baker
Sally Robb

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2023 Interim Report

Over the course of three meetings during the 2023 interim, the Joint Committee on Pensions had briefings on the Teachers' and Employees' Supplemental Retirement Plans, legislative proposals requested by the Board of Trustees for the State Retirement and Pension System (SRPS), and its annual briefings on the actuarial valuation of the system and the system's investments.

Results of the 2023 Actuarial Valuation and Fiscal 2025 Contribution Rates

SRPS's funded status (the ratio of projected actuarial assets to projected actuarial liabilities) decreased from 76.6% at the end of fiscal 2022 to 74.7% at the end of fiscal 2023 (these figures exclude funding for local governments that participate in the State plan). In addition to the system's improved investment performance, the system has also benefited from reforms. The reformed benefit structure enacted in 2011 increased employee contributions, added additional caps to cost-of-living adjustments (COLA) earned after 2011, increased the vesting period and reduced the multiplier for employees hired after 2011, and appropriated a share of savings as supplemental contributions. The State also eliminated the corridor funding method in favor of a full actuarial funding method. From fiscal 2022 to 2023, the total State unfunded liability increased from $18.3 billion to $21.0 billion.

Fiscal 2025 Contribution Rates

Exhibit 1 shows that the fiscal 2025 employer contribution rates with reinvestment savings are relatively stable when compared with the fiscal 2024 rates. The aggregate contribution rate for all systems increases from 18.18% in fiscal 2024 to 19.74% in fiscal 2025. Based on projected payroll growth and other factors, the SRPS actuary estimates that total employer pension contributions will increase from $2.216 billion in fiscal 2024 to $2.619 billion in fiscal 2025. The funding levels and contribution amounts for fiscal 2025 include the $75 million supplemental contribution required by Chapter 489 of 2015 but not the pension sweeper as required by Section 7-311 (j) of the State Finance and Procurement Article. The fiscal 2025 contribution rates are the actuarially determined contribution (ADC) rates and reflect an investment return assumption of 6.8% adopted by the SRPS board for the current fiscal year.

Exhibit 1
State Pension Contributions
Fiscal 2024 and 2025 Projected
($ in Millions)

	2024		2025	
Plan	**Rate**	**Contribution**	**Rate**	**Contribution**
Teachers' Combined	15.15%	$1,238.9	16.83%	$1,464.8
Employees' Combined	21.41%	788.9	22.06%	928.2
State Police	79.04%	102.4	86.23%	125.3
Judges	43.00%	24.2	47.22%	28.9
Law Enforcement Officers	46.28%	61.7	46.76%	71.6
Aggregate	**18.18%**	**$2,216.1**	**19.74%**	**$2,618.7**

Note: Except for the Teachers' Combined System (TCS), contribution rates and dollar amounts reflect State funds only, excluding municipal contributions. For TCS, they reflect the combined total of State and local contributions. Figures also reflect the $75 million supplemental contribution required by Chapter 489 of 2015.

Source: Gabriel, Roeder, Smith, & Co., Results of the June 30, 2023, Actuarial Valuation for Fiscal Year 2025

Fiscal 2023 Investment Performance

The SRPS investment return for the fiscal year that ended on June 30, 2023, was 3.14%. This failed to meet the assumed rate of return of 6.8%. System assets increased by $0.6 billion to a market value of $65.2 billion, as of June 30, 2023. Investment returns have exceeded the assumed rate of return in only 1 of the last 5 years. The system as a whole outperformed its Investment Policy Benchmark by 0.94% (94 basis points). This benchmark is calculated by the board and allows a comparison between actual performance and a passively managed portfolio. The 5-year weighted average annual return as of June 30, 2023, is 6.93%, which is 0.65% (65 basis points) above the plan return benchmark for that period. The weighted average annual return for the past 10 years is 7.04%, which is 0.54% (54 basis points) above its benchmark for that period. Both the 5- and 10-year averages also exceed the system's assumed rates of return. The system's investment approach is cautious and, when compared to other pension funds, returns tend to underperform in years with strong asset growth and overperform in years in which assets decline. All returns are calculated net of management fees.

Maryland Teachers and State Employees Supplemental Retirement Plans

The Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) provided a briefing to the joint committee on the plans. MSRP offers optional defined contribution plans for State employees. The supplemental plans are intended to augment the retirement savings an employee will earn with SRPS. MSRP was created in 1985 to merge the responsibility for deferred compensation plans that were being administered by three different agencies. MSRP currently offers four types of retirement plans, including the 401(a) match plan that was reinstated on July 1, 2023.

401(a) Match Plan

Following the enactment of Chapter 100 of 2023, MSRP reactivated the 401(a) match plan after it had been deactivated due to a lack of funding. Under the match plan, the State provides up to $600 toward an employee's retirement savings each year if the employee meets certain criteria. Whether an employee qualifies with retirement contributions or student loan payments, the State will apply up to $600 to the employee's State supplemental retirement plan. An employee can only receive the State match from one of the two eligibility criteria in a year. MSRP reported that, as of late September 2023, 13,000 employees had enrolled in the match plan and 23,000 previous participants had re-enrolled.

Fund Performance

MSRP experienced trailing returns in fiscal 2022 amid global economic difficulty. The annual rate of returns for all of MSRP's investment options, as of June 30, 2023, for 1 year was -13.31%. The rate was much higher for 3 years (3.55%), 5 years (5.19%), and 10 years (6.96%). Similarly, the annual rate of return for all of MSRP's investment indices was negative for 1 year (-12.56%) but was higher for 3 years (4.05%), 5 years (4.98%), and 10 years (7.59%). The agency has not yet released an annual report for fiscal 2022.

Member Services

MSRP offers members services to support and educate State employees about the benefits of retirement savings. The effort is led by 4 certified retirement counselors and 2 administrative professionals. In 2023, member services were provided via in-person and virtual events, including seminars, workshops, new employee orientations, an awareness week, and a symposium. In 2022, across 194 members services events, the agency connected with 13,000 employees.

Automatic Enrollment

State employees are not required to enroll with MSRP, though 38% of eligible employees have voluntarily enrolled. During the 2023 session, Senate Bill 6 and House Bill 296 were introduced to establish automatic enrollment for new State employees. The bills did not pass, but MSRP followed up with a study on the topic. MSRP presented the study to the joint committee in October, and the agency plans to pursue automatic enrollment legislation in the 2024 session.

Board Requested Legislation

Personal Statement of Benefits

With the advent of the SRPS online member portal, MySRPS, the State Retirement Agency (SRA) believes that the personal statement of benefits (PSB) for active members has become obsolete. Section 21-112 of the State Personnel and Pensions Article requires the Board of Trustees for SRPS to provide each member with a summary of the benefits that they have accrued, including: (1) the member's vested benefits or the benefits that the member will be entitled to once they are vested; (2) the date when the member was or will be vested; and (3) the present value of any annuity that the member has earned. Historically, SRA has provided this information to the SRPS members in September of each year for benefits earned as of June 30 for the immediately preceding fiscal year. For the last three years, PSBs have not been mailed to members but have been sent to their MySRPS accounts. Members who have not set up a MySRPS account can reach out to SRA to request that their PSB be mailed to them.

When members receive their annual PSB in September, the information included in the document is membership information that is already three months old, so this outdated information conflicts with the up-to-date information that is provided on MySRPS. SRA notes that these discrepancies cause confusion and concern for the members who call SRA wanting explanations regarding these differences.

In addition, SRA notes that there are problems with the production of the PSBs each year, including the computer logic that is used to produce these documents. The format for PSBs was created long before MySRPS. As a result, prior to the PSBs being added to a member's MySRPS account, SRA staff must sample hundreds of accounts. This sampling includes checking data points that are already included on MySRPS. As recently as this year, SRA staff encountered technical issues that delayed the release of the PSBs by several weeks.

To prepare members for no longer receiving a PSB on their MySRPS account, SRA will include notice of this change in *The Mentor* (the active member SRA newsletter that is mailed to all active members) and on SRA's website. Furthermore, in summer 2024, SRA will mail postcards to the system's active members informing them that SRA will no longer be issuing PSBs and encouraging members to set up a MySRPS account. Because PSBs are only sent to active members, SRA indicated that it is confident that members who do not have a computer at home will likely have access to computers at work where they can set up their MySRPS account. For members who do not feel comfortable using their computers at work, MySRPS can be accessed from smart phones with internet capability. Members who do not have access to a computer or a smartphone may continue to call SRA for this information.

The board recommended legislation to clarify that SRA may utilize MySPRS to satisfy the requirements for the board to provide information to system members. SRA does not anticipate any fiscal impact to implement this proposal. SRA expressed confidence that while the changes may not generate any cost savings for SRA, it will free up employee resources to focus on other projects.

The joint committee will sponsor the requested legislation.

Technical Changes for Cost-of-living Adjustment Provisions – Consumer Price Index

Section 29-401 of the State Personnel and Pensions Article defines the Consumer Price Index (CPI) for purposes of calculating annual retiree COLAs as "the annual average Consumer Price Index (all urban consumers, United States city average, all items, not seasonally adjusted, 1967 = 100) for the calendar year ending December 31 as published by the United States Department of Labor, Bureau of Labor Statistics." The CPI for all urban consumers measures the monthly change in consumer prices for a representative basket of goods and services. The definition under § 29-401 uses 1967 as the base year for determining the CPI. However, the 1967 index was retired in 1988 by the Bureau of Labor Statistics (BLS) and replaced with the 1982-84 index. While BLS is still publishing the 1967 index, there is a risk that they will discontinue publishing it at some point. SRA notes this could be problematic for staff if this occurs when the legislature is out of session, as corrective legislation would not be possible until the legislature has convened. SRA reached out the Department of Legislative Services (DLS), and DLS confirmed that several other areas of the Maryland Annotated Code that reference the CPI have already switched from the 1967 index to the 1982-84 index. A comparison of the growth rate determined by SRA's formula for calculating the CPI for retiree COLAs using both the 1967 index and the 1982-84 index was recently completed. SRA's findings show that the same growth rate was calculated using the 1967 index and the 1982-84 index, indicating that had staff used the 1982-84 index to calculate the retiree COLAs for the past 10 years, this would have resulted in the same retiree COLAs that were calculated using the 1967 index.

The board recommended amending the definition of CPI under § 29-401(d) to reference the 1982-84 index instead of the 1967 index. SRA indicated that this change should have no financial impact and will provide consistency with other provisions of the Maryland Annotated Code that reference the CPI.

The joint committee will sponsor the requested legislation.

Technical Changes for Seven-year Deferred Retirement Option Program – Chapter 400 of 2023 Correction

Chapter 400 of 2023 extends the timeframe for participation in the Deferred Retirement Option Program (DROP) for members of the State Police Retirement System (SPRS) and Law Enforcement Officers Pension System (LEOPS) from five years to seven years. Section 2 of

Chapter 400 creates a six-month election period, from July 1, 2023, to December 31, 2023, for current SPRS and LEOPS DROP members to extend their DROP participation for up to two extra years. Chapter 400 erroneously states that members currently participating in DROP who wish to extend their participation in DROP to seven years must terminate DROP by age 60, similar to the mandatory retirement age for members of the SPRS. However, provisions of the State Personnel and Pensions Article provide that only members of SPRS are subject to a mandatory retirement age of 60; members of LEOPS do not have a mandatory retirement age.

Based on a letter from the Attorney General discussing this drafting error and the proper interpretation of the bill, SRA implemented the mandatory age provision included in Section 2 of Chapter 400 to apply only to existing SPRS members participating in DROP. The board requested a corrective change to Section 2 of Chapter 400 to correct the error of including an age restriction on the extension for existing LEOPS DROP members.

The joint committee will sponsor the requested legislation.

Reemployment of Retired Sheriffs

Current provisions of the State Personnel and Pensions Article require that members of most of the several systems, including LEOPS, separate from all employment with the State or other participating employers in order to commence receiving benefits. Most retirees of the system are prohibited from accepting any employment with the State or other participating employers within 45 days of retirement. As a member prepares to retire from the State or a participating employer of the system, SRA counselors, the member's retirement coordinators, and the language of the retirement application all make it very clear that under no circumstances should the member's decision to retire be conditioned upon an offer of reemployment. More specifically, each of these resources (SRA counselors, retirement coordinators, and the retirement application) inform a member going through the retirement process that no offers of reemployment should even be discussed by the member and a participating employer of the State prior to retirement. Finally, the retirement application that members are required to complete and sign includes an acknowledgement by the member that the member understands these restrictions and a certification that the member has had no discussions about reemployment with any employer that participates in SRPS.

The reemployment restrictions are predicated on Internal Revenue Service (IRS) rulings and Internal Revenue Code provisions that address retirement and reemployment after retirement. While IRS has not specifically defined what constitutes a bona fide separation from service, a temporary cessation of pay alone is not sufficient, particularly where there is no actual intent on the part of the member to resign from their position and discontinue all employment relationships with a participating employer.

County sheriffs are members of LEOPS. Provisions of the State Personnel and Pensions Article that govern LEOPS do not include earnings limitations for LEOPS retirees who return to work for the employer from which they retired. Over the past year, SRA has been made aware of instances regarding county sheriffs running for reelection who retired from LEOPS on

October 1, 2022, shortly before their potential reelection but at least 45 days before they would potentially be sworn in for their next term. Once sworn in, these reelected sheriffs, in addition to receiving a normal service retirement from LEOPS, also began receiving their full sheriff's salary. In these instances, the reelected sheriffs were running unopposed. As a result, it was extremely likely that these individuals would be reemployed by the same employer from which they retired. Additionally, SRA believes running unopposed and retiring within days of being sworn in raises serious questions about whether there was actual intent on the part of the retiree to resign from their position and discontinue any employment relationship with their employer.

The board believes that the State Personnel and Pensions Article should be revised to prohibit a member of LEOPS from retiring while running for elected office. The board is recommending this only with respect to LEOPS because LEOPS (1) does not have an earnings limitation for reemployed retirees and (2) is one of only three plans that includes elected officials. The Legislative Pension Plan (LPP) includes elected officials; however, retirees of LPP who are reelected are reenrolled in the LPP. The Employees' Pension System includes local elected officials, but this plan has an earnings limitation for reemployed retirees that discourages retirees from returning to work after retirement.

Alternatively, the joint committee considered addressing the issue by suspending the retirement benefits for a retiree who seeks reelection as a county sheriff after retirement. Under this approach, a retiree who is elected as a county sheriff after retirement from LEOPS would have the LEOPS retirement suspended so that no retirement benefits are paid while the individual is serving as sheriff. After the individual leaves office, their retirement benefits would resume, with the application of any COLAs that had accumulated during the time the benefits were suspended. There are existing provisions of law providing for the suspension of benefits when a retiree is employed as a judge, when a former Governor is employed by the State, and for certain disability retirees who are reemployed. Retirees who have suspended benefits retain any survivor benefits as provided by law. The approach of suspending retiree benefits when a retiree is elected as a county sheriff would also avoid a situation where an individual could time their retirement to be before they file to run for county sheriff.

The joint committee will sponsor legislation to require the suspension of a LEOPS retirement allowance while a retiree is reemployed as a county sheriff.

Title 37 Transfers of Service

Title 37 of the State Personnel and Pensions Article governs the transfer of service credit from a State or local retirement or pension system to another State or local retirement or pension system, if each system is operated on an actuarial basis. Recently, SRA discovered provisions that include an incorrect reference or are impracticable to administer. The board recommended legislation to address these issues.

Incorrect Member Contribution Rate

Section 37-203.1 of the State Personnel and Pensions Article includes an incorrect reference to the LEOPS member contribution rate as the contribution rate in effect before it was increased as part of the 2011 reforms. The board recommended correcting this reference to reflect the existing member contribution rate for LEOPS members.

The joint committee will sponsor the requested legislation.

Five Years of Service After Transferring

A provision in Title 37 states "[i]f an individual retires within five years after transferring into a new system, the benefits payable with respect to the transferred service credit may not be greater than the benefits that would have been payable by the previous system with respect to that service if the individual had remained in the previous system." In other words, if a member retires within five years of transferring into a new system, the member's retirement allowance will be calculated as a bifurcated benefit. To calculate an individual's benefit, SRA reports it would need to determine what the benefit formula was in the old plan for the period of time that the member accrued service in that plan and calculate the member's benefit using that formula. Additionally, SRA would also need to calculate the member's benefit in the SRPS plan based on the years of service earned in the SRPS plan. The two calculations would then be added together for the member's total retirement allowance.

SRA reported that implementation of this provision is unrealistic due to the administrative difficulties that would be incurred. From the perspective of SRA, once a member transfers service into one of the several systems of the SRPS, the transferred service from the old system is indistinguishable from the service earned in SRPS. Staff would need to flag all accounts where a transfer was completed, and then at the time of retirement, manually break apart the service between the new and the old system to determine if the member reached the five-year threshold in their State system. If the member did not meet the five-year threshold, staff then would need to determine the benefit multiplier of the old system in effect at the time that the member transferred, in order to manually calculate the benefit for the service from the old system. While this would be very difficult if the member were moving between the several systems of the State, it would be next to impossible for members who transfer from a local retirement or pension system into a State system. As a result, SRA has not been able to implement this provision. Additionally, SRA indicated that it is unaware of any local retirement or pension system that implements this provision. The board recommended repealing the five-year requirement for transferred service to be calculated under the benefit calculation formula of the plan into which service was transferred.

The joint committee will sponsor the requested legislation.

Extraordinary Salary Increases

SRA recently learned of several State agencies that have completed or will be completing formal compensation studies for the employees of those agencies. Of the agencies that have already completed compensation studies, some have found that the compensation of their employees is well below the midpoint salary for similar positions either based on neighboring states or, in some instances, nationally. To correct this, many State employees have received significant salary increases, including some State employees who have received salary increases greater than 20%.

Provisions of the State Personnel and Pensions Article currently provide that a member's average final compensation (AFC) does not include a salary increase in the last three years of employment (or five years if the individual became a member of one of the several systems on or after July 1, 2011) if it is an extraordinary salary increase according to SRPS regulations. The system's regulations provide that an increase of more than 20% to a member's average earnable compensation is considered an extraordinary salary increase and is not included in the member's average annual earnable compensation in any one of the last three years or five years of employment, unless:

1. the increase is the result of the member's:

   a. promotion by the member's employer; or

   b. appointment or election to a public office;

2. including the increase when determining the member's average final compensation would increase the member's allowance by $25 or less per month; or

3. the Board of Trustees determines that the increase is not an extraordinary salary increase.

The regulations further provide the process for SRA to follow when faced with a member who may have received an extraordinary salary increase. At the time of retirement, if staff determines that the member may have received an extraordinary salary increase in the period used to determine the member's AFC, staff shall prepare a preliminary report that includes: (1) a list of each member who has been preliminarily determined to have received an extraordinary salary increase; (2) the member's employer; (3) the amount of increase to the member's AFC; (4) the reason provided to SRA by the member's employer for the increase; and (5) a comparison of the member's allowance calculated with and without inclusion of the extraordinary salary increase in the member's AFC. After the report is prepared, SRA staff sends each member listed in the report a copy of the report with a statement of the member's right to file with the Executive Director of SRA a written statement of the reasons why the member believes the determination that the member received an extraordinary salary increase is incorrect. The Executive Director is then required to submit to the board a report that includes a copy of the report and any written statement received from a member disagreeing with SRA's findings. Following the board's review of these documents, the board shall determine whether each member received an extraordinary salary increase.

A review of the legislative history of the provisions governing extraordinary salary increases for purposes of retirement benefits indicate that the original provisions were added to the Maryland Annotated Code in 1972. The original 1972 provisions were enacted following a

1971 report from the Retirement Subcommittee of the Joint Audit and Budget Committee of the General Assembly. In that report, it was brought to the subcommittee's attention that several persons just prior to retirement had received large lump sum salary adjustments, which put them in an advantageous position when determining their AFC. To preclude possible abuse, the subcommittee recommended that any extraordinary increases in the final year's salary be excluded from the AFC determination, leaving to the discretion of the Boards of Trustees of the Retirement Systems what constitutes "extraordinary." Since 1972, very few nonsubstantive changes have been made to the provisions addressing extraordinary salary increases that exist today in the State Personnel and Pensions Article.

Given that SRA's regulations require that the board review each individual case of a member receiving an extraordinary salary increase and only at the time of retirement, the board is unable to review any particular agency's salary increases as a whole and in advance of the retirement of the impacted employees. In fiscal 2023, the board received only one report of an extraordinary salary increase.

SRA staff received salary increase data from two agencies that have performed compensation studies in recent years. The first was a compensation study performed by Agency X, wherein this agency compared the compensation of its entire agency with comparable positions of the neighboring states to Maryland and local jurisdictions within Maryland. This study resulted in 121 employees of Agency X receiving salary increases of more than 20% in fiscal 2023. Of the 121 employees, 13 are eligible to retire immediately with a normal service retirement allowance. If any of these 13 employees were to retire today, the computation of their AFC would include one year (fiscal 2023) when they received an extraordinary salary increase. The second agency, Agency Y, compared the compensation of 26 of its employees within a certain group of the agency with comparable positions nationally. Ultimately, this study resulted in 4 employees in this group receiving salary increases greater than 20% in fiscal 2023. Of these 4 employees, 1 employee is eligible to retire immediately. Accordingly, this member's AFC would include a year when the member received an extraordinary salary increase.

Additionally, while provisions of the State Personnel and Pensions Article provide that the board has the authority to determine through its regulations what constitutes an extraordinary salary increase, SRA staff believes that due to the potentially significant increase of instances that might qualify under the board's existing regulations and the fact that these salary increases are as a result of compensation studies for either entire agencies or groups of employees within an agency, changes to the existing policy should come at the direction of the General Assembly. For that reason, the board presented this issue to the joint committee requesting guidance and offered the following possible options to address this issue.

Option A – Status Quo

The first option offered by the board to the joint committee is to maintain the current status quo and not direct the board to make any changes to its current policy regarding extraordinary salary increases. Under the board's regulations, a member's AFC will include annual compensation in any year that a member receives up to a 20% salary increase, and anything above

20% is not included in the calculation of the member's retirement allowance. However, if a member receives a salary increase of greater than 20% and continues to work for three or five additional years (depending on when they joined the system), the full amount of the salary increase, including any increase above 20%, will be included in the member's retirement allowance calculation. Maintaining the current practice governing extraordinary salary increases could serve as an incentive for members to remain with the State or a participating employer of the system for a longer period of time.

Options B1 and B2 – Amend the Period of Time When an Extraordinary Salary Increase Is Not Included in a Member's AFC and/or Increase the Cap Before an Increase is Considered Extraordinary

As discussed previously, provisions of the State Personnel and Pensions Article provide that, subject to certain exemptions outlined in the board's regulations, a member's AFC will not include an extraordinary salary increase if a member receives the salary increase in the last three years of employment, or last five years of employment if the member joined the system on or after July 1, 2011. The board recommended that the joint committee consider reducing the time for all members under which an extraordinary salary increase greater than 20% would not be included in the member's AFC, regardless of when they joined the system. For example, instead of excluding from a member's AFC any extraordinary salary increase above 20% that occurs within the last five years of employment for individuals who joined the system after July 1, 2011, this period of time could be amended to three years, so all members of the system are treated the same with regard to these salary increases. While such a change would create parity with the pre- and post-pension reform members, SRA noted that reducing the five years to three years would not impact how extraordinary salary increases are treated for pre-reform members.

Alternatively, the board offered that the joint committee could reduce the period of time to two years for all members. This would provide both the pre- and post-reform members with a lesser period of time that they would have to continue working after receiving an extraordinary salary increase while maintaining some guardrails to incentivize members to continue working following such an increase.

Another option the board presented to the joint committee to consider is raising the salary increase cap from 20% to 30% before the increase is considered extraordinary. Such a change would provide a member with 10% more of their salary increase factored into their AFC before it would be considered extraordinary.

SRA advised that the joint committee should note that any change to the policy could result in a fiscal impact to the State. Under the first suggestion, the number of individuals who would be eligible to have an extraordinary salary increase of greater than 20% factored into their AFC would increase. The second suggestion would not increase the number of individuals who would be eligible to have their increase factored into their AFC; however, it would increase the benefit amount for any member who retires within three or five years of receiving the salary increase. SRA cannot confirm that the fiscal impact resulting from either change to the existing policy would be de minimis and advises the joint committee to consult with the General Assembly's actuary to determine what the increased cost to the State will be.

Option C – Include an Exemption for Extraordinary Salary Increases Resulting from Formal Compensation Studies

SRA noted that it could be argued that when the provisions of the State Personnel and Pensions Article addressing extraordinary salary increases and SRA's corresponding regulations were introduced in 1972, the notion of formal compensation studies of comparable positions for State employees was not contemplated. Because of this, when the list of exemptions for these increases was established in the board's regulations, the board may not have considered adding an exemption for extraordinary salary increases resulting from compensation studies. Now faced with several State agencies already having completed such studies and with many agencies preparing to complete these studies in the near future, SRA noted that the joint committee could choose to codify the board's existing regulations and add an exemption for salary increases that are related to a review and adjustment to the compensation for a position classification based on a compensation study. Under this option, the board recommended including the Department of Budget and Management when drafting any legislation to implement this change, as compensation studies are personnel-related studies.

SRA noted that providing an exemption for any salary increase (regardless of the amount of the increase) that is the result of a compensation study will have a greater fiscal impact on the system than the previous option proposed to reduce the period of time a member would have to work following receipt of such an increase. However, SRA reported there are very few members who receive such large increases compared to the total membership of each plan. This, coupled with the fact that only a small amount of the membership pool would be immediately eligible to retire, may result in the actuary determining that the fiscal impact to the system would be de minimis.

The joint committee will sponsor legislation to exclude any increase in compensation from being considered an extraordinary salary increase if the increase was related to a review and adjustment to the compensation for a position classification.

Appendix 1

Maryland State Retirement and Pension System

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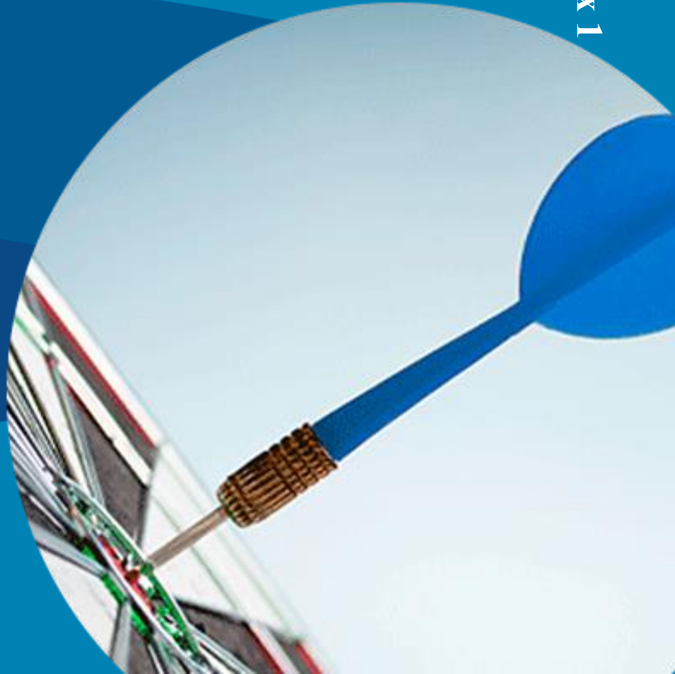
Results of the June 30, 2023 Actuarial Valuation for Fiscal Year 2025

November 16, 2023 Meeting of the
Joint Committee on Pensions



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GRS

Background

Purposes of the Actuarial Valuation

- Measure the financial position of MSRPS
- Provide the Board with State and PGU contribution rates for certification
- Provide certain disclosure information for financial reporting
  - Included in separate GASB 67/68 report
- Analyze aggregate experience over the last year

Funding Objectives

1. Benefit Security
   - Plan sponsor commitment, strong governance, effective administration, and accommodated by sources of revenue.
2. Stable pattern of contribution rates
   - Average State Contribution rate increased by 1.27% of payroll this year.
3. Intergenerational equity with respect to plan costs
   - This is a long term goal. We will only know in hindsight if it is achieved. The break with corridor funding was a step in the right direction.
4. Stable or increasing ratio of assets to liabilities
   - Funded ratio decreased this year on an actuarial value of assets basis and on a market value basis.

Primary Assumptions (No changes for 2023)

- Economic assumptions updated for 2021 valuation
  - Economic Assumptions
    - 6.80% investment return; 2.75% payroll growth; 2.25% CPI
    - 1.96% COLA, 2.24% COLA, 2.25% COLA for service where COLA is capped at 3%, 5% or not capped, respectively
    - 1.30% COLA for service earned after July 1, 2011 where COLA is capped at 2.5% in years when the System earns at least the investment assumption or capped at 1% in years when the System earns less than the investment assumption

- Valuation asset method adjusted in 2021 valuation
  - 40% of FY 2021 investment gains recognized in initial year (rather than 20%)
    - 15% recognized in each following 4 years
- Demographic actuarial assumptions based on the 2014-2018 experience study (first used in 2019 Valuation)
  - Demographic Assumptions
    - Public Sector mortality tables with generational mortality projection using scale MP-2018
      - Calibrated to MSRPS experience
    - Retirement, termination, disability and seniority and merit salary increase rates based on plan experience

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Variables Affecting Valuation Results

- Benefits (Retirement, Disability, Survivor)
- Actual past experience
- Recent Legislative Changes
  - 2023 General Assembly passed SB 139
    - Increase maximum DROP participation time from 5 to 7 years (or up to 32 years of service) for State Police and LEOPS
  - 2023 General Assembly passed SB 466
    - Implements "layered" amortization of unfunded liability by source for State Systems effective July 1, 2023 (will first affect the 2024 valuation)
  - 2020 General Assembly passed HB 588
    - Member contributions cease upon reaching maximum benefit for State Police (28 yrs.) and LEOPS (32.5 yrs.)
  - 2018 General Assembly passed HB 1042 and 1049
    - Increased LEOPs maximum benefit and extended State Police DROP participation
  - 2017 General Assembly passed HB 28
    - Amended provisions of HB 72, below.
    - Beginning in FY 2021 and continuing until the System is 85% funded, 25% of the budget surplus in excess of $10 million, up to a maximum of $25 million, would be made as an additional contribution to SRPS.

Funding Policy

- Entry Age Actuarial Cost Method
- 5-year asset smoothing/20% market value collar
  - 40% of FY2021 gains recognized, with 15% recognized in each following year
- Amortization policy
  - State Systems
    - Single period closed amortization ending in FY 2039 (15 years remaining in 2023 valuation)
    - Layered amortization will begin in 2024 valuation
      - 15 years for experience gains and losses
      - 25 years for changes in actuarial assumptions and methods
      - 10-15 years for benefit changes
      - 5 years for early retirement incentives
  - Municipal Systems
    - ECS: Single period closed amortization period ending in FY 2043. 19 years remaining in 2023 valuation (FY 2025).
    - LEOPS: Single period closed amortization period ending in FY 2040
    - CORS: Single period closed amortization period ending in FY 2047
    - Single period amortization needs to be reconsidered to control volatility once remaining period falls below about 10-15 years.
  - Level % of payroll

PARTICIPANT DATA

Demographic Data

	Statistics as of June 30				
	2023			2022	
Number Counts	**State**	**PGU**	**Total**	**Total**	**% Chg**
Active Members	172,277	26,370	198,647	194,210	2.3%
Vested Former Members	40,995	6,092	47,087	47,503	-0.9%
Retired Members	153,951	20,658	174,609	172,235	1.4%
Total Members	367,223	53,120	420,343	413,948	1.5%
Total Valuation Payroll ($ in Millions)	$12,853.0	$1,531.6	$14,384.6	$13,201.8	9.0%
Active Member Averages					
Age	46.1	48.5	46.4	46.5	-0.1%
Service	12.2	10.7	12.0	12.3	-2.3%
Pay	$ 74,607	$ 58,081	$ 72,413	$ 67,977	6.5%
Total Retiree Benefits ($ in Millions)	$4,428.8	$373.1	$ 4,801.8	$ 4,516.8	6.3%
Average Retiree Benefit	$ 28,767	$ 18,059	$ 27,501	$ 26,225	4.9%

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ASSET DATA

Actuarial Value of Assets - ($ Millions)

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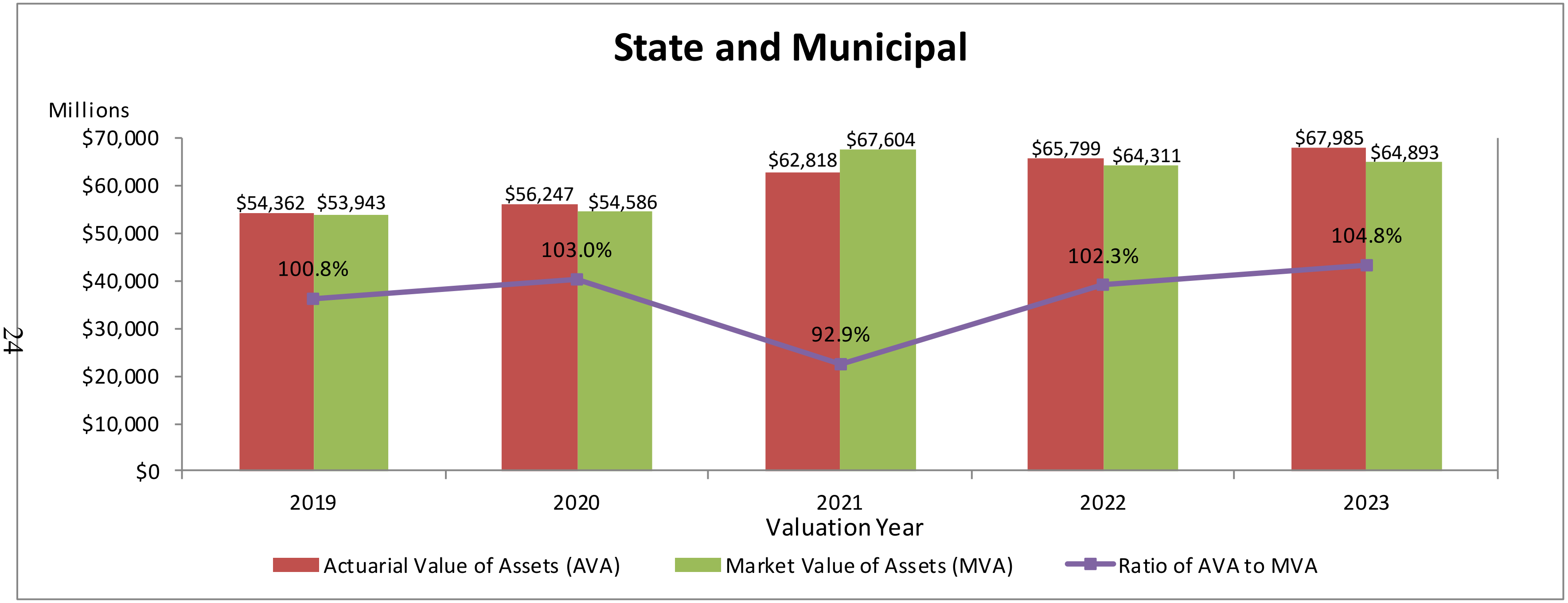

The actuarial valuation is not based directly upon market value, but rather uses a smoothed value of assets that phases in each year's gain or loss above/below the investment return assumption over 5 years.

STATE RESULTS

Aggregate Experience, Net Increase in State Rates

Downward Forces

- Payroll increase of 8.9% vs. 2.75% assumed (affects UAAL rate)
- More Members in Reformed Systems

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Upward forces

- Less Investment Return (5.51% actuarial, 3.11% market[1]) than 6.80% assumed
- Individual Pay Increases above assumptions
- FY 2024 COLA above assumption (8.003% vs. 2.25% for unlimited, 3% vs. 1.96% for 3% Cap, and 1.0% vs. 1.30% for Reformed)

[1] *Rate shown is based on actuarial estimation method and differs modestly from figures reported by State Street.*

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Actuarially Determined Contribution Rates (% of Pay)

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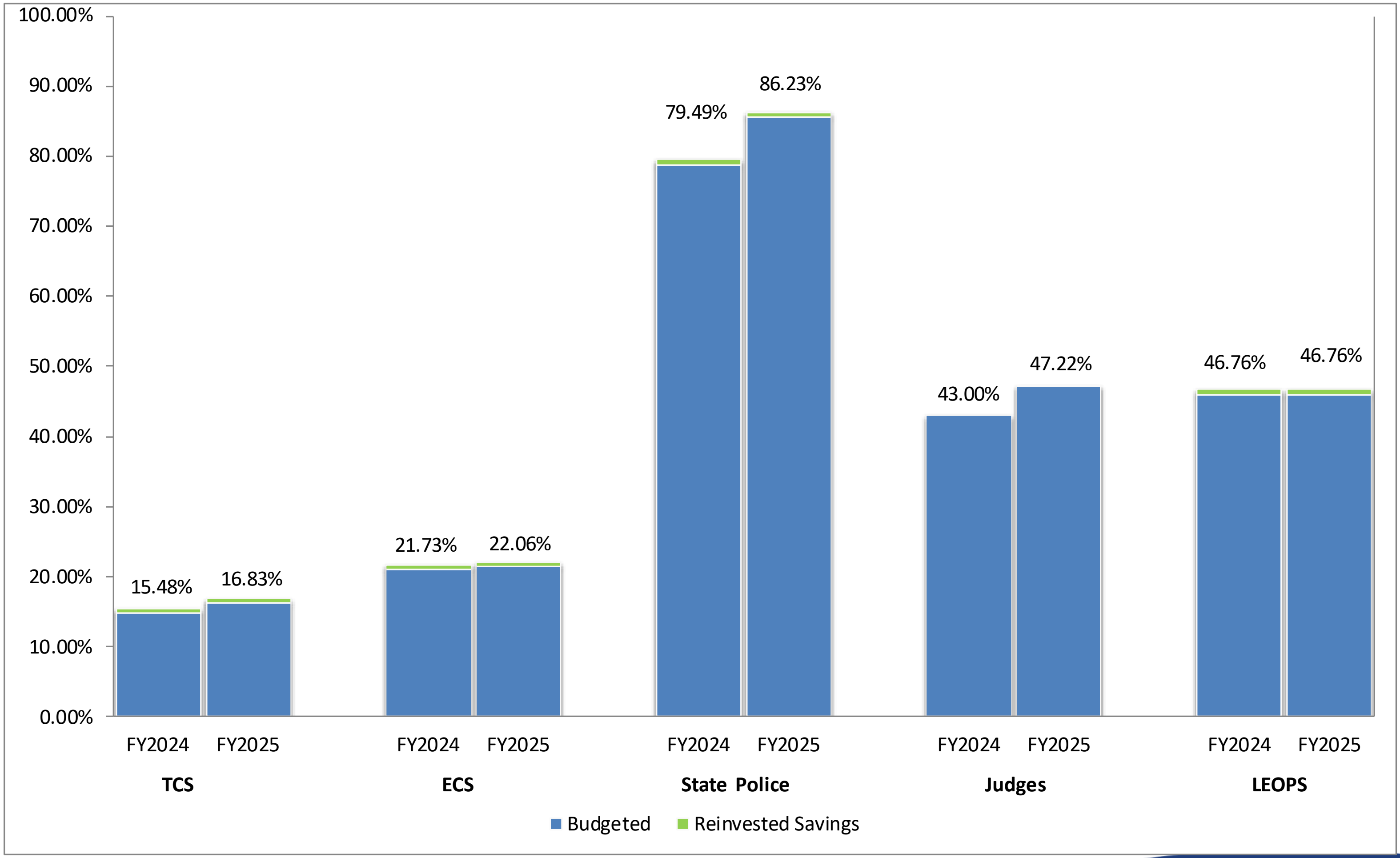

Year to Year Comparison of Results: STATE Systems

(STATE ONLY except as noted, $ in Millions)

	Teachers' Combined System	Employees' Combined System	State Police	Judges	LEOPS	Total
FY 2025 Contr. Rate (w. Reinv. Savings)[1]	16.83%	22.06%	86.23%	47.22%	46.76%	19.74%
FY 2024 Contr. Rate (w. Reinv. Savings)[1]	15.48%	21.73%	79.49%	43.00%	46.76%	18.52%
Increase/(Decrease) from Prior Year	*1.35%*	*0.33%*	*6.74%*	*4.22%*	*0.00%*	*1.22%*
FY 2025 Actuarial Contribution Rate[2]	16.25%	21.54%	85.51%	47.22%	46.00%	19.15%
FY 2024 Actuarial Contribution Rate[3]	14.86%	21.13%	78.68%	43.00%	45.89%	17.88%
Increase/(Decrease) from Prior Year	*1.39%*	*0.41%*	*6.83%*	*4.22%*	*0.11%*	*1.27%*
2023 Actuarial Value of Assets	$ 41,303	$ 17,196	$ 1,939	$ 613	$ 988	$ 62,039
2023 Unfunded Actuarial Liability	11,145	8,303	965	102	486	21,001
2022 Unfunded Actuarial Liability	9,634	7,395	796	70	438	18,333
Increase/(Decrease) from Prior Year	*1,511*	*908*	*169*	*32*	*48*	*2,668*
Funded Ratios						
2023	78.8%	67.4%	66.8%	85.8%	67.0%	74.7%
(Including Municipal)[4]		70.6%			67.9%	75.3%
2022	80.6%	69.2%	70.1%	89.5%	68.1%	76.6%
(Including Municipal)		72.5%			68.9%	77.2%
Increase/(Decrease) from Prior Year	*(1.9%)*	*(1.7%)*	*(3.3%)*	*(3.8%)*	*(1.0%)*	*(1.9%)*
(Including Municipal)		*(1.8%)*			*(1.1%)*	*(1.9%)*

[1]Contribution rates with Reinvested Savings are illustrative only and are shown to facilitate comparison when including the $75M as a percent of payroll.
[2]FY 2025 Actuarial Contribution Rate assumes Reinvested Savings of $35.3M will be contributed in FY 2024.
[3]FY 2024 Actuarial Contribution Rate assumes Reinvested Savings of $75M will be contributed in FY 2023.
[4]Municipal Actuarial Value of Assets of $5,946 Million and Municipal Unfunded Actuarial Liability of $1,333 Million are also included in the development of the Total Funded Ratio of 75.3%. Contribution rates are percent of pay. Contribution rates are percent of pay.

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Reconciliation of Employer Contribution Rates (% of Pay)

	Teachers' Combined System	Employees' Combined System	State Police	Judges	LEOPS	Total
FY 2024 Actuarial Contribution Rate	**14.86%**	**21.13%**	**78.68%**	**43.00%**	**45.89%**	**17.88%**
Change due to Investment Return	0.53%	0.46%	1.50%	1.14%	0.75%	0.52%
Change due to Demographic and Non-Inv. Exp.	1.19%	1.91%	10.38%	3.65%	3.00%	1.55%
Change due to Benefit Provisions	0.00%	0.00%	-0.67%	0.00%	-0.65%	0.00%
Change due to Total Payroll Experience	-0.40%	-1.92%	-5.35%	-0.88%	-3.26%	-0.84%
Change due to Other	0.07%	-0.04%	0.97%	0.31%	0.27%	0.04%
FY 2025 Actuarial Contribution Rate	**16.25%**	**21.54%**	**85.51%**	**47.22%**	**46.00%**	**19.15%**
Reinvested Savings Rate	0.58%	0.52%	0.72%	0.00%	0.76%	0.59%
Final FY 2025 Total Budgeted Contr. Rate	**16.83%**	**22.06%**	**86.23%**	**47.22%**	**46.76%**	**19.74%**
Investment Gain/Loss as % of Payroll	-6.1%	-5.2%	-17.1%	-13.0%	-8.5%	-6.0%
Non-Investment Gain/Loss as % of Payroll	-13.8%	-21.7%	-118.1%	-41.5%	-34.1%	-17.8%
Total Payroll Increase from Prior Year	6.4%	14.2%	12.1%	8.8%	14.8%	8.9%

Contributions for FY 2024 were based upon the June 30, 2022 valuation.

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Allocation of Contribution to Local Employers (Boards of Education)

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Teachers Combined System

	FY2025 Contribution ($ in Millions)			
	% of Pay	Total	Local Employers	State
Employer Normal Cost	4.96%	$ 431.7	$ 397.1	$ 34.6
UAAL Amortization	11.29%	982.3	-	982.3
Reinvested Savings	0.58%	50.8	-	50.8
Total	16.83%	$ 1,464.8	**$ 397.1**	$ 1,067.7

	FY2024 Contribution ($ in Millions)			
	% of Pay	Total	Local Employers	State
Employer Normal Cost	5.04%	$ 412.1	$ 380.2	$ 31.9
UAAL Amortization	9.82%	802.9	-	802.9
Reinvested Savings*	0.29%	23.9	-	23.9
Total	15.15%	$ 1,238.9	**$ 380.2**	$ 858.7

**Reflects the reduction to the FY 2024 reinvested savings amount from $75 to $35.3 Million.*

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Municipal Results

Year-to-Year Comparison of Results: MUNICIPAL Systems

(MUNICIPAL ONLY, $ in Millions)

	Employees' Combined System	LEOPS	CORS	Total
FY 2025 Basic (Pooled) Contribution Rate	8.44%	38.07%	15.42%	**10.32%**
FY 2024 Basic (Pooled) Contribution Rate	7.79%	36.91%	11.87%	**9.58%**
Increase/(Decrease) from Prior Year	*0.65%*	*1.16%*	*3.55%*	*0.74%*
2023 Actuarial Value of Assets	$ 5,411	$ 493	$ 43	$ 5,946
2023 Unfunded Actuarial Liability	1,106	215	12	1,333
2022 Unfunded Actuarial Liability	923	188	5	1,116
Increase/(Decrease) from Prior Year	*183*	*27*	*6*	*217*
Funded Ratios				
2023	83.0%	69.6%	78.6%	**81.7%**
2022	85.1%	70.8%	88.7%	**83.8%**
Increase/(Decrease) from Prior Year	*(2.1%)*	*(1.2%)*	*(10.1%)*	*(2.1%)*

The Municipal systems experienced actuarial losses overall, comprised of investment losses on the actuarial value of assets, higher than assumed COLAs and individual salary increases. Total payroll increases exceeded the assumption which reduced the contribution rates slightly. CORS saw a large increase in Unfunded Liability due to a PGU transferring members to CORS.

Contribution rates are percent of pay.

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CONCLUSION

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Recommended Budgeted Contributions Fiscal Year 2025: STATE

	Fiscal 2025		Prior Year	
System	**Actuarial Rate**	**Illustrated Dollars (Millions)**	**Actuarial Rate**	**Illustrated Dollars (Millions)**
TCS	**16.25%**	$1,414	14.86%	$1,215
ECS	**21.54%**	906	21.13%	778
State Police	**85.51%**	124	78.68%	102
Judges	**47.22%**	29	43.00%	24
LEOPS	**46.00%**	70	45.89%	61
Total	19.15%	$2,544	17.88%	$2,181
TCS Local Employer Portion		397		380
Total State Only Portion		$2,147		$1,801

Reinvested savings of $75 Million are to be added to the amounts above. The final Illustrated State Total for FY 2025 is therefore $2,222 Million plus any amounts resulting from the sweeper amendment. Contribution rates are percent of pay.

Recommended Basic Contributions Fiscal Year 2025: MUNICIPAL

System	FY 2025	FY 2024
ECS	**8.44%**	7.79%
LEOPS	**38.07%**	36.91%
CORS	**15.42%**	11.87%

PGU Contributions consist of the basic pooled rate shown above, certain surcharges, deficits or credits related to pre-2001 ECS liability, and new entrant and withdrawal payments and credits, all of which are shown in the full report. Contribution rates are percent of pay.

Concluding Comments

- Experience in total was unfavorable during FY 2023 leading to an increase in aggregate State (and Municipal) employer contribution rates.
- Upward pressure on contribution rates expected through FY 2029 due to deferred asset losses.
- State Systems are targeting a 100% funded ratio by 2039.

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Disclosures

- This presentation is intended to be used in conjunction with the June 30, 2023 actuarial valuation reports. This presentation should not be relied on for any purpose other than the purpose(s) described in the valuation reports.

- This presentation shall not be construed to provide tax advice, legal advice or investment advice.

- The actuaries submitting this presentation (Brad Armstrong and Jeff Tebeau) are Members of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

- The purposes of the actuarial valuation are to measure the financial position of MSRPS, assist the Board in establishing employer contribution rates necessary to fund the benefits provided by MSRPS, and provide certain actuarial reporting and disclosure information for financial reporting. There is an additional report and documents with other actuarial reporting and disclosure information for financial reporting.

Disclosures

- Future actuarial measurements may differ significantly from the current and projected measurements presented in this presentation due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's funded status); and changes in plan provisions or applicable law.

- This is one of multiple documents comprising the actuarial reports for the combined systems and the municipal corporations. Additional information regarding actuarial assumptions and methods, and important additional disclosures are provided in the Actuarial Valuations as of June 30, 2023.

- This results in this presentation were prepared using our proprietary valuation model and related software, which in our professional judgment, has the capability to provide results that are consistent with the purposes of the valuation and has no material limitations or known weaknesses. We performed tests to ensure that the model reasonably represents that which is intended to be modeled.

- If you need additional information to make an informed decision about the contents of this presentation, or if anything appears to be missing or incomplete, please contact us before relying on this presentation.

Appendix 2

Annual State Retirement and Pension System Investment Overview

Presented to the
Joint Committee on Pensions

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

December 2023

Annual State Retirement and Pension System's Investment Overview

At the request of the Joint Committee on Pensions, the Department of Legislative Services (DLS) annually reviews the investment performance of the State Retirement and Pension System (SRPS) for the preceding fiscal year. This report is intended to provide an overview of SRPS performance, a comparison of this performance to its peers, and an identification of issues meriting further comment by the State Retirement Agency (SRA).

State Retirement and Pension System Investment Performance

Asset Allocation

The SRPS Board of Trustees sets the allocation of assets to each investment class and continuously monitors the appropriateness of the allocation in light of its investment objectives. The SRPS *Investment Policy Manual* sets forth the investment objectives:

> The board desires to balance the goal of higher long-term returns with the goal of minimizing contribution volatility, recognizing that they are often competing goals. This requires taking both assets and liabilities into account when setting investment strategy as well as an awareness of external factors such as inflation. Therefore, the investment objectives over extended periods of time (generally 10 to 20 years) are to achieve an annualized investment return that:
>
> 1. In nominal terms, equals or exceeds the actuarial investment return assumption of the system adopted by the board. The actuarial investment return assumption is a measure of the long-term rate of growth of the system's assets. In adopting the actuarial return assumption, the board anticipates that the investment portfolio may achieve higher returns in some years and lower returns in other years.
>
> 2. In real terms, exceeds the U.S. inflation rate by at least 3%. The inflation-related objective compares the investment performance against the rate of inflation as measured by the Consumer Price Index plus 3%. The inflation measure provides a link to the system's liabilities.
>
> 3. Meets or exceeds the system's Investment Policy Benchmark. The Investment Policy Benchmark is calculated by using a weighted average of the board-established benchmarks for each asset class. The Policy Benchmark enables comparison of the system's actual performance to a passively managed proxy and measures the contribution of active investment management and policy implementation.

The assets allocation is structured into five categories:

- ***Growth Equity:*** public equity (domestic, international developed, and international emerging markets) and private equity investments;

- ***Rate Sensitive:*** investments in bonds, loans, or associated derivatives with an average portfolio credit quality of investment grade;

- ***Credit:*** investments in bonds, loans, or associated derivatives with an average portfolio credit quality of below investment grade;

- ***Real Assets:*** investments whose performance is expected to exceed the rate of inflation over an economic cycle; and

- ***Absolute Return:*** consists of investments that are expected to exceed the three-month U.S. Treasury bill by 4% to 5% over a full market cycle and exhibit low correlation to public stocks.

Included within these asset classes are sub-asset classes. The board approves adjustments to the asset allocations and sets transitional targets. The board also approves target ranges for sub-asset classes as well as constraints on hedge fund exposure, with total hedge fund investments capped across all asset classes. In fall 2021, the board adjusted the system's asset allocation. **Exhibit 1** shows system asset allocations in relation to the strategic targets in effect on June 30, 2023, compared to the board's allocation targets.

Exhibit 1
State Retirement and Pension System Asset Allocation

Asset Class	Actual June 30, 2023	Target July 1, 2023
Growth Equity		
U.S. Equity	12.2%	15.5%
International Equity	7.3%	9.5%
Emerging Markets Equity	7.1%	9%
Global Equity	3.5%	n/a
Private Equity	21.8%	16%
Subtotal	***51.9%***	***50%***
Rate Sensitive		
Nominal Fixed Income	13.7%	16%
Inflation-linked Bonds	3.4%	4%
Subtotal	***17.1%***	***20%***
Credit/Debt		
High Yield Bonds and Bank Loans	7.7%	8%
Emerging Market Debt	1.0%	1%
Subtotal	***8.7%***	***9%***
Real Assets		
Real Estate	10.5%	10%
Natural Resources and Infrastructure	4.8%	5%
Subtotal	***15.4%***	***15%***
Absolute Return	**5.9%**	**6%**
Total Fund	**100%**	**100%**

Note: Columns may not add to total due to rounding.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2023; State Retirement and Pension System

The system's asset allocation is reflective of a decision to restructure the portfolio in fiscal 2008 and 2009. The overall strategy is part of an approach by the board to decrease risk through diversification in the wake of the 2008 financial crisis and is also a prudent approach as the system becomes more mature with an increasing ratio of retirees to active members. Increased investment in private equity has resulted in positive returns for the system with less experienced volatility than public equity. Lower allocations to public equity investments are expected to result in lower returns when public equities are in growth patterns. However, as public equity can be a highly volatile asset class, a more diverse investment allocation should reduce volatility to provide protection when equity markets perform poorly or decline. While mitigating volatility will result in not taking full advantage of highly performing public equity markets, more stable investment returns will also mitigate swings in employer contribution rates. The board of trustees and the investment committee monitor the allocation of assets and continue to discuss the appropriate allocation (in consultation with the system's investment staff and investment consultants) that will achieve the system's investment return needs. Given the certain nature of defined benefit payment obligations, prudent allocation strategy should consider both achieving positive returns as well as being positioned to avoid losses. While investment division staff have some authority to make tactical, short-term adjustments to asset allocations, the *Investment Policy Manual* states an objective of long-term investment strategy, acknowledging that the system's long-term investment horizon may lead to short-term volatility. The manual will reflect actions of the board altering the asset allocation and can be found on SRA's website.

Investment Performance

The system's investment return for fiscal 2023 was 3.14% net of management fees below the assumed rate of return of 6.80%. Although the system exceeded its policy benchmarks for the system as a whole, returns less than the assumed rate of return are an investment loss. As shown in **Exhibit 2**, the system's assets' market value totaled \$65.2 billion as of June 30, 2023, compared to \$64.6 billion in assets at the end of fiscal 2022.

Exhibit 2

State Retirement and Pension System of Maryland

Fund Investment Performance for Periods Ending June 30, 2023

($ in Millions)

			Time Weighted Total Returns		
	Assets	**% Total**	**1 Year**	**5 Years**	**10 Years**
Growth Equity					
Public Equity	$19,688	30.2%	13.77%	7.04%	8.41%
Private Equity	14,247	21.8%	0.26%	17.16%	16.42%
Subtotal[1]	***$33,952***	***52.1%***	***7.83%***	***10.34%***	***10.65%***
Rate Sensitive					
Nominal Fixed Income	$8,935	13.7%	-4.65%	-0.21%	1.34%
Inflation Sensitive	2,217	3.4%	-0.97%	2.62%	2.49%
Subtotal	***$11,152***	***17.1%***	***-3.70%***	***0.54%***	***1.67%***
Credit/Debt					
High Yield Bonds and Bank Loans	$2,467	3.8%	9.77%	4.15%	n/a
Private Credit	2,527	3.9%	1.02%	6.57%	8.32%
Credit Hedge Fund	33	0.1%	-12.49%	-3.74%	0.01%
Non-U.S. Credit	665	1.0%	7.79%	0.63%	-0.79%
Subtotal	***$5,692***	***8.7%***	***5.99%***	***4.18%***	***4.56%***
Real Assets					
Real Estate	$6,817	10.5%	-8.37%	6.94%	8.80%
Natural Resources and Infrastructure	3,115	4.8%	8.70%	n/a	n/a
Commodities	129	0.2%	n/a	n/a	n/a
Subtotal	***$10,060***	***15.4%***	***-3.43%***	***6.77%***	***4.59%***
Absolute Return	**$3,822**	**5.9%**	**-1.37%**	**3.02%**	**2.66%**
Multi Asset	**$236**	**0.4%**	**-1.55%**	**1.23%**	**n/a**
Cash	**$292**	**0.4%**	**5.26%**	**3.54%**	**3.67%**
Total Fund	**$65,207**	**100.0%**	**3.14%**	**6.93%**	**7.04%**

[1] The Growth Equity Subtotal includes an additional $16.8 million in stock distribution assets.

Note: Returns beyond one year are annualized. Returns are net of fees. Columns may not add to total due to rounding.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2023

Substantial investment gains or losses can impact the allocation of the investment portfolio to certain asset classes. The asset allocation targets set by the board are intended to maintain an acceptable risk tolerance for the system, providing protection for the system against investment volatility. The investment returns of each asset class can result in deviation from the target allocations, requiring additional oversight to maintain the overall asset allocation within the system's established risk tolerance.

In spite of realizing returns that were less than the assumed rate of return in fiscal 2023, **Exhibit 3** shows that the system performed 0.94% (94 basis points) above the total system return benchmark.

Exhibit 3

State Retirement and Pension System of Maryland

Benchmark Performance for Year Ending June 30, 2023

	Return	Return Benchmark	Excess
Growth Equity	**7.83%**	**6.46%**	**1.38%**
Public Equity	13.77%	13.80%	-0.03%
Private Equity	0.26%	-2.86%	3.13%
Rate Sensitive	**-3.70%**	**-3.48%**	**-0.22%**
Nominal Fixed Income	-4.65%	-4.23%	-0.42%
Inflation Sensitive	-0.97%	-1.33%	0.36%
Credit	**5.99%**	**9.01%**	**-3.02%**
High Yield Bonds and Bank Loans	9.77%	9.43%	0.34%
Private Credit	1.02%	n/a	n/a
Credit Hedge Fund	-12.49%	1.61%	-14.09%
Non-U.S. Credit	7.79%	5.94%	1.84%
Real Assets	**-3.43%**	**-6.72%**	**3.29%**
Real Estate	-8.37%	-10.33%	1.96%
Natural Resources and Infrastructure	8.70%	2.22%	6.47%
Absolute Return	**-1.37%**	**1.41%**	**-2.78%**
Multi Asset	**-1.55%**	**2.20%**	**-3.75%**
Cash and Cash Equitization	**5.26%**	**3.75%**	**1.51%**
Total Fund	**3.14%**	**2.20%**	**0.94%**

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2023

DLS requests that SRA comment on the fiscal 2023 return performance in relation to the policy benchmarks. For any asset classes and asset sub-classes that underperformed the benchmark, SRA should comment on the factors that led to the underperformance, whether those factors are expected to negatively affect performance in fiscal 2024, and what actions are being taken to mitigate those factors from impacting the fiscal 2024 returns.

Performance Relative to Other Systems

One method of evaluating the system's investment performance is to compare the system's investment performance with the performance of other systems. The Wilshire Trust Universe Comparison Service (TUCS) rankings are useful for providing a big picture, snapshot assessment of the system's performance relative to other large public pension plans. In the TUCS analysis, systems are ranked on a scale of 1 to 100, with a rank of 1 being the system with the highest investment returns for the time period. According to TUCS, the system's fiscal 2023 total fund investment performance was rated in the ninety-sixth percentile among the public pension funds with at least $25 billion in assets, as shown in **Exhibit 4**. As the system has historically had a low allocation to equity investments compared to its peers – and domestic equity in particular – the system's investment policy will have a low TUCS ranking when equity markets are experiencing strong performance, as has been the case for a number of recent years. The long-term relative performance rankings have placed SRPS' relative total fund performance in the bottom quartile, with improvement in recent years. The TUCS rankings are based on returns gross of fees.

Exhibit 4
TUCS Percentile Rankings for Periods Ending June 30
Fiscal 2020-2023

	2020	2021	2022	2023
1 Year	53	64	37	96
3 Years	60	57	37	71
5 Years	71	75	43	59
10 Years	87	88	75	78

TUCS: Wilshire Trust Universe Comparison Service

Note: Rankings for systems greater than $25 billion.

Source: Wilshire Trust Universe Comparison Service

The impact of asset allocation on total system TUCS rankings can also be seen in the system's TUCS rankings on performance within individual asset classes. When the system as a whole has experienced relatively low rankings when compared to peer systems, the system has experienced better relative performance by asset class. **Exhibit 5** shows the difference in relative rankings between the system as a whole and the system by asset class. The asset allocation has impacted the relative ranking of the total system return, with the system having lower allocations to public equity and domestic public equity in particular when compared to peer plans. This effect can also be seen in the ranking for total equity. The system does not have a bias to U.S. equity, which had strong performance in recent years. A system with higher allocations to well performing asset classes will have better relative performance. The system's 5- and 10-year returns by asset class indicate sustained above average performance in multiple asset classes. With public equity – particularly U.S. public equity – comprising very efficient public investment markets, the system's long-term average performance indicates a measured approach to balance risk and return in those volatile asset classes. While the overall performance within each asset class generally indicates successful management, the performance in fixed income has dropped significantly over the past three years.

Exhibit 5

TUCS Percentile Rankings for Periods Ending June 30, 2023

Asset Class	1-year	3-year	5-year	10-year
Total Equity	71	79	83	66
U.S. Equity	21	28	28	33
International Developed	48	32	26	52
International Emerging	62	50	83	n/a
Fixed Income	93	99	46	25
Private Equity	62	1	1	1
Real Estate	81	50	31	33

TUCS: Wilshire Trust Universe Comparison Service

Note: Rankings for systems greater than $1 billion.

Source: Wilshire Trust Universe Comparison Service

DLS requests that SRA comment on the relative TUCS performance rankings by asset class and how overall asset allocation impacts the total system's TUCS rankings.

Additionally, DLS requests that SRA comment on the drop in TUCS performance rankings in the fixed income asset class over the past three years and the volatility in the private equity ranking over the past year, and the strategies being implemented to improve performance within the asset classes.

Recent historical returns have seen both exceptionally strong and exceptionally weak returns in public equity, which demonstrates how highly volatile this asset class is. Allocations that limit exposure to more volatile assets should result in more stable employer contribution rates over time. An allocation that would result in mitigating volatility of returns (whether excess gains, returns below the assumed rate of return, or investment losses) will also mitigate the impact to employer contributions from contribution rate increases. A system's asset allocation should be impacted by a number of considerations that reflect a system's risk tolerance. A system's maturity (ratio of retirees to active members), funded status, assumed rate of return, benefit structure, regularity of full contributions, and other considerations factor into a system's risk tolerance. The importance of these factors will vary from plan to plan, leading to different tolerances for risk, variation in investment allocations, and differences in annual returns.

TUCS provides data on the risk-return profile of its members that shows that the system's level of risk over the three-year period ending June 30, 2023, was below the median for other public funds with assets greater than $25 billion. This is consistent with the system's comparatively lower allocation to public equity that can be a highly volatile asset class. The system's asset allocation strategy is intended to protect against more extreme losses in down markets. Due to the nature of the benefits that the system's investments ultimately fund, there is prudence in setting an asset allocation that achieves the necessary investment returns with the lowest level of risk capable of achieving those returns, while also mitigating volatility. The system's allocation strategy has appeared to continue providing this intended result. Despite having a return of -2.97% in fiscal 2022 and a return of 3.14% in fiscal 2023, many other plans experienced significantly higher investment losses in fiscal 2022 that necessitated a higher level of investment risk to achieve higher subsequent returns to recover the experienced losses.

DLS requests that SRA comment on how the system's asset allocation strategy mitigated investment volatility over fiscal 2022 and 2023 and the impact to the system of the mitigated volatility.

Investment Management Fees

As shown in **Exhibit 6**, SRPS incurred $434 million in investment management fees during fiscal 2023, a decrease from $569 million in fiscal 2022 fees, and fees paid as a percentage of assets were also less in fiscal 2023 than 2022. Management fees for the plan have grown substantially since the system adjusted its asset allocation to invest more heavily in alternative asset classes with higher fee structures. The shift of public equity assets to global and emerging market equity managers, which are almost all active managers, has also contributed to the growth in fees over the years. Fees will also fluctuate as assets increase or decrease.

Exhibit 6
Asset Management Fees Paid by Asset Class
Fiscal 2022-2023
($ in Millions)

Asset Class	2022 Management Fee	2022 Incentive Fee	2022 Total	2022 Fees as % of Asset	2023 Management Fee	2023 Incentive Fee	2023 Total	2023 Fees as % of Asset
Equity	$72.9	$12.7	$85.6	0.56%	$56.5	-$22.8	$33.9	0.27%
Rate Sensitive	14.5	8.6	23.1	0.41%	15.8	14.0	29.8	0.64%
Credit	7.2	n/a	7.2	0.18%	5.5	n/a	5.5	0.19%
Private Equity	134.8	n/a	134.8	1.01%	126.8	n/a	126.8	0.93%
Real Estate	45.7	8.4	54.0	0.89%	55.5	4.5	60.1	0.84%
Real Return	15.0	0.1	15.2	0.56%	18.1	0.7	18.8	0.87%
Absolute Return	61.1	70.2	131.3	2.45%	50.5	43.3	93.9	2.34%
Multi Asset	1.3	n/a	1.3	0.23%	1.1	n/a	1.1	0.49%
Credit/Debt	18.0	n/a	18.0	0.99%	18.9	0.2	19.0	0.84%
Equity Long Short	17.2	72.0	89.2	4.43%	16.4	20.4	36.8	1.97%
Service Providers	9.3	n/a	9.3	n/a	8.2	n/a	8.2	n/a
Total Fund	**$397.0**	**$172.0**	**$569.0**	**0.84%**	**$373.3**	**$60.5**	**$433.9**	**0.68%**

Note: Columns may not sum to total due to rounding. Fees as % of Asset column indicates fees as a percentage of the average market value of the asset under management.

Source: State Retirement Agency

Review of the SRPS fees by the system's investment consultant has noted that SRPS has been effective at negotiating more favorable fee arrangements than peer systems. Transitioning assets to internal management is also expected to result in fee savings to the system. As discussed below, the system has moved $12.8 billion in assets under internal management, which is approximately 20% of system assets. SRA has stated that its goal is to increase this to as much as 50% of assets by the tenth year of this program, which is 2028.

Active Management

While active management of assets results in higher overall fees, the system has benefited from active management. The system has found passive investment strategies to be effective where available. However, active management is able to add more diversification to system investments by investing in assets where active management can generate returns in assets where passive investment is not available or efficient. The goal of active management is to allow SRA to invest in assets that cannot be managed passively and thereby increase diversification and long-term returns. Additionally, active management can allow for tactical adjustments to respond to short-term or rapidly developing market conditions. **Exhibit 7** shows the system's fiscal 2023 performance where active and passive management are utilized. With respect to U.S. nominal fixed income, active management outperformed passively managed assets for the fiscal year by avoiding more substantial losses. Actively managed U.S. equity tracked closely with passive assets in the short term and outperformed passively managed assets for the fiscal year and the five-year periods. During the fiscal year, the system liquidated its passive emerging markets public equity assets, leaving only actively managed assets. For the period ending June 30, 2023, the actively managed emerging market equity assets had underperformance compared to returns that were reported for an emerging market equities index fund.

Exhibit 7
Active and Passive Management Performance
Periods Ending June 30, 2023
($ in Millions)

	Assets	1 Month	3 Months	FYTD	3-year	5-year
U.S. Equity						
Passive Management	$3,535.5	6.88%	7.95%	18.25%	14.14%	10.74%
Active Management	3,939.6	6.63%	8.71%	20.29%	13.02%	11.41%
Emerging Market Equity						
Passive Management	$0	7.60%	4.46%	5.20%	3.36%	4.13%
Active Management	4,584.7	4.36%	1.00%	2.02%	4.79%	2.61%
U.S. Nominal Fixed Income						
Passive Management	$3,729.0	-0.02%	-1.66%	-4.41%	-9.13%	0.07%
Active Management	4,219.0	0.06%	-0.94%	-0.88%	-5.66%	1.90%

FYTD: fiscal year-to-date

Note: Returns are net of fees.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2023

DLS requests that SRA comment on the strategy to allocate the system's emerging market investments fully in active management, and the potential impact of allocating a portion of the system's emerging market equity investments in passively managed index funds.

Absolute Return Fees

Absolute return fee structures typically include base fixed management fees and incentive compensation based on performance. Fees paid for absolute return were $93.9 million in fiscal 2023, which represents approximately 22% of all management fees. Absolute return comprises 5.9% of SRPS investments. With the exception of the fiscal 2021 returns, the absolute return investment return has consistently performed well below the system's assumed rate of return as well as additionally performing below the benchmark. The system's *Investment Policy Manual* describes the absolute return asset class as, "investments whose performance is expected to exceed the three-month U.S. Treasury bill by 4% to 5% over a full market cycle and exhibit low correlation to public stocks."

In fiscal 2023, managers achieved returns of -1.37% against a benchmark of 1.41%. Performance relative to benchmarks was mixed within the asset class, with only 9 of the absolute return managers achieving returns above the asset class benchmark. Returns varied considerably between under- and over-performance. A significant number of investments sustained losses with 9 managers underperforming their benchmarks by more than 5%, and 3 underperforming by almost 20%. Only 7 managers had returns exceeding the Financial Times Stock Exchange three month treasury bill benchmark of 3.75%.

Absolute return has returns below benchmarks for the 1-, 3-, 5-, and 10-year periods ending June 30, 2023. Since inception, the returns have exceeded the benchmarks, but that return is only 3.16% against a benchmark of 2.64%. In contrast, the system's cash assets (0.4% of total system assets) have returned 3.52% since inception (against a benchmark of 0.73%) and have outperformed the absolute return assets over the 1-, 5-, and 10-year periods ending June 30, 2023.

Given the historic low rate of return, underperformance relative to benchmarks, and high management fee structures, DLS requests SRA to comment on the returns of the absolute return asset class, including the market conditions leading to the low level of returns and benchmark underperformance, and what market conditions would result in markedly improved returns for investments in the asset class.

Private Equity Fees

Management fees for private equity comprised nearly 29% of total management fees, while constituting 21.8% of system assets in fiscal 2023. The reason for the higher amount of fees in private equity involves a substantial degree of active management. Fee structures typically include a fixed base management fee, plus a portion of earnings referred to as "carried interest." The management fees only reflect the base fees, not carried interest. Because of the nature of private equity fee arrangements, carried interest fees are tied to performance. When the system pays higher carried interest fees, a higher return on investment is earned by the system. SRA indicates that private equity returns are reported net of management fees and carried interest.

The private equity return was 0.26%, with a benchmark of -2.86%, and was the first time in several years in which the asset class failed to achieve double-digit returns. Investment in private equity has resulted in positive returns for the system with less experienced volatility than public equity. Returns for the 1-, 3-, 5-, and 10-year periods ending June 30, 2023, were 0.26%, 23.77%, 17.16%, and 16.42%, respectively. Returns for those same periods also provided excess returns over the asset class benchmarks. Private equity investment performance has also outperformed peer systems consistently, as noted in Exhibit 5, with the system ranking in the top 1% for its 3-, 5-, and 10-year returns in the TUCS rankings.

SRA has also been utilizing co-investments in private equity. Such investments are companion investments to private equity funds that SRPS is already investing in but would not carry the same associated fee structure. Under this approach, SRPS is effectively reducing its fees for any private equity investments it co-invests by increasing the invested funds with the co-invested portion of the investment being subject to a lower fee structure. One potential risk in co-investing is that it can result in decreased diversification by consolidating private equity assets in fewer investments. Management of private equity assets will play a crucial role in the continued success of the asset class.

In August 2023, the federal Securities and Exchange Commission (SEC) adopted new rules regarding private fund advisors. The SEC rules will require increased disclosure from private fund advisers and prohibit certain fee arrangements. The rules will require private fund advisers to supply investors with quarterly statements, including information on fees, expenses, and performance; obtain an annual audit for each fund it manages; and acquire a fairness opinion in connection with an adviser-led secondary transaction. In its fact sheet on the new rules, SEC noted the increase in private fund assets under management over the past decade and the importance of private fund assets to "millions of Americans" with "exposure to private funds through their participation in public and private pension plans, endowments, foundations, and certain other retirement plans." Compliance with the new rules is required within 12 or 18 months, depending on the required activity and size of the fund advisor. In November 2023, industry trade groups filed a court challenge to the new rule.

DLS requests SRA to provide an update on estimated carried interest for calendar 2023. Additionally, DLS requests SRA to comment on any anticipated short- and long-term impacts on the system's private equity investments of the SEC's private fund advisor rules.

Investment Division Staffing

Chapters 727 and 728 of 2018 granted the board authority to set the compensation of personnel in the SRA Investment Division and to establish positions within the division, subject to certain limitations. Investment Division staff are now to be "off-budget" and funded as system expenses. Investment positions are also now outside the State personnel system. The stated purpose of the legislation by SRA and the board was twofold. First, SRA's Chief Investment Officer (CIO) noted that the ability to create positions and set compensation would reduce compensation-related turnover in the division and help in recruitment to adequately staff the division to perform its existing functions. Testimony submitted in support of the legislation noted that the authority is expected to enhance system investment performance by maintaining and adding staff. The testimony noted that additional staffing resources will "enable the division to expand the universe of potential managers or investments to pursue, enhance the methodology of evaluating those opportunities, or design tactical strategies to adjust the mix of investments for intermediate-term performance." Additional staffing is also intended to free senior investment staff of administrative duties, resulting in increased focus on enhancing investments. The testimony noted that providing the board with authority over positions and compensation "will not result in paying the existing staff more money for doing the same job, but instead, will allow these positions to be more focused on the investment process rather than the administrative and reporting functions." The request for staffing authority contemplated SRA's need to expand its staff resources, as both the complexity of the fund assets and the size of the assets under management is expected to grow.

Since the passage of Chapters 727 and 728, SRA has been able to hire additional staff and move forward into internal management of assets. The Investment Division has grown to 46 approved positions since passage of the legislation. Periodic review of the division's operations will evaluate the need for additional future positions. Chapters 727 and 728 included limitations on the amount compensation may be increased in a fiscal year, which had led to issues with disparate compensation for division staff who were hired prior to the compensation authority being granted to the board. Chapter 356 of 2022 gave the board authority to "catch-up" these employees' salaries to the salary midpoint for their position.

Chapters 727 and 728 also included provisions establishing an Objective Criteria Committee (OCC) to review compensation for the Investment Division and to make recommendations to the board regarding the exercise of its authority to set compensation for the division. OCC scheduled three meetings during the 2023 interim to meet the statutory requirement to review division compensation. The 2018 legislation included a number of limitations on the board's authority to set compensation and, in particular, incentive compensation. The restrictions included in Chapters 727 and 728 were intended to strike a balance between giving the board necessary flexibility to be able to recruit and retain investment division personnel while also being respectful of broader compensation available to other State employees. Consistent with this intent, the authority granted to the board was a narrow authorization to set competitive compensation for positions with job responsibilities that are unique within State government, namely exercising discretion over investments of the multi-billion dollar trust that supports over 400,000 system member and beneficiary accounts. With regard to the use of incentive compensation, the legislation required incentive compensation to only be granted based upon objective criteria adopted by the board. OCC is a body charged with making recommendations to the board for the adoption of the objective criteria.

At the November meeting of OCC, the board's consultant reviewed the compensation structures for Investment Division personnel, including both base compensation and incentive compensation. The committee discussed a need to find a balance between base compensation and incentive compensation comprising an employee's total cash compensation. There was discussion of the statutory cap on incentive compensation being limited to 33% of base compensation, resulting in limitations on getting employees to the target ranges for total cash compensation. The discussion noted that incentive compensation can align an employee's personal interests with those of the system by encouraging strong investment management performance and that higher base compensation could have the result of "rewarding" underperformance. On the other hand, DLS notes that during the passage of Chapters 727 and 728, there was discussion around the risks that higher weight toward incentive compensation can incentivize an employee to take additional risks when managing system assets. There was also discussion of how Chapters 727 and 728 have impacted division recruitment and retention. It was noted that while there are some positions that have been more competitive to recruit due to national labor market issues, very few investment employees have vacated their positions since the passage of the legislation. State agency personnel vacancies were at an all-time high in fiscal 2021, much of this attributable to low State compensation. That the investment division is faring better than other State agencies suggests that compensation is more line with similar organizations than in most other State agencies.

DLS requests that SRA comment on the use of the compensation adjustment authority provided under Chapters 727 and 728 and Chapter 356, and whether the board has faced any difficulties recruiting and retaining staff since the passage of Chapters 727 and 728. DLS further requests SRA to update the committee on the number of resignations and terminations since the passage of Chapters 727 and 728.

Incentive Compensation

Fiscal 2020 was the first year in which Investment Division staff and the CIO were eligible for incentive compensation under Chapters 727 and 728. Due to restrictions on the payment of incentive compensation in years in which State employees are subject to a furlough, incentive payments are subject to deferral to ensure compliance with this restriction. Additionally, the statute requires incentive compensation to be paid out over multiple years, and the board's current policy is to pay incentives earned over a two-year period. The Acts included this requirement as a retention incentive and was modeled off of a previous existing policy of the board to pay incentive compensation for the CIO over a period of three years. Incentive compensation is earned based on the performance of assets under an employee's management. The incentive compensation earned is based on the performance of assets related to the system's actuarial rate of return, the system's policy benchmark, and asset class-specific performance benchmarks.

DLS requests that SRA update the committee on the use of incentive compensation for recruitment and retention and provide information on the number of division staff eligible for incentive compensation based on fiscal 2023 returns.

Internal Management of Assets

The second purpose under Chapters 727 and 728 was that the authority over positions and compensation would be necessary to expand and begin moving externally managed assets to internal management by division staff. The timeline indicated for internal management contemplated beginning with passively managed assets toward the end of an initial 2-year phase-in. Internal management would be broadened in years 3 through 5 to types of assets directly managed, including co-investment in private assets. By year 10, as much as 50% of assets could be managed internally. One of the arguments for internal management is that it can reduce fees paid for asset management. SRA indicates that fee savings of just 1 basis point would net the system approximately $6 million. DLS has previously noted that SRA has been effective at negotiating favorable fee arrangements with external managers, and external management provides SRPS with options to select asset managers and to diversify the management of assets among multiple managers. DLS also previously noted that a shift to internal management would require significant operational changes. Performance measures would need to be adopted to monitor and evaluate the effectiveness of internal management of system assets compared to external management. Additionally, guidelines and reporting requirements would need to be implemented to track the internal management of system funds as well as any expansion or reduction of internal management once implemented.

Since the passage of Chapters 727 and 728, the system has begun to move assets under internal management. In total, the system has moved $12.8 billion in assets under internal management, which is approximately 20% of system assets. **Exhibit 8** shows the performance of the system's internal management program. The internally managed assets generally exceeded or tracked closely with the asset benchmarks. The internally managed assets do not carry the same fee expenses as externally managed assets, and the performance shown in Exhibit 8 does not reflect fee savings.

Exhibit 8

SRPS Internal Management Performance

Investment Performance for Periods Ending June 30, 2023
($ in Millions)

	Total Assets	Fiscal 2023 Actual	Fiscal 2023 Benchmark	Inception Actual	Inception Benchmark	Inception Date
MD TIPS	$2,216.7	-1.10%	-1.33%	1.92%	1.88%	7/1/2019
MD Long Government Bonds	2,594.7	-6.49%	-6.79%	-9.12%	-9.25%	3/1/2020
MD Investment Grade Corporate Bonds	618.3	1.53%	1.55%	-6.97%	-6.65%	7/1/2021
MD Securitized Bonds	516.0	-1.24%	-1.50%	-6.04%	-6.10%	10/1/2021
MD U.S. Large Cap Equity	3,151.9	19.34%	19.36%	11.73%	11.74%	10/1/2020
MD U.S. Small Cap Equity	383.6	9.83%	9.75%	-3.41%	-3.49%	10/1/2021
MD Global Infrastructure	1,628.2	n/a	n/a	-0.19%	-0.76%	12/1/2022
MD International x U.S. Large Cap Equity	396.6	n/a	n/a	5.60%	3.03%	4/1/2023
MD International x U.S. Sci-beta Value	1,297.9	n/a	n/a	1.20%	0.57%	5/1/2023

SRPS: State Retirement and Pension System
MD: Maryland
TIPS: Treasury inflation-protected securities

Source: State Retirement Agency

DLS requests that SRA comment on the estimated fee savings attributable to internally managed assets.

Additionally, DLS requests that SRA provide an update on the Investment Division's internal management of system assets and the development of necessary compliance and controls on the use of internal asset management. More specifically, SRA should comment on how the Investment Division:

- **has developed proficiency in managing assets currently being managed internally;**

- **will develop proficiency before expanding into internal management of additional asset classes;**

- **will evaluate the performance of internal management compared to available external management services; and**

- **will develop methodologies for determining fee savings achieved through internal management.**

Investment Climate Risk

The impact of climate change on the invested assets of public (and private) retirement systems has been receiving increasing attention over the last few years. As climate-related risk to investments is becoming more well understood and manifest, investment fiduciaries are becoming more aware of the potential risks to current assets and the potential for future opportunities to invest as climate risks manifest. Much of the discussion around climate risk has focused on divesting from carbon-producing and -using businesses or severing relationships with entities who are divesting from carbon producing and using businesses. In 2022, the Maryland General Assembly adopted an approach centered around the requirement for system fiduciaries to prudently invest the assets of the system. Chapters 24 and 25 of 2022 codified the responsibility of a fiduciary of SRPS, when managing assets of the system and in accordance with statutory fiduciary responsibilities, to consider the potential systemic risks of the impact of climate change on the system's assets.

The Acts do not require the system to take any specific action from any particular asset. Instead, the goal is to ensure that the system fiduciaries are well informed of the potential climate related risks to system assets, just as they have duties to stay informed of any other financial risks to system assets. The Acts are intended to ensure that the system is aware of developing information regarding climate risk so that it is able to respond prudently and efficiently when climate related risk – or opportunity – arises. In many ways, the Acts codify activity that the system has already established as regular practice. The system has received analysis from its primary investment consultant modeling the impact of climate risk to the system's assets during the system's periodic review of the asset allocation. Previously, the system has noted that its ownership interests in businesses have provided access to engage with companies on climate risk issues. The system's *Investment Policy Manual* also has a number of policies for shareholder proxy voting on climate-related issues.

As Chapters 24 and 25 included requirements that would either continue current practices or require the build out of new activities for the system's Investment Division, it was expected that additional positions and consultants may be needed. Using the authority to create new positions within the Investment Division granted by Chapters 727 and 728, the system recently created and filled a new Senior Governance Manager position in the division to oversee activity related to environmental, social, and governance investment matters.

DLS requests SRA to provide an update on the implementation of Chapters 24 and 25.

Terra Maria Program

The Terra Maria program is the system's emerging manager program. One of the Terra Maria program's stated goals is to achieve returns in excess of benchmarks. The program has demonstrated the ability to achieve excess returns over benchmarks, with instances of significant returns over benchmarks at times. Over the past few years, SRPS reorganized the program to better utilize the asset diversification that the program can bring to SRPS. The program transition included consolidating under 5 managers, eliminating mandates for allocations to large-cap domestic equity, and increasing mandates for international small-cap and emerging markets. Program investments in domestic equity in recent years were tracking close to markets, making it more difficult to achieve excess returns in an asset class where it is already difficult to outperform the market in addition to incurring active management fees. The program has maintained a diverse roster of managers through the transition.

Total assets devoted to the program increased to $2.4 billion in fiscal 2023, up from $2.2 billion in fiscal 2022. As a proportion of total assets, Terra Maria increased from 3.4% of total assets in fiscal 2022 to 3.7% in fiscal 2023. **Exhibit 9** provides an overview of the Terra Maria program by program manager and asset class.

Exhibit 9

Terra Maria Program Performance

Investment Performance for Periods Ending June 30, 2023
($ in Millions)

		Performance			
	Total Assets	**Fiscal 2023 Actual**	**Fiscal 2023 Benchmark**	**Inception Actual**	**Inception Benchmark**
Program Manager					
Attucks International Equity	$635.6	18.59%	17.41%	10.00%	7.13%
Attucks US Equity/Rate Sensitive	969.3	3.27%	3.88%	10.01%	9.76%
Xponance	321.1	10.01%	10.08%	8.11%	8.37%
Leading Edge	490.0	15.96%	17.41%	8.63%	7.13%
Asset Class[1]					
U.S. Equity	$333.0	8.56%	11.59%	7.07%	7.25%
International Developed Equity	1,445.3	15.73%	16.19%	3.30%	2.38%
Rate Sensitive	578.4	-0.01	-0.67	1.38%	0.96%
Credit/Debt	58.0	8.41%	9.09%	3.36%	3.36%
Total	**$2,416.0**	**10.25%**	**10.86%**	**4.84%**	**4.62%**

[1] Excludes $1.4 million in emerging market investments.

Note: Actual returns are net of fees; returns beyond one year are annualized. Total assets may not sum to total due to rounding.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2023

In fiscal 2023, the program as a whole experienced returns of 10.25%, slightly underperforming the program benchmark by 0.61 percentage points. Three of the four program managers had returns below the benchmark. By asset class, only U.S. and international developed equity had strong returns but failed to outperform the benchmarks. Since inception, all four program managers have had returns above the system's assumed rate of return, with three of the four outperforming their benchmarks.

Of particular note, the actively managed Terra Maria portfolio had significantly better performance in its rate sensitive assets compared to non-Terra Maria assets. For U.S. nominal fixed income investments, Terra Maria returned -0.01% compared to returns of -0.88% for actively managed non-Terra Maria investments and -4.41% for passively managed investments.

Currency Program

Adopted in fiscal 2009, the program is designed to protect against losing value when the dollar appreciates relative to some foreign currencies in countries in which the system holds assets. During periods when the dollar is weak, the currency management program's cost manifests as a slight drag on international equity holdings. However, when the dollar appreciates, the program provides gains that help offset the currency losses generated by the strengthening dollar. As of June 30, 2023, the currency program added total value of $398.4 million since inception (up from $385.9 million through June 30, 2022). Gains when the dollar is strong should outweigh losses when the dollar is weak, and the system has taken steps to lock in program gains. The primary objective of the program is to lower volatility related to currency fluctuations.

The currency hedging program has limited application and is only applied to a relatively small portion of the system's total assets. In addition, not all foreign currencies are included in the hedging program. Due to liquidity constraints and higher transaction costs in some currencies, the program is currently limited to the euro, Japanese yen, Swedish krona, Swiss franc, Canadian dollar, Australian dollar, and British pound.

Appendix 3

State Retirement Agency

Response to Questions Received from DLS

December 7, 2023

DLS requests SRA to comment on the fiscal 2023 return performance in relation to the policy benchmarks. For any asset classes and asset sub-classes that underperformed the benchmark, SRA should comment on the factors that led to the underperformance, whether those factors are expected to negatively affect performance in fiscal 2024, and what actions are being taken to mitigate those factors from impacting the fiscal 2024 returns.

In fiscal year 2023, the System achieved an investment return of 3.14%. While this performance did not meet the long-term assumed actuarial rate of 6.8%, it exceeded the Board's policy benchmark by 0.94%, or 94 basis points, representing over $600 million in added value. The policy benchmark is the weighted average of each of the individual asset class benchmarks and represents what the System would have returned if the asset class benchmark returns were achieved and is a more appropriate benchmark when evaluating shorter-term performance. The total fund excess return of 94 basis points was a product of strong performance in the asset classes of private equity and real assets. Over the ten years ending June 30, 2023, the System has achieved an average annualized return of 7.04%, beating the policy benchmark of 6.50% by 54 basis points annualized net of all fees and expenses.

The Board of Trustees does not expect each asset class to outperform every year, but instead over time and across economic cycles, in a risk-balanced and efficient manner. The effectiveness of this asset allocation approach is demonstrated by the System's Sharpe Ratio, a commonly-used measure of risk-adjusted returns. Over the last 5- and 10-years, the System ranks in the top decile on this measure among a peer universe of similar plans. Investment Division staff reviews the performance of underperforming asset classes to assess whether the performance is consistent with expectations, or a sign of a longer-term problem. In fiscal year 2023, three major asset classes significantly trailed the performance of their respective benchmarks – rate sensitive, credit and absolute return.

The underperformance of the rates sensitive allocation for the fiscal year is due to security and sector selection by investment managers. Fiscal year 2023 was marked by significant volatility for bonds, as the Federal Reserve continued to aggressively hike the federal funds rate to get inflation under control and on a path toward the 2% target. During fiscal year 2023, the Fed raised interest rates seven times for an aggregate of 3.5%. These increases were in addition to the three hikes in fiscal year 2022 totaling 1.5%. While inflation, as measured by the Consumer Price Index, has receded from its high of 9.1% in June 2022 to 3.0% as of June 30, 2023, it remains above the Fed's 2% target.

This environment of high inflation and rising interest rates is not conducive for generating attractive returns in traditional bonds and the fixed income markets continued to struggle in fiscal year 2023. The sector of the bond market most sensitive to this environment are longer duration bonds whose values decrease more as rates rise. A few of the System's active managers were overweight duration in fiscal year 2023, which contributed to the relative underperformance. In addition to the duration overweight, the yield curve positioning of these managers detracted from performance, as they were positioned for the curve to steepen. This overweight to the short end of the curve worked against these managers, as the curve flattened over the fiscal year, particularly during the quarter ending June 30, 2023.

While the System's bond portfolio underperformed its respective benchmarks in fiscal year 2023 due to security and sector allocation, these factors are not expected to persist as the market environment evolves and transitions to another economic regime. Over the longer term, this asset class has achieved positive relative performance, as shown in Table 1 below.

Table 1
MSRPS Rate Sensitive Performance
As of June 30, 2022

	1-Year	3-Years	5-Years	10-Years
Maryland Rate Sensitive	-3.70%	-7.36%	0.54%	1.67%
Rate Sensitive Benchmark	-3.48%	-7.15%	0.59%	1.57%
Excess	-0.22%	-0.20%	-0.04%	+0.10%

The credit asset class has been a very strong performer over all time periods except for the one-year, as shown in Table 2 below:

Table 2
MSRPS Credit Performance
As of June 30, 2023

	1-Year	3-Years	5-Years	10-Years
Maryland Credit	5.99%	4.98%	4.18%	4.56%
Credit Benchmark	9.01%	2.45%	2.90%	3.46%
Excess	-3.02%	+2.53%	+1.28%	+1.10%

The underperformance for the one-year period can be explained by timing differences created by private investments being benchmarked to public indices. These private structures experience what is known as the J-curve effect, marked by low, or negative, returns during the early stage of an investment when values are typically held near cost until value creation is realized. During this initial period, the System pays management fees on these investments, which acts as an additional drag on performance. Over the past two fiscal years, the System has committed roughly $2 billion to these private credit strategies. The impact of the J-curve is accentuated when the public market credit benchmark produces a strong return, as was the case in fiscal year 2023. While private credit investments detracted from the fiscal year performance, the longer-term returns have significantly outperformed the public market benchmark, as shown in Table 3 below. These excess returns are expected to persist in the future:

Table 3
MSRPS Private Credit Performance
As of June 30, 2023

	1-Year	3-Years	5-Years	10-Years
Maryland Private Credit	1.02%	11.96%	6.57%	8.32%
Credit Benchmark	9.01%	2.45%	2.90%	3.46%
Excess	-7.99%	+9.51%	+3.67%	+4.86%

While the absolute return segment lagged its benchmark in fiscal year 2023, the portfolio provided moderate diversification and downside protection relative to the rate sensitive portfolio, returning -1.37% when bonds generated -3.70%. The objective of the absolute return portfolio is to generate a positive return over cash of 4% over time with low correlation to stocks and bonds. While this portfolio did not meet the return objective in fiscal year 2023, performance has improved over the last three years, generating an annualized return of +4.93% versus the 3-month treasury bill return of +1.33%.

Staff has positioned the absolute return portfolio to be more defensive and less volatile than the custom blend benchmark. As a result, the portfolio's benchmark is likely to experience a higher exposure to both equity and bond markets, as well as realizing a higher annualized volatility relative to the System's absolute return portfolio. Consequently, in a period marked by strong performance in public markets, like stocks in the second half of fiscal year 2023, absolute return may experience lower participation relative to its benchmark.

Given the differences in implementation and styles employed by managers in the absolute return portfolio, there often exists a high degree of performance dispersion across the different strategies. Relative performance can largely be attributed to biases in sector exposure and manager selection. In the fiscal year ending June 30, 2023, the absolute return portfolio's performance was dragged down by its exposure to a few idiosyncratic events across the portfolio.

During the year, several managers in the portfolio experienced outsized losses, contributing to significant negative attribution despite being appropriately sized in the portfolio. These losses were due to being on the wrong side of a trade to which they had outsized exposure. For example, one manager held exposure in the insurance/re-insurance market following a significant insurance triggering event, which resulted in significant losses in that portfolio. A different manager in the portfolio experienced significant portfolio losses following a contentious FCC vote that resulted in the rejection of a proposed company buyout and take-private transaction. Fiscal year 2023 proved to be a difficult environment for managers employing global macro strategies. These managers employ various trading strategies based on global macroeconomic views and their impact on relative asset prices. During the year, one macro manager in the portfolio was positioned to be short U.S. equities in anticipation of an economic "hard landing," or recession, following the Federal Reserve's rate hikes. The manager expected that these hikes would stunt economic growth and cause a broad equity sell-off, at which point the manager would benefit from the short equity position. This trade theme ultimately did not play out as the manager expected as equity markets continued to rally, and consumer sentiment and the labor market remained strong.

Staff continues to take steps to mitigate the impact that negative idiosyncratic manager events may have on the portfolio. In fiscal year 2023, staff terminated several lower conviction managers and increased investments in higher conviction existing managers, as well as investing in three new managers. Staff remains active in identifying and allocating to attractive opportunities and managers, including private investments, co-investment opportunities, and capacity constrained managers coming to market. Staff expects these changes will reduce downside risk in the portfolio and result in a more consistent return profile. In a market environment that is expected to be markedly different from previous market cycles with higher interest rates and increased volatility, staff is confident that the absolute return portfolio will improve and be able to meet long term risk and return objectives.

DLS requests that SRA comment on the relative TUCS performance rankings by asset class and how overall asset allocation impacts the total system's TUCS rankings.

As noted in the DLS Investment Overview, the System's one-year total fund performance compared against a peer group of other large public pension plans ranked in the 96th percentile. Peer group rankings are driven mainly by two factors – asset allocation and implementation of the asset allocation. Asset allocation refers to the way the fund assets are distributed to the various asset classes, and implementation refers to staff's ability to select skillful managers and tactically position the portfolio to take advantage of market opportunities.

An effective method to determine which of these factors is driving the total fund peer rankings is to analyze the peer ranking of each individual asset class. As noted in the DLS report, most of the System's asset classes have achieved above median returns over time. Private equity, the System's best-performing asset class, representing 21.8 percent of total fund assets, has consistently ranked in the top quartile of the peer group over time. In fact, for the ten-year period ending June 30, 2023, the System's private equity portfolio is ranked in the 1st percentile. That the individual asset class rankings are generally higher than those of the total fund supports the notion that the mix of asset classes is mainly driving the results, and not the performance of the individual asset classes. For example, the System has higher target allocations to non-U.S. equities than the average peer in the universe. Over the past ten years, U.S. stocks have significantly outperformed foreign stocks. The System's relative underweight to U.S. stocks has resulted in a lower peer ranking than would be assumed based solely on rankings of individual asset classes. This is also demonstrated by the System's total equity ranking in the 71st percentile for the fiscal year, while the rankings of the regional components are significantly better.

While the asset class rankings for the System's fixed income portfolio are strong over the longer-term, the performance trailed the peer group in fiscal year 2023. This is due to the longer duration profile of the System's portfolio relative to peers, who typically hold more core and shorter-duration bonds. Yields increased significantly over the fiscal year, with the ten-year treasury rate increasing from 2.9

percent to 3.8 percent. Longer-duration bonds are more sensitive to changes in interest rates and lost more in value in fiscal year 2023 than shorter-duration debt. The System allocates more to long-duration bonds for greater protection in disinflationary environments, to better match the plan's longer-term liabilities and to hedge against stock market drawdowns to preserve more principle. The correlation between stocks and bonds is typically negative, meaning as stocks go down, bonds will increase in value.

The System typically reports its peer rankings against a relatively small universe of roughly thirty public pension plans on a gross-of-fee basis. Given the System's asset allocation, with a relatively higher allocation to private market investments like private equity, private credit and real estate, it might also be instructive to measure performance against a larger universe on a net-of-fee basis. Private investments typically do not report gross investment returns, but only performance net of all fees. As a result, the System's gross returns are a combination of gross and net performance. To the extent the System invests more heavily in private investments, the difference between the gross and net numbers will be smaller relative to a peer plan that employs a higher allocation to traditional assets. This is illustrated in Table 4 below, which ranks the System's performance against a larger universe of ninety-two public pension plans after investment expenses have been netted out.

Table 4
Total System vs. Public Plans > $1 Billion Universe
(June 30, 2023 net of fees)

	1 Year	3 Years	5 Years	10 Years
Total System	**3.14%**	**8.23%**	**6.93%**	**7.04%**
Rank	**98**	**54**	**26**	**48**

* **Represents the InvMetrics Public Defined Benefit > $1 billion peer group**

The focus on investment performance tends to be on returns. However, the Board and staff recognizes that risk is equally important. To get a more complete picture of the System's investment program, risk-adjusted returns should also be evaluated. The System's risk profile, as measured by the dispersion of returns around the mean, falls in the bottom quartile of the peer group over the last five years. This lower risk posture has been achieved by targeting a lower relative weighting to public stocks versus the peer group. Sharpe ratio is another metric that accounts for risk in the assessment of investment performance, and represents risk-adjusted returns, or returns per unit of risk. Based on the Sharpe ratio measure, the System ranks in the top decile (better than 90% of funds) over the last five- and ten-years. This is illustrated in Table 5 below, which ranks the System's Sharpe ratio against a larger universe of ninety-two public pension plans after investment expenses have been netted out.

Table 5
Total System vs. Public Plans > $1 Billion Universe
Sharpe Ratio Comparison
(June 30, 2023 net of fees)

	5 Years	10 Years
Total System	**0.7%**	**0.9%**
Rank	**10**	**9**

Represents the InvMetrics Public Defined Benefit > $1 billion peer group

***Additionally, DLS requests that SRA comment on the drop in TUCS performance rankings in the fixed income asset class over the past three years and the volatility in the private equity ranking over the past year, and the strategies being implemented to improve performance within the asset classes*.**

As noted earlier, the low rankings of the fixed income asset class over the last three years can be attributed to the longer duration profile of the System's portfolio. The System allocates more to long-duration bonds for enhanced diversification in disinflationary environments, to better match the plan's longer-term liabilities and to provide downside protection against most stock market drawdowns to preserve more principle, as the correlation between stocks and bonds is typically negative, meaning as stocks go down, bonds will increase in value. While long duration bonds perform well in disinflationary environments when interest rates typically decline, they perform poorly when inflation is high, and the Fed must raise rates in response. Since March 2022, the Fed has hiked rates eleven times for an aggregate increase of 5.25%. While all bonds will struggle in this environment, long duration bonds will perform worse than shorter term bonds. While the System's bond portfolio has a low peer ranking over the last three years, we do not expect this to persist. As rates plateau or begin to fall, as has been the case in November 2023, the long duration positioning should outperform more core, shorter maturity strategies as maturity proceeds and coupon payments are reinvested at higher yields.

For the fiscal year, the System's private equity program ranked in the 62nd percentile in the TUCS universe, which appears to be an outlier relative to the top rankings over the longer term. It is difficult to assess this contrast, as there is no transparency into the composition of the TUCS universe or granular detail regarding portfolio characteristics. It appears that most of the relative underperformance occurred in the quarter ending September 30, 2022, which would reflect private equity performance as of June 30, 2022 given the quarter lag associated with private markets performance reporting. During this quarter, publicly-traded stocks performed poorly with the S&P 500 returning -16.10%. The System's private equity portfolio has a large allocation to large buyout funds, which generally appraise more closely to the public equity market and may hold more public stocks in the fund. This higher exposure to large buyout funds may explain the lower ranking for this quarter, given the significantly negative performance for public stocks. The System's investment focus continues to be generating strong long-term performance. While the performance of the private equity portfolio was below median for fiscal year 2023, the longer-term returns are near the top of the TUCS universe and represent the System's best performing asset class.

DLS requests that SRA comment on how the system's asset allocation strategy mitigated investment volatility over fiscal year 2022 and 2023 and the impact to the system of the mitigated volatility.

The Board's asset allocation policy is designed to achieve the actuarial rate of return over long periods of time by assembling a diversified portfolio of asset classes, each of which may have a large or small, positive or negative return in any given year. By assembling assets that exhibit distinct risk and return characteristics in different market environments, the Board expects more stable investment returns over time than a less diversified portfolio. This lower risk portfolio should result in a larger asset pool for the System's beneficiaries than a more volatile portfolio with the same average return. This diversified approach allowed the System to outperform its peers in fiscal year 2022 when both stocks and bonds were down, while trailing the peer group in fiscal year 2023 when public stocks rebounded sharply, particularly in the second half of the fiscal year as optimism grew around the economic benefits of artificial intelligence.

Over this two-year period, the System's diversified and balanced asset allocation generated less volatility and higher returns than a traditional portfolio consisting of 60% stocks and 40% bonds. The System's total net return over the two-year period was 0.08%, compared to -0.15% for a 60/40 portfolio of the S&P 500 stocks and U.S. bonds. This outperformance represents approximately $159 in added value over the 60/40 alternative. Even more meaningful than the higher returns achieved is the impact of lower volatility associated with the System's portfolio. When there are negative cash flows in any investment portfolio, volatility of returns results in a smaller asset pool relative to a portfolio with no cash flows. Since the System must pay monthly benefits and is in a negative cash flow position, mitigating the negative effects of volatility is critically important. In addition to the added value from higher returns, the lower volatility profile of the System relative to the 60/40 portfolio contributed even more to the Systems asset base. The lower volatility factor generated roughly $356 million, in addition to the $159 million attributable to higher returns. This comparison to a 60/40 portfolio is shown in Table 6 below.

Table 6
Total System vs. 60/40 Portfolio
Excess Dollars
(July 1, 2021 - June 30, 2023 net of fees)

	Total	**Higher Return Impact**	**Lower Volatility Impact**
System's Added Value vs. 60/40	**$515 mil**	**$159 mil**	**$356 mil**

DLS requests that SRA comment on the strategy to allocate the system's emerging market investments fully in active management, and the potential impact of allocating a portion of the system's emerging market equity investments in passively managed index funds.

The System has implemented a fully active strategy in emerging markets equity. Prior to June 2023, there was a small allocation to a passively managed index strategy valued at roughly $30 million. During June 2023, the System redeemed this small passive account. This redemption distorted the reported return for this account for the month of June 2023, resulting in incorrect longer-term performance appearing higher than the System's active portion. The System has determined that active management in the emerging markets equity asset class can outperform the passive alternative. This decision is supported by the strong performance of the System's active portfolio relative to the benchmark. This performance, as well as the returns of the passive product in which the System was formerly invested, is shown in Table 7 below.

Table 7
Emerging Market Equity Returns
June 30, 2023

	1-Year	3-Years	5-Years	10-Years
Maryland Active EM	2.02%	4.79%	2.61%	4.06%
SSGA Passive Product	1.37%	2.09%	0.75%	2.88%
Benchmark Return	1.75%	2.32%	0.93%	2.95%

Given the historic low rate of return, underperformance relative to benchmarks, and high management fee structures, DLS requests SRA to comment on the returns of the absolute return asset class, including the market conditions leading to the low level of returns and benchmark underperformance, and what market conditions would result in markedly improved returns for investments in the asset class.

The objective of the System's absolute return asset class is to provide diversification and risk reduction to the total fund by having little exposure to the common risk factors found in the rest of the portfolio. The return objective is to outperform a cash return by 4% over a full market cycle, recognizing that shorter-term performance can deviate from this objective significantly. The portfolio has a further objective of maintaining diversification when equity markets are volatile, and returns are negative. Conversely, when public market returns are positive, the defensive posturing of the portfolio may lead to underperformance relative to the plan and public markets. However, over the longer-term, the portfolio has not met its return objective and has failed to match or exceed its benchmark return. There are several reasons for this underperformance related to the market environment and exposure to common risk factors. Additionally, in fiscal year 2023, the absolute return portfolio experienced several negative idiosyncratic events that attributed outsized losses to the portfolio.

Hedge funds comprise most of this asset class and are characterized by trading strategies that attempt to take advantage of relative value opportunities between different securities and asset classes. The most favorable environment for this type of trading is one where volatility is high, correlations are low, and dispersion is high. Volatility is the degree to which asset prices fluctuate, correlation is the degree to which assets move in the same direction, and dispersion refers to the difference in asset price movements regardless of whether they are moving in the same direction. Essentially, hedge funds have historically performed best in more chaotic or volatile markets. If high dispersion and uncertainty remain in the markets, and stocks and other risk assets do not move consistently higher, hedge funds are likely to do well.

The absolute return asset class has struggled to outperform its benchmark, which was changed in fiscal year 2022 from the HFRI Fund of Funds Conservative Index plus 100 basis points to a strategy-blended benchmark consisting of 50% HFRI Relative Value, 25% HFRI Event-Driven and 25% HFRI Macro. After this change, staff re-evaluated the portfolio's exposures in tandem with its consultants, implementing several notable changes to further optimize the portfolio's expected risk and return profile. The absolute return asset class has been able to provide significant downside protection during equity drawdowns due to its decreased risk posture and lower equity sensitivity relative to the benchmark. Examples of this protection include the fourth quarter of 2018, first quarter of 2020, and the first half of calendar 2022, when the portfolio significantly outperformed public equities during periods of market stress. However, this outperformance during market stress has been contrasted with significant underperformance relative to public markets and the portfolio's benchmark during months in which public equites finished positively. Underperformance of the absolute return program versus the custom blended benchmark in periods of positive public market performance can be attributed to lower correlation, beta and volatility to such markets. Going forward, the objective of the portfolio is to continue to preserve value when equity markets struggle, while also maintaining performance cadence with the benchmark when equities perform positively.

Staff has continued to focus on improving the performance and efficiency of the portfolio through manager consolidation, upsizing higher conviction managers, improving cash management, and tactically seeking and allocating to higher return or diversifying mandates that will better position the portfolio for improved performance going forward. During the fiscal year, staff terminated five managers due to underperformance and portfolio fit. Staff continues to proactively monitor the portfolio, re-underwriting existing managers and canvassing the market to identify attractive opportunities that may substitute current exposures or serve to complement the existing portfolio. Efforts are also underway to continue the portfolio's focus on improving management fee arrangements by lowering the base management fees in exchange for higher manager performance incentives, thereby improving alignment between the manager and the System. Additionally, staff has invested in one co-investment during fiscal year 2023. Staff continues to target co-investment opportunities and expects these investments to increase in 2024 and beyond, resulting in reduced fees paid to external managers. The changes made to the portfolio thus far have led to improved performance over the last several years, viewed in totality, relative to the portfolio's long-term return target over cash.

The recent restructuring, in addition to further implementation changes, should result in a more diversified and balanced strategy allocation that is modeled to increase the portfolio's volatility to a level that more closely resembles the benchmark, while maintaining the added benefit of diversification to the plan during periods of market stress. Staff is confident the forward-looking opportunity set of the asset class is attractive and believes the portfolio is well-positioned to execute on its diversifying properties to the plan and other asset classes.

DLS requests SRA to provide an update on estimated carried interest for calendar 2023. Additionally, DLS requests SRA to comment on any anticipated short- and long-term impacts on the system's private equity investments of the SEC's private fund advisor rules.

The System records carried interest earned by its managers on a calendar year basis to align with the reporting schedule for audited financial statements for most of the System's alternative investment vehicles. In calendar year 2022, the System's managers earned estimated carried interest of roughly $227.1 million. It is important to distinguish the difference between management fees and carried interest, or performance incentives, as many private market investors do not consider incentive fees to be management fees. Management fees are contractual obligations that must be paid regardless of performance. Incentive fees, which primarily apply only to private market investments and not traditional asset classes, represent a portion of investment profits that is earned by a manager, and are only paid if performance thresholds are achieved and generally after the investor has recouped all management fees and expenses. They are utilized to motivate the manager to make profitable investments, and to ensure alignment of interests. The percentage of profits that is allocated to the manager is substantially lower than the amount received by the System. Because of this disproportionate sharing of profits, the amounts realized by the System would far exceed any incentive fees paid to managers. Large amounts of carried interest should be considered a positive result, as this would imply much greater gains to the System at a level of roughly fourfold. Based on the amount of carried interest earned in 2022, the implied gains to the System over a period of several years would equate to approximately $908 million. While the System would like to see an improved profit-sharing allocation in favor of the investor, and negotiates contract terms aggressively where possible, the overall market, consisting of both managers and investors, establishes the sharing percentages. If the System avoided these investments based on the fee structure alone, it would not have experienced the superior net-of-fee returns provided by private equity relative to all other asset classes.

Staff has been monitoring the new SEC private fund advisor rules and has participated in industry group discussions relating to these rules. In general, the rules should be positive for the System's private investments, as they require more detailed reporting and transparency and will result in greater consistency in the way managers treat and report to investors. Enhanced reporting requirements include more detailed disclosure of gross versus net performance at the entity level as well as the impacts of credit lines and other borrowing on the total fund performance. Investors will also have greater transparency regarding expenses with more detailed itemization of the various expenses.

The potential negative aspects of the rules to investors are relatively minor in staff's view. Any increased costs associated with enhanced accounting, reporting and compliance will likely be passed on to investors, which will result in slightly lower net performance. Also, the managers may be less inclined to provide any level of customized reporting to individual investors due to the more detailed and uniform reporting requirements. As a large institutional investor, the System is often eligible for more advantageous contract terms relative to other investors based on the investment size. It is uncertain whether larger investors will continue to be able to negotiate better economic terms based on the size of their commitments. At this time, the consensus is that this practice will still be allowed but may require greater disclosure to the other investors. In addition, since these rules require greater accounting, reporting and regulatory compliance, smaller and newer managers may find it more difficult to comply with these new regulations than firms with more resources, and may be discouraged from raising new funds, thus limiting the pool of investment options for investors.

DLS requests that SRA comment on the use of the compensation adjustment authority provided under Chapters 727 and 728 and Chapter 356, and whether the board has faced any difficulties recruiting and retaining staff since the passage of Chapters 727 and 728. DLS further requests SRA to update the committee on the number of resignations and terminations since the passage of Chapters 727 and 728.

At the request of the Board of Trustees, during the 2018 session, the General Assembly enacted legislation that provided the Board with the authority to determine and create the type and number of Investment Division staff, as well as compensation for these positions, subject to certain constraints. These constraints included limiting annual increases to no more than 10%. This annual cap on salary increases resulted in a disparity between legacy employees hired prior to the 2018 legislation and newer employees hired within the last few years under the new classification and salary structure. We were able to offer these recent hires a higher salary closer to the market midpoint, while legacy employees with the similar skills, experience and responsibilities would have to wait several years to reach an equivalent salary level.

During the 2022 legislative session, the Board requested the Joint Committee on Pensions to sponsor legislation to address this disparity. The Joint Committee agreed and on July 1, 2022 this legislation became effective. This legislation authorizes the Board of Trustees to provide two adjustments before June 30, 2024, to the compensation for legacy employees within the Investment Division whose salary is below the midpoint for their positions. The legislation specifically provides that these adjustments do not preclude the Board from also providing annual salary increases to all employees of the Investment Division.

Nine legacy employees had a salary below the midpoint of the approved range. In October of 2022, the Board approved salary adjustments for these individuals closer to the midpoint of their respective ranges. For employees with a salary closer to the midpoint or target salary, the Board approved a one-time adjustment to be effective in November 2022. For individuals with a significant difference between current salaries and the midpoint or target salary, the implementation of the salary adjustments occurred in two stages. The first increase was effective in November 2022, and the second adjustment was implemented in April of 2023 to coincide with the regular schedule of salary reviews for the entire Investment Division. As a result of these adjustments, there are no remaining compensation disparity issues among investment-focused employees.

This legislation has been an effective tool in recruiting and retaining Investment Division personnel. Since the legislation was enacted in 2018, the Investment Division has been able to hire a total of 28 employees, 20 of these represent investment-focused positions, while 8 are part of the accounting, operations and compliance areas. A portion of this growth in headcount was to remediate the level of understaffing that existed prior to the passage of the legislation, and the remaining positions were dedicated to building out the internal management initiative, as well as adding depth and ensuring a sustainable long-term staffing structure with appropriate succession planning resources. This legislation enabled the System to hire qualified and experienced investment professionals, many of whom would not have been interested candidates under the former compensation structure. The effectiveness of this legislation can be measured by the low level of turnover the Investment Division has experienced since the legislation was passed. Since 2018, only eight employees of the Investment Division separated from service for various reasons, four in the administration unit and four investment-focused positions. One of these 8 employees retired after more than thirty years of service and most of the others left to pursue other career opportunities, and not for compensation reasons.

The division has experienced challenges in recruiting for positions in the accounting and operations area, marked by lower response rates to job postings and a mismatch in skills, qualifications and experience. Employees in this unit were not included in the 2018 legislation that granted the Board authority to set compensation levels for Investment Division employees. This exclusion has also resulted in disparity within the division where different compensation policies are applied to the two groups. Adding the accounting and operations unit to the 2018 legislation would improve recruiting, morale and teamwork within the Investment Division by moving from a two-class structure to one where all employees are covered under the same compensation policies.

DLS requests SRA update the Committee on the use of incentive compensation for recruitment and retention and provide information on the number of division staff eligible for incentive compensation based on fiscal 2023 returns.

In June 2019 the Board approved an incentive program for certain positions within the Investments Division based on recommendations from the Board's compensation consultant and the Objective Criteria Committee. This program has been an important tool in recruiting and retaining skilled and experienced investment personnel as only one investment-focused employee resigned from the System in fiscal year 2023 and there have been no departures to date in fiscal 2024. This program is subject to certain constraints, which are highlighted below:

- Financial incentives in any fiscal year shall not exceed 33% of a position's salary
- Any financial incentives paid shall be paid over multiple fiscal years in equal installments
- The Board may not pay out financial incentives in a fiscal year in which state employees are subject to a furlough
- Financial incentives shall be paid on the dates set by the Board at the time of award, and an individual who has been awarded financial incentives but separates from employment in the Investment Division may not receive any remaining financial incentives due to be paid after the date of separation from employment, except for retirement.

The Board also approved the performance metrics for determining incentive awards, which are highlighted below:

- Net total fund returns vs. total fund policy benchmark over 3 years
- Net total fund returns vs. actuarial assumed rate of return over 3 years
- Net asset class returns vs. asset class benchmarks over 3 years

For the three years ending June 30, 2023, the System achieved a net annualized investment return of 8.23%, exceeding the policy benchmark of 7.07 by 116 basis points. This level of excess return resulted in the maximum incentive of 33% for this component of the calculation. A second part of the incentive calculation focuses on the actuarial rate of return, which averaged 7.0% over the last three years. For the three years ending June 30, 2023, the 8.23% return exceeded the actuarial rate by 123 basis points. As a result, staff was eligible to receive the maximum incentive based on this metric.

The last piece of the incentive calculation is based on the performance of the individual asset classes. Most of the asset class teams exceeded the performance of their respective benchmarks and were eligible for incentive compensation based on this metric, while one was not. In fiscal year 2023, a total of twenty-seven employees in the Investment Division were eligible for incentive compensation.

DLS requests that SRA comment on the estimated fee savings attributable for internally managed assets.

The Board and Investment Division have a three-pronged plan to enhance the ability of achieving the investment objectives of the plan. The first prong focuses on continual improvement in the asset allocation process. The second is improving implementation of that asset allocation through improved staffing and resourcing of the division and the third is to lower the cost of managing the assets through direct fee negotiations, direct management of public assets and direct management of private assets through co-investment. As of June 30, 2023, the annual management fee savings due to direct management of public assets and private market co-investments is estimated to be $27 million. Carried interest savings related to private market co-investments are expected to be significantly higher due to the industry-standard structure that bases this calculation on a percentage of profits, typically 20%. Over several years, the estimated carried interest savings based on these private market co-investments made to date are over $200 million. As the System expands the internal management initiative into more active strategies and increases its co-investment program, staff expects the longer-term annual savings to be over $150 million.

Additionally, DLS requests that SRA provide an update on the Investment Division's internal management of system assets and the development of necessary compliance and controls on the use of internal asset management. More specifically, SRA should comment on how the Investment Division:

- **has developed proficiency in managing assets currently being managed internally;**
- **will develop proficiency before expanding into internal management of additional asset classes;**
- **will evaluate the performance of internal management compared to available external management services; and**
- **will develop methodologies for determining fee savings achieved through internal management.**

The System has been working to develop its internal management capabilities since 2016. The initial efforts were geared to building the ability to execute trades internally. Elements of this process included establishing procedures to evaluate and select brokers, create operational processes to execute and communicate trades to the custodian and procure contracts with Futures Clearing Merchants. These processes supported the level of activity that was occurring historically and were necessary steps toward building an internal management process.

In 2019, staff worked with the Attorney General's office and external counsel to create policies and procedures for internal management including enhanced policies governing staffs' personal trading, conflicts of interests and handling of material non-public information. These policies and procedures were approved by the Board or codified in the Division's Operations Manual in early 2020. In 2020, the System procured a trade order management system to handle the processing of trades including pre-trade compliance and straight-through processing.

The proficiency of internal staff to manage internal portfolios has come in two ways. Existing staff had prior experience in managing assets directly and prior direct management experience was a major factor in the hiring process for new staff members.

The System has a rigorous product development process, the elements of which include:

1. Identify a potential product for internal management that staff expects to be able to execute as well or better than external managers
2. Develop guidelines that detail the performance objective, portfolio construction limits, and reporting requirements
3. Create portfolio management tools to execute the strategy
4. Manage a paper portfolio with pre-approval of every trade and creation of complete reporting package
5. Test the trading platform and provide training to middle and back office team as needed
6. Engage with the General Consultant for an independent operational due diligence evaluation and address any shortcomings identified
7. After demonstrating proficiency, present a full diligence memo to the internal investment committee and respond to questions and other follow up items

8. With internal investment committee approval, establish a portfolio inception date with the Chief Investment Officer including a source of funding

As of June 30, 2023, nine internal portfolios valued at $12.8 billion had been established following this process: U.S. TIPS, U.S. Long Government Bonds, Russell 1000 large-cap U.S. equity, investment-grade corporate bonds, U.S. small cap equity, U.S. securitized bonds, International large-cap equity, International equity value factor strategy and public equity infrastructure. Staff is currently in the development process to implement additional internal portfolios, including enhanced cash and currency hedging. Staff also expects to gradually increase the level of active management within the existing passive portfolios.

The division has built a process that is designed to evaluate the internal products in a manner similar to the selection and oversight of external managers. This includes presenting the strategy to the internal investment committee in the same manner as external managers. It also includes independent annual evaluation of the product by the System's general consultant. The division has also created an Internal Management Oversight Committee to provide independent evaluation of the efficacy of the strategies and managers. This group exists so that the investment teams are not put in the position of evaluating their own products. Finally, each quarter, every asset class reports to the internal investment committee on the performance of the asset class including individual manager performance. At these meetings, the committee members often challenge the team on the efficacy of continuing to retain underperforming managers.

DLS requests SRA to provide an update on the implementation of Chapters 24 and 25.

Some of the provisions of Chapters 24 and 25 of 2022 codify existing practices of the System relating to climate change investment risk, while others require the development of new policies and procedures. To support its ongoing activities in governance and evaluating ESG risks, in 2021, the System created a new Corporate Governance Manager position that was filled in October 2022. This position leads the advancement and implementation of the System's ESG initiatives.

One element of the legislation requires the System to incorporate its provisions into the System's Investment Policy Manual. The Board approved the addition of these items in February 2023. The Board also approved an Engagement and Advocacy policy as tools to mitigate risks and enhance opportunities for the investment of System assets. Engagement and advocacy work together with proxy voting to promote the best outcomes for active investments by prudently addressing poor corporate governance practices, including those associated with climate risk.

Staff has also updated the Investment Division's Annual Compliance Questionnaire, sent to all investment managers and consultants, to incorporate ESG and climate specific information to assess their policies and practices in this area. The System has also included an analysis relating to the level of climate risk across the total investment portfolio as part of the annual risk assessment to the legislature. Staff has also been actively identifying investment opportunities in the energy transition by meeting with managers who specialize in this area and is tracking these meetings and opportunities as part of normal routine. To create more structure around this effort, the Investment Division has formed a Theme Team to focus on investment opportunities that may benefit form broad macro-economic trends like the energy transition.

To gain insight and education regarding best practices regarding climate change, staff has increased participation with industry climate action groups. These groups provide forums for discussion and exchange of ideas to support both asset owners and managers in setting and implementing investor climate action and energy transition plans. Staff is also in active discussions with industry leaders and academics regarding the most effective way to structure a climate advisory panel or education series to help guide the Board and staff in managing climate risk and evaluating related investment opportunities. Going forward, staff will continue to implement the requirements of this legislation through more direct engagement with managers, companies and industry advocacy groups. Staff will also develop more robust processes to evaluate transition readiness in high-impact sectors through the use of asset class specific metrics and standards.

Appendix 4

2024 Board Requested Legislation

The following legislative proposals are recommended by the Board of Trustees for the State Retirement and Pension System (System) to the Joint Committee on Pensions for its consideration to sponsor as legislation for the 2024 legislative session.

Personal Statements of Benefits – Final Edition

With the advent of MySRPS, staff for the State Retirement Agency (Agency) believes that the personal statement of benefit (PSB) for active members has become obsolete. Section 21-112 of the State Personnel and Pensions Article requires the Board to provide each member with a summary of the benefits they have accrued, including: (1) the member's vested benefits or the benefits the member will be entitled to once they are vested; (2) the date when the member was or will be vested; and (3) the present value of any annuity the member has earned. Historically, the Agency has provided this information to the System's members in September of each year, for benefits earned as of June 30 for the immediately preceding fiscal year. For the last three years, PSBs have not been mailed to members, but sent to their MySRPS accounts. Those members who have not set up a MySRPS account can reach out to the Agency and request that their PSB be mailed to them.

When members receive their annual PSB in September, the information included in the document is membership information that is already three months old. As a result, this information conflicts with the information that is provided on MySRPS that contains updated information. These discrepancies cause confusion and concern for the members who call the Agency wanting explanations regarding these differences.

Additional problems with the production of the PSBs each year include the computer logic that is used to produce these documents. The PSBs were created long before MySRPS; this antiquated logic now only serves to generate the PSBs. As a result, prior to the PSBs being added to a member's MySRPS account, staff must sample hundreds of accounts. This sampling includes checking data points that are already included on MySRPS. As recently as this year, staff encountered technical issues that delayed the release of the PSBs by several weeks.

To prepare members for no longer receiving a PSB on their MySRPS account, notice of this change will be included in The Mentor (the active member Agency newsletter that is mailed to all active members), and on the Agency's website. Furthermore, postcards will be mailed to the System's active members over the 2024 summer informing them that the Agency will no longer be issuing PSBs and encouraging members to set up a MySRPS account. Because PSBs are only sent to active members, we feel confident that for those members that do not have a computer at home, many will have access to computers at work where they can set up their MySRPS account. For those that do not feel comfortable using their computers at work, MySRPS can be accessed from smart phones with internet capability. For those members that do not have access to a computer or a smartphone, they can continue to call the Agency for this information.

Staff does not anticipate any fiscal impact to the Agency to implement this proposal. In fact, staff is certain, that while it may not generate any cost savings for the Agency, it will certainly free up employee resources to focus on other projects.

Technical Changes for COLA Provisions and 7-Year DROP

COLA – Consumer Price Index

Section 29-401 of the State Personnel and Pensions Article defines the Consumer Price Index for purposes of calculating annual retiree cost of living adjustments as "the annual average Consumer Price Index (CPI) (all urban consumers, United States city average, all items, not seasonally adjusted, 1967 = 100) for the calendar year ending December 31 as published by the United States Department of Labor, Bureau of Labor Statistics. The CPI for all urban consumers measures the monthly change in consumer prices for a representative basket of goods and services. The definition under § 29-401 uses 1967 as the base year for determining the CPI. However, the 1967 index was retired in 1988 by the Bureau of Labor Statistics and replaced with the 1982-84 index. While the Bureau of Labor Statistics is still publishing the 1967 index, there is a risk that at some point they will discontinue publishing it. This could be problematic for staff if this occurs when the legislature is out of session, and we cannot get legislation for several months. Additionally, we have reached out the Department of Legislative Services and have been told that several other areas of the Maryland Annotated Code that reference the CPI, have already switched from using the 1967 index to now using the 1982-84 index. Finally, a comparison of the growth rate determined by our formula for calculating the CPI for retiree COLAs using both the 1967 index and the 1982-84 index was recently completed. The findings show that the same growth rate was calculated using the 1967 index and the 1982-84 index, indicating that had staff used the 1982-84 index to calculate the retiree COLAs for the past 10 years, this would have resulted in the same retiree COLAs that were calculated using the 1967 index.

Staff is recommending amending the definition of CPI under § 29-401(d) to reference the 1982-84 index instead of the 1967 index. As discussed above, there should be no financial impact to this change and it will provide consistency with other provisions of the Maryland Annotated Code that reference the CPI.

7-Year DROP – Senate Bill 139 of 2023 Correction

Senate Bill 139 extends the timeframe for participation in the Deferred Retirement Option Program ("DROP") for members of the State Police Retirement System ("SPRS") and Law Enforcement Officers Pension System ("LEOPS") from five years to seven years. Section 2 of Senate Bill 139 creates a 6-month election period, from July 1, 2023 to December 31, 2023, for current SPRS and LEOPS DROP members to extend their DROP participation for two extra years, but erroneously states that LEOPS members currently participating in the DROP who wish to extend their participation in the DROP to seven years, must terminate DROP by age 60, similar to the mandatory retirement age for members of the SPRS. However, provisions of the

State Personnel and Pensions Article provide that only members of SPRS, are subject to a mandatory retirement age of 60.

Based on a letter from the Attorney General discussing this drafting error and the proper interpretation of the bill, staff has been reading the mandatory age provision included in Section 2 of Senate Bill 139 to apply only to existing SPRS members participating in the DROP. Staff is proposing amending Section 2 of Senate Bill 139 to correct the error of including a mandatory retirement age for existing LEOPS DROP members.

Reemployment of Retired Sheriffs

Current provisions of the State Personnel and Pensions Article require that members of most of the several systems, including LEOPS, separate from all employment with the State or other participating employers in order to commence receiving benefits. Additionally, most retirees of the System are prohibited from accepting any employment with the State or other participating employers within 45 days of retirement. As a member prepares to retire from the State or a participating employer of the System, Agency counselors, the member's retirement coordinators, and the language of the retirement application all make it very clear that under no circumstances should the member's decision to retire be conditioned upon an offer of reemployment. More specifically, each of these resources (Agency counselors, retirement coordinators, and the retirement application) inform a member going through the retirement process that no offers of reemployment should even be discussed by the member and a participating employer of the State prior to retirement. Finally, the retirement application that members are required to complete and sign includes an acknowledgement by the member that the member understands these restrictions and a certification that the member has had no discussions about reemployment with any employer that participates in the System.

These reemployment restrictions are predicated on Internal Revenue Service (IRS) rulings and Internal Revenue Code provisions that address retirement and reemployment after retirement. While the IRS has not specifically defined what constitutes a bona fide separation from service, a temporary cessation of pay alone is not sufficient, particularly where there is no actual intent on the part of the member to resign from their position and discontinue all employment relationships with a participating employer.

County sheriffs are members of the LEOPS. Provisions of the State Personnel and Pensions Article that govern LEOPS do not include earnings limitations for LEOPS retirees who return to work for the employer from which they retired. Over the past year, staff has been made aware of instances regarding county sheriffs running for reelection who retired from the LEOPS on October 1, 2022, shortly before their potential reelection, but at least 45 days before they would potentially be sworn in for their next term. Once sworn in, these reelected sheriffs, in addition to receiving a normal service retirement from LEOPS, again began receiving their full sheriff's salary. In these instances, the reelected sheriffs were running unopposed. As a result, it was extremely likely that these individuals would be reemployed by the same employer from which they retired. Additionally, staff believes running unopposed and retiring within days of being sworn in, raises serious questions about whether there was actual intent on the part of the retiree to resign from their position and discontinue any employment relationship with their employer.

Staff believes that the State Personnel and Pensions Article should be revised to prohibit a member of LEOPS from retiring while running for elected office. Staff is recommending this amendment only with respect to LEOPS, because it does not have an earnings limitation and, with the exception of the Legislative Pension Plan, it is the only plan that includes elected officials. This would not be an issue for retirees of the Legislative Pension Plan, since retirees of this plan who are reelected, are reenrolled in the Plan. The Employees' Pension System (EPS) does include local elected officials but also has an earnings limitation for reemployed retirees; therefore, discouraging retirees from returning to work after retirement.

Title 37 Clean-up

Title 37 of the State Personnel and Pensions Article governs the transfer of service credit from a State or local retirement or pension system to another State or local retirement or pension system if each system is operated on an actuarial basis. Recently staff discovered provisions that include an incorrect reference or are simply impracticable to administer. Staff is recommending legislation to address these issues.

Incorrect Member Contribution Rate

Section 37-203.1 includes an incorrect reference to the LEOPS member contribution rate. Staff is recommending correcting this reference.

Five Years of Service After Transferring

Also included in Title 37 is the provision that states "[i]f an individual retires within five years after transferring into a new system, the benefits payable with respect to the transferred service credit may not be greater than the benefits that would have been payable by the previous system with respect to that service if the individual had remained in the previous system." In other words, if a member retires within five years of transferring into a new system, the member's retirement allowance will be calculated as a bifurcated benefit. For example, an individual joins the EPS at age 61, and transfers six years of service from their old plan. After accruing four years in the EPS, at age 65, the individual retires with 10 years of service (six from the old plan and four from the EPS). To calculate this individual's benefit, staff for the Agency would need to determine what the benefit formula was in the old plan for the period of time the member accrued service in that plan and calculate the member's benefit using this formula. Additionally, staff would also need to calculate the member's benefit in the EPS based on the four years of service earned in that system. The two calculations would then be added together to for the member's total retirement allowance.

Staff reports that implementation of this provision is unrealistic due to the administrative difficulties that would be incurred. From the perspective of the staff for the Agency, once a member transfers service into one of the several systems of the State, the transferred service from the old system is indistinguishable from the service earned in the new system. Staff would need to flag all accounts where a transfer was completed, and then at the time of retirement, manually break apart the service between the new and the old system to determine if the member reached the five year threshold in their State system. If the member did not meet the five year threshold, staff then would need to determine the benefit multiplier of the old system in effect at the time the member transferred in order to manually calculate the benefit for the service from the old system. While this would be very difficult if the member were moving between the several systems of the State, it would be next to impossible for those members that transfer from a local retirement or pension system into a state system. As a result, staff has not been able to implement this provision. Moreover, we are unaware of any local retirement or pension system that implements this provision. For these reasons we are recommending repealing the five-year requirement for transferred service.

Extraordinary Salary Increases

Staff has recently learned of several State agencies that have completed or will be completing formal compensation studies for the employees of those agencies. Of the agencies that have already completed compensation studies, some have found that the compensation of their employees is well below the midpoint salary for similar positions either based on neighboring states, or in some instances, nationally. To correct this, many State employees have received significant salary increases, including some State employees who have received salary increases greater than 20%.

Provisions of the State Personnel and Pensions Article currently provide that a member's average final compensation (AFC) does not include a salary increase in the last three years of employment (or five years if the individual became a member of one of the several systems on or after July 1, 2011) if it is an extraordinary salary increase according to the Agency's regulations. The Board's regulations provide that an increase of more than 20% to a member's average earnable compensation is considered an extraordinary salary increase and is not included in the member's average annual earnable compensation in any one of the last three years or five years of employment, unless:

1. the increase is the result of the member's:
    a. promotion by the member's employer; or
    b. appointment or election to a public office;
2. including the increase when determining the member's average final compensation would increase the member's allowance by $25 or less per month; or
3. the Board of Trustees determines that the increase is not an extraordinary salary increase.

The regulations further provide the process for the Agency to follow when faced with a member who may have received an extraordinary salary increase. At the time of retirement, if staff determines that the member may have received an extraordinary salary increase in any of the three or five years used to determine the member's AFC, staff shall prepare a preliminary report that includes: (1) a list of each member who has been preliminarily determined to have received an extraordinary salary increase; (2) the member's employer (3) the amount of increase to the member's AFC; (4) the reason provided to the Agency by the member's employer for the increase; and (5) a comparison of the member's allowance calculated with and without inclusion of the extraordinary salary increase in the member's annual final compensation. After the report is prepared, staff sends each member listed in the report a copy of the report with a statement of the member's right to file with the Executive Director a written statement of the reasons why the member believes the determination that the member received an extraordinary salary increase is incorrect. The Executive Director is required then to submit to the Board a report that includes: (1) a copy of the report; and (2) any written statement received by a member disagreeing with the Agency's findings. Following the Board's review of these documents, the Board shall determine whether each member received an extraordinary salary increase.

A review of the legislative history of the provisions governing extraordinary salary increases for purposes of retirement benefits, indicate that the original provisions were added to the Maryland Annotated Code in 1972. The original 1972 provisions were enacted following a 1971 report from the Retirement Subcommittee of the Joint Audit and Budget Committee of the General Assembly. In that report, the Retirement Subcommittee included the following discussion and recommendation regarding extraordinary salary increases.

> It was brought to the Subcommittee's attention that several persons just prior to retirement had received large lump sum salary adjustments which put them in an advantageous position when determining their average final compensation. To preclude possible abuse, the Subcommittee recommends that any extraordinary increases in the final year's salary be excluded from the average final compensation determination, leaving to the discretion of the Boards of Trustees of the Retirement Systems what constitutes "extraordinary".

Since 1972, very few non-substantive changes have been made to the provisions addressing extraordinary salary increases that exist today in the State Personnel and Pensions Article.

Given that the Agency's regulations require that the Board review each individual case of a member receiving an extraordinary salary increase, and only at the time of retirement, the Board is unable to review any particular agency's salary increases as a whole and in advance of the retirement of the impacted employees. In fiscal 2023, the Board received only one report of an extraordinary salary increase. Staff has received salary increase data from two agencies that have performed compensation studies for in recent years. The first was a compensation study performed by Agency X, wherein this agency compared the compensation of its entire agency with comparable positions of the neighboring states to Maryland and local jurisdictions within Maryland. This study resulted in 121employees of Agency X receiving salary increases of more than 20% in fiscal 2023. Of the 121 employees, 13 are eligible to retire with a normal service retirement allowance, immediately. If any of these 13 were to retire today, the computation of their AFC would include one year (fiscal 2023) when they received and extraordinary salary increase. The second agency, Agency Y, compared the compensation of 26 of its employees within a certain group of the agency with comparable positions, nationally. Ultimately, this study resulted in four employees in this group receiving salary increases greater than 20% in fiscal

2023. Of these four employees, one is eligible to retire immediately. Accordingly, this member's AFC would include a year when the member received an extraordinary salary increase.

Additionally, while provisions of the State Personnel and Pensions Article does provide that the Board has the authority to determine through its regulations what constitutes an extraordinary salary increase, staff believes that due to the potentially significant increase of instances that might qualify under the Board's existing regulations and the fact that these salary increases are as a result of compensation studies for either entire agencies or groups of employees within an agency, changes to the existing policy should come at the direction of the Legislature. For that reason, staff is recommending presenting this issue to the Joint Committee on Pensions requesting guidance and offering possible options to address this issue.

Status Quo

The first option the Joint Committee may want to consider is to maintain the current status quo and not direct the Board to make any changes to its current policy regarding extraordinary salary increases. Under the Board's regulations, a member's AFC will include annual compensation in any year that a member receives up to a 20% salary increase; anything above 20% is not included in the calculation of the member's retirement allowance. However, if a member receives a salary increase of greater than 20% and continues to work for three or five additional years (depending on when they joined the System), the full amount of the salary increase, including any increase above 20%, will be included in the member's retirement allowance calculation. Maintaining the current practice governing extraordinary salary increases could serve as an incentive for members to remain with the State or a participating employer of the System for a longer period of time.

Amend the Period of Time When an Extraordinary Salary Increase Is Not Included in a Member's AFC and/or Increase the Cap Before an Increase is Considered Extraordinary.

As discussed above, provisions of the State Personnel and Pensions Article provide that, subject to certain exemptions outlined in the Board's regulations, a member's AFC will not include an extraordinary salary increase of greater than 20% if a member receives this salary increase in the last three years of employment, or last five years of employment if the member joined the System on or after July 1, 2011. The Joint Committee could consider reducing the time for all members under which an extraordinary salary increase greater than 20% would not be included in the member's AFC, regardless of when they joined the System. For example, instead of excluding from a member's AFC any extraordinary salary increase above 20% that occurs within the last five years of employment for individuals who joined the System after July 1, 2011, this period of time could be amended to three years, so all members of the System are treated the same with regard to these salary increases. While such a change would create parity with the pre- and post-pension reform members, reducing the five years to three years would not impact how extraordinary salary increases are treated for pre-reform members. Alternatively, the Joint Committee could reduce the period of time in question to two years for all members. This would provide both the pre- and post-reform members with a lesser period of time that they would have to continue working after receiving an extraordinary salary increase, while maintaining some guardrails to incentivize members to continue working following such an increase. Another option the Joint Committee may want to consider is raising the salary increase cap from 20% to 30% before the increase is considered extraordinary. Such a change would provide a member with 10% more of their salary increase factored into their AFC, before it would be considered extraordinary.

The Joint Committee should note, though, that any change to this policy will result in a fiscal impact to the State. In the first option, the number of individuals who would be eligible to have an extraordinary salary increase of greater than 20% factored into their AFC, would increase. The second suggestion would not increase the number of individuals who would be eligible to have their increase factored into their AFC; however, it would increase the benefit amount for any member who retires within three or five years of receiving the salary increase. Staff cannot confirm that the fiscal impact resulting from either change to the existing policy would be de minimis, so the Joint Committee will want the Legislature's actuary to determine what the increased cost to the State will be.

Include an Exemption for Extraordinary Salary Increases Resulting From Formal Compensation Studies

It could be argued that when the provisions of the State Personnel and Pensions Article addressing extraordinary salary increases and the Agency's corresponding regulations were introduced in 1972, the notion of formal compensation studies of comparable positions for State employees was not contemplated. Because of this, when the list of exemptions for these increases was established in the Board's regulations, the Board may not have considered adding an exemption for extraordinary salary increases resulting from compensation studies. Now faced with several State agencies already having completed such studies, and with many agencies preparing to complete these studies in the near future, the Joint Committee may choose to codify the Board's existing regulations and add an exemption for salary increases resulting from these studies. If this is an option the Joint Committee opts to pursue, we would recommend including the Department of Budget and Management when drafting any legislation to implement this change, as compensation studies are personnel related studies. Additionally, the Joint Committee should expect that providing an exemption for any salary increase (regardless of the amount of the increase) that is the result of a compensation study will have a greater fiscal impact on the System than the previous option proposed regarding the period of time a member would have to work following receipt of such an increase. That being said, because there are so few members who receive such large increases compared to the total membership of each plan, coupled with the fact that only a small amount of this pool would be immediately eligible to retire, the Legislature's actuary may determine that the fiscal impact to the System would be de minimis.

Appendix 5

Maryland Supplemental Retirement Plans Overview Presentation

MARYLAND SUPPLEMENTAL RETIREMENT PLANS

Joint Committee on Pensions
October 24, 2023

MARYLAND SUPPLEMENTAL RETIREMENT PLANS
6 Saint Paul Street - Suite 200
Baltimore, Maryland 21202-1608
Tel: 410-767-8740 or 1-800-543-5605
Agency Website: www.msrp.maryland.gov
Plan Administrator Website: www.marylanddc.com

MSRP

Overview

Supplemental Retirement Plans

01 401(k) Savings & Investment Plan

02 457(b) Deferred Compensation Plan

03 403(b) Tax Sheltered Annuity Plan

04 401 (a) Match Plan – (recently reinstated)

401K Savings & Investment Plan

- Second largest of the 4 Plans, with 3,617 of its 31,460 participants in payout status with 14,529 actively deferring

- Total assets held in trust: $2.49B* (largest balance of the 4 Plans)

- Contributions decreased by 7% from previous quarter*

*As of June 30, 2023

457(b) Deferred Compensation Plan

- Largest of the 4 Plans, with 3,471 of its active 35,698 participants in payout status with 18,498 actively deferring

- Total assets held in trust: $2.19B* (second largest balance of the 4 Plans)

- Contributions decreased by 7.5% from previous quarter*

* As of June 30, 2023

403(b) Tax Sheltered Annuity Plan

- Smallest of the 4 Plans, with 147 of its 804 active participants in payout status, with 298 actively deferring
- Total assets held in trust: $111.6M*
- Contributions increased by 23% from previous quarter*

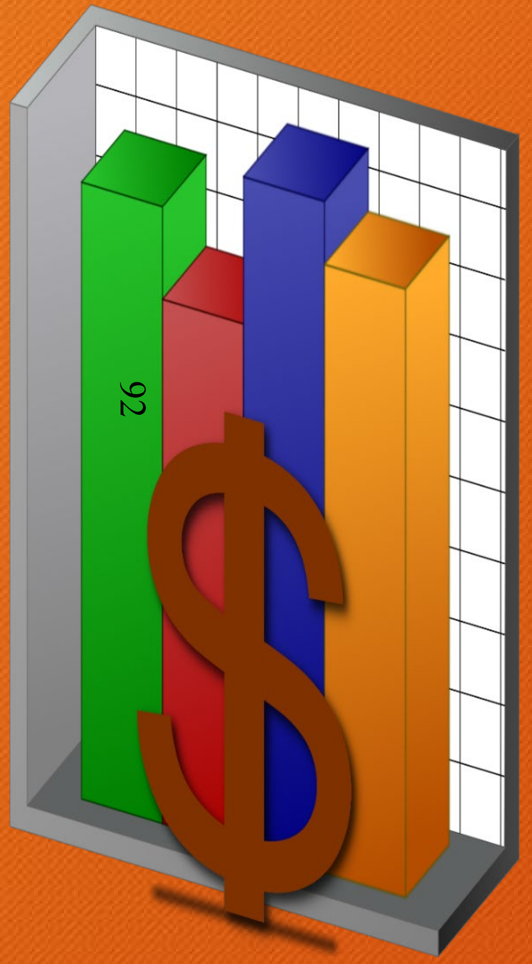
* As of June 30, 2023
This Plan is open to individuals in higher education

401(a) Match Plan

- The Match Plan was reactivated as of July 1, 2023
- The Plan has 37,812 participants, with 3,217 in payout status
- Total assets held in trust: $230.3M* and $9,825,475* in contributions

*Nationwide Retirement Solutions Data: 9/25/2023

MSRP Match Program Details



- Reinstated July 1, 2023, as a result of the Speaker's 2023 bill (HB 982)
- Over 13,000 new enrollments and 23,000 participants re-enrolled**
- CY 2023 Match contributions exceeded $9M*
- Implementation process included Central Payroll Bureau and Nationwide Retirement Solutions programming changes
- All contributions posted to participant accounts within 5 business days
- Only eligible employee contributions were matched (0% error rate)

*Nationwide Retirement Solutions Data: 9/25/2023

***Enrollees include participants who enrolled between 7/1/2009 and 6/30/2023.*

Fund Performance Analysis

All Plans Combined

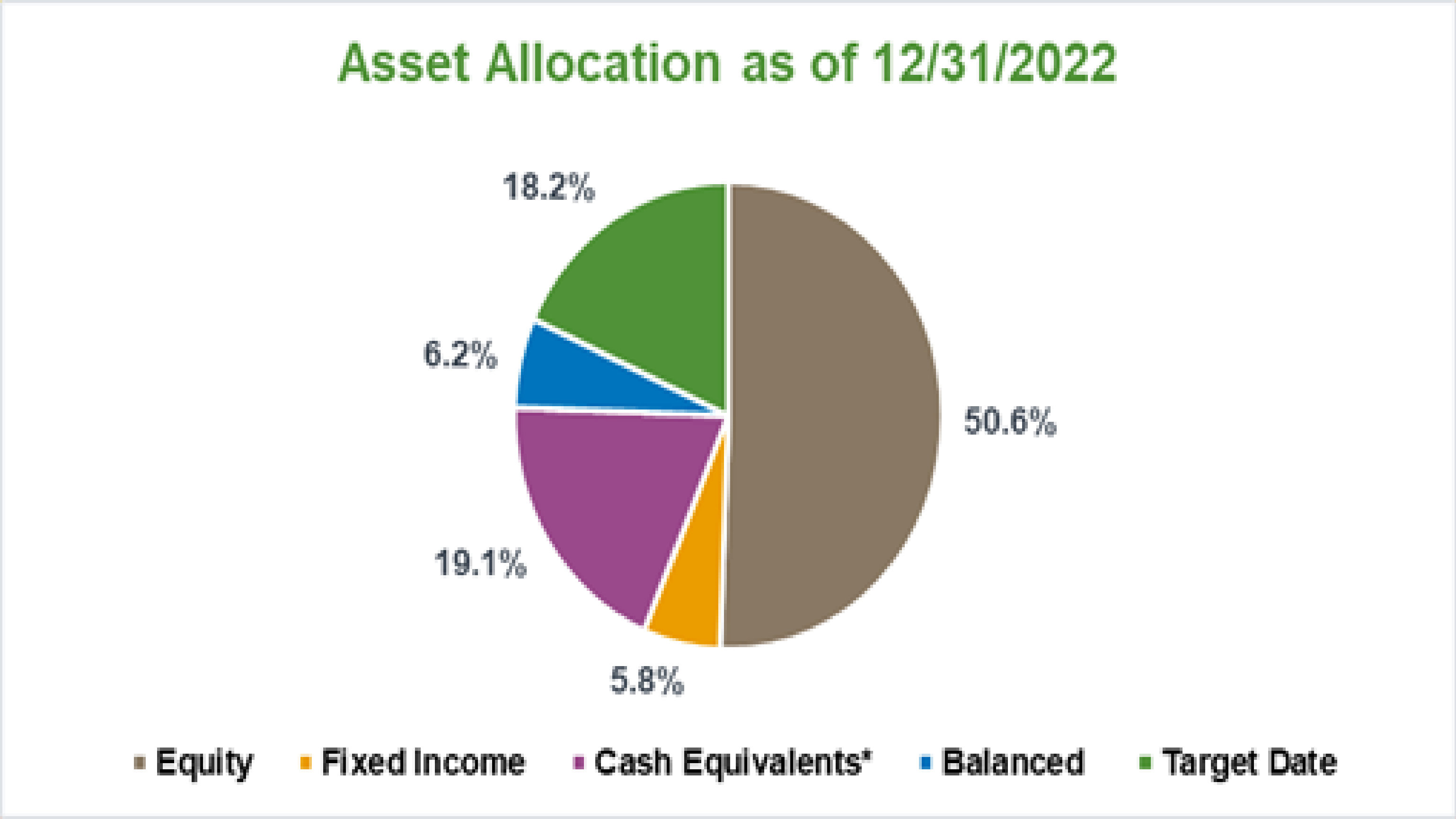
- Domestic and international equity experienced trailing returns for the year, at (19.2%) and (16.0%), respectively.
- Fixed income decreased at (13.0%), thus performing better, relatively speaking, than equity due mostly to the federal rate changes.
- The fixed income market showed some improvement with cooling economic growth.
- A tightened labor market improved domestic equity during the final quarter of the year, with a 7.2% gain, but it was not sufficient to cover the lagging three previous quarters.
- The Fed rate increased by 125 basis points (or 1.25%) with an expectation of further increases to combat inflation.

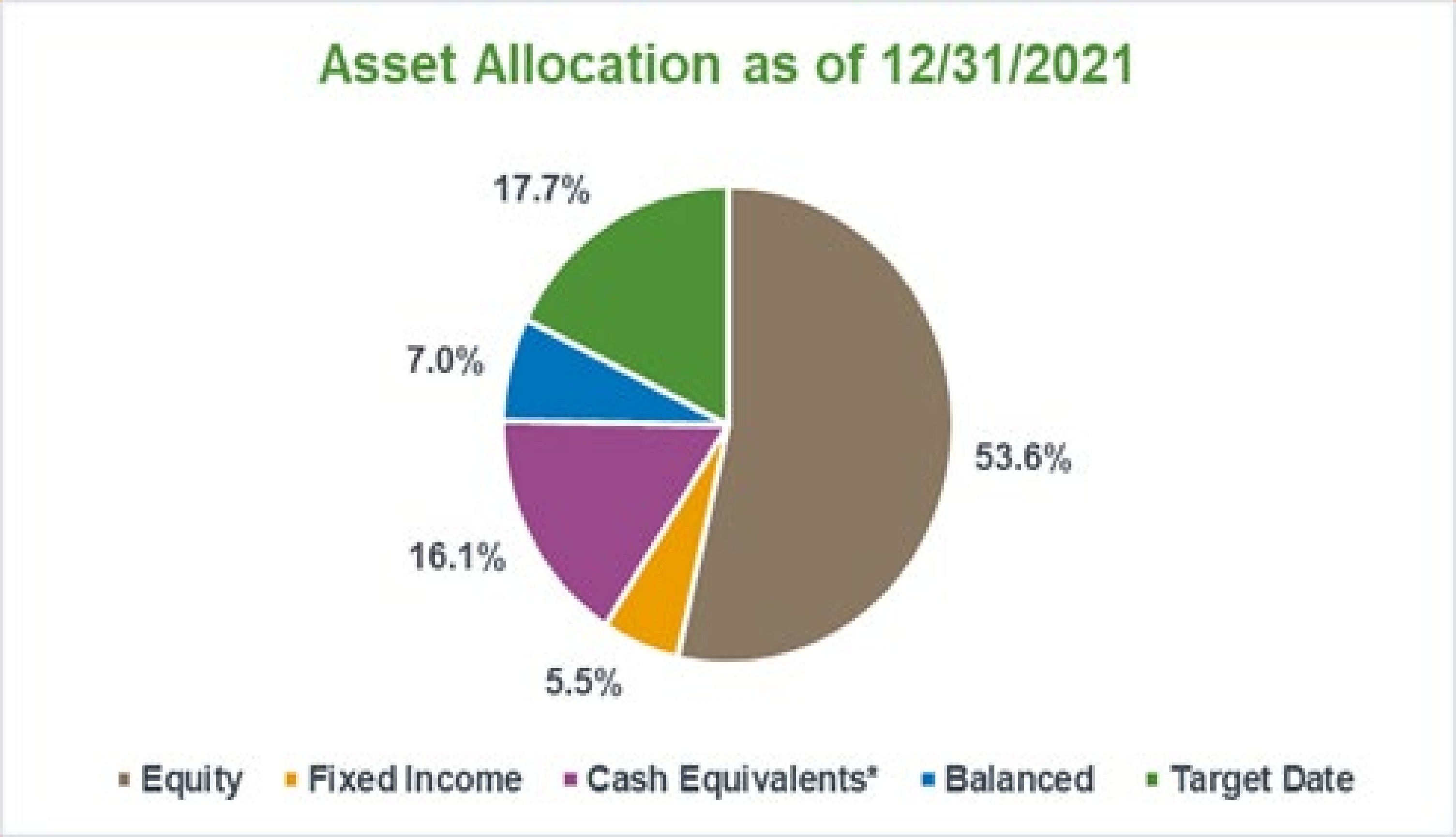
Annual Weighted Average Returns

All options

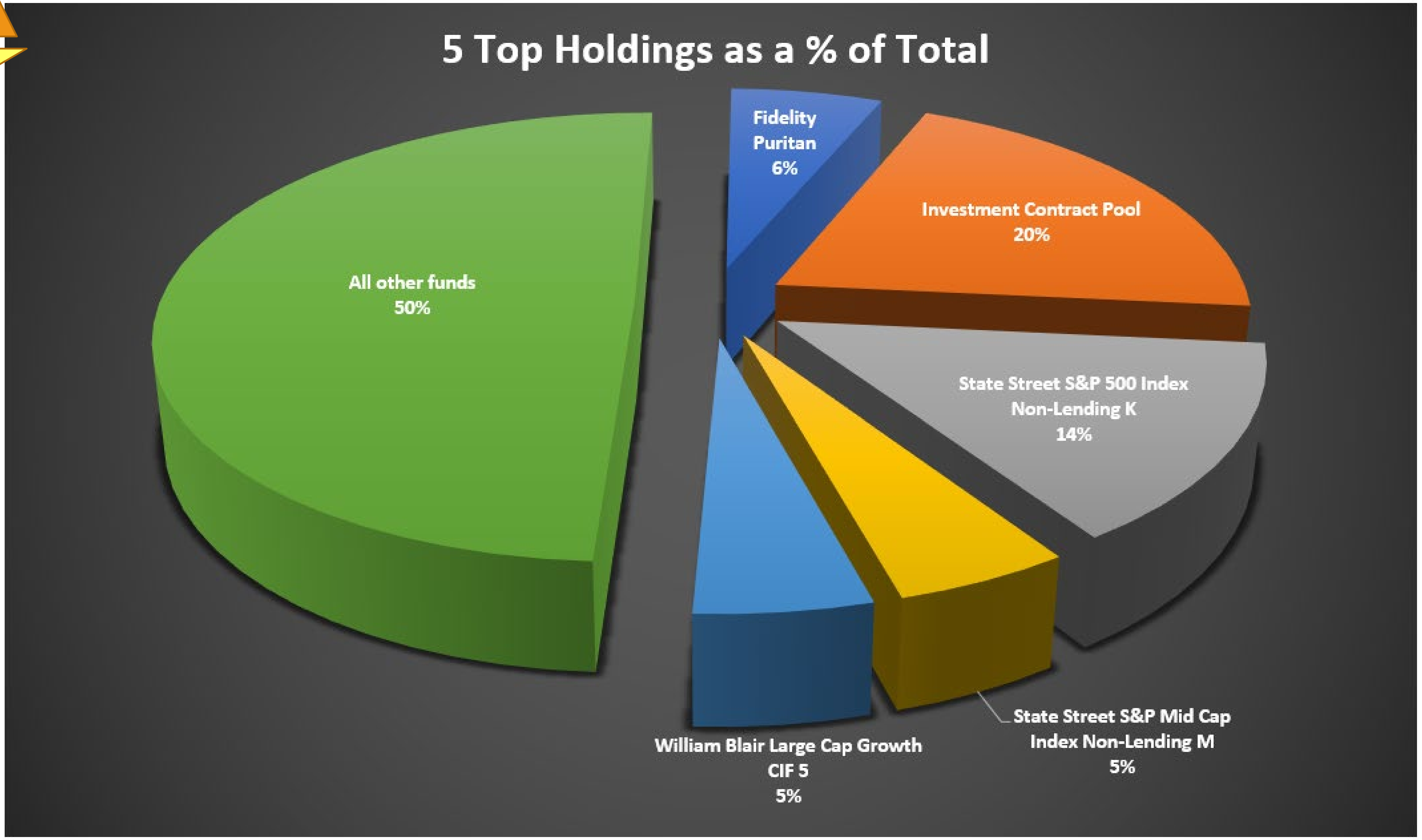
Annual Rates of Return as of June 30, 2023	**1 Year**	**3 Years**	**5 Years**	**10 Years**
Average Returns for all Investment Options	-13.31%	3.55%	5.19%	6.96%
Average of all Investment Indices	-12.56%	4.05%	4.98%	7.59%

Asset Allocation – CY 2022/2021





Top Holdings - All Plans



Top 5 Holdings	% of Total
Investment Contract Pool	20%
State Street S&P 500 Index Non-Lending K	14%
Fidelity Puritan	6%
William Blair Large Cap Growth CIF 5	5%
State Street S&P Mid Cap Index Non-Lending M	5%
All other funds	50%

Fee Structure

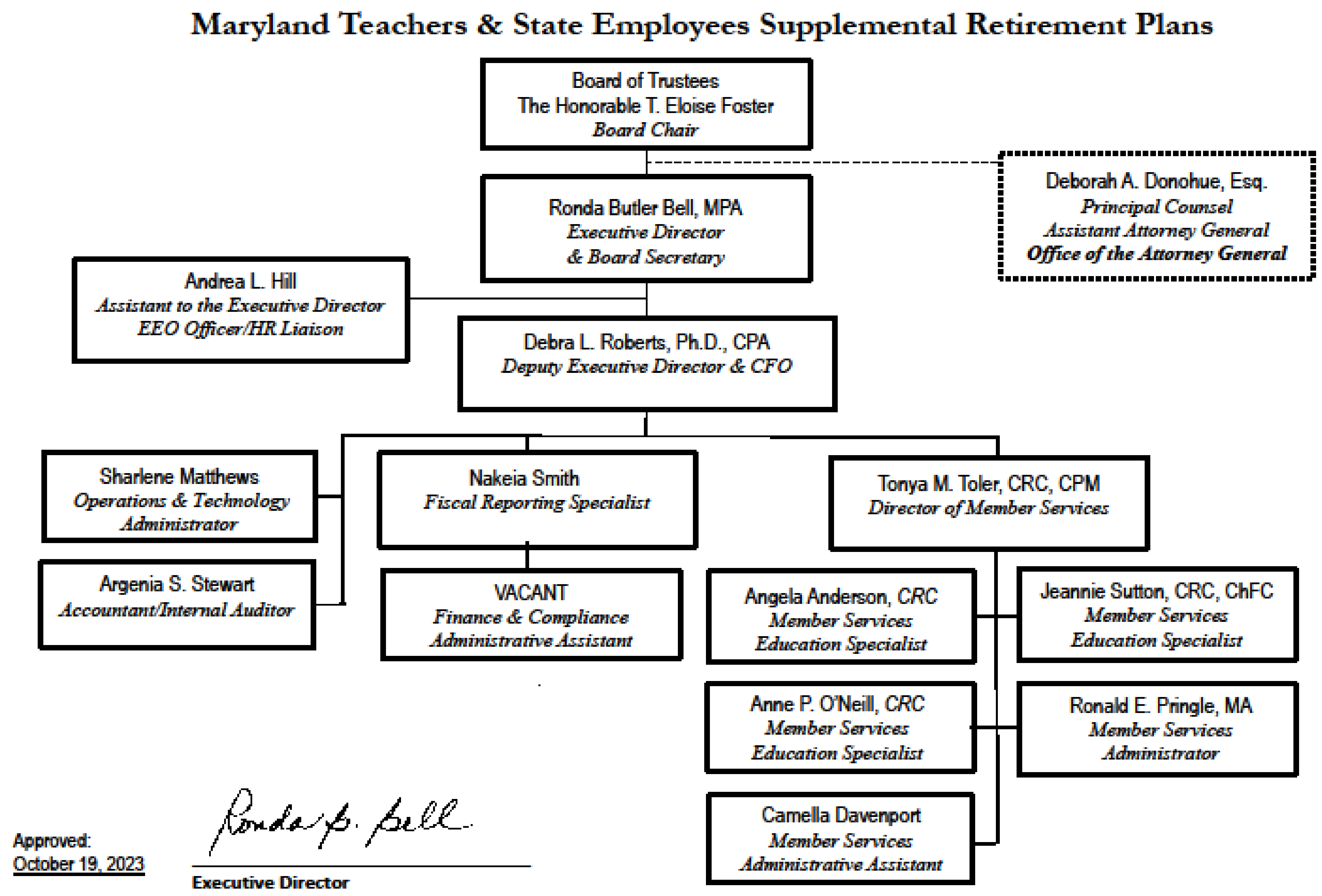
Charged to participants

- **Asset-based fee**
  - Based on the net assets at the close of the previous month
  - Capped at $2,000 per calendar year
- **Account-based fee**
  - $.50 per account
  - Accounts with <$500.00 balance are exempt

Fee Holidays

- **MSRP Board of Trustees approved a standing 4th quarter asset fee holiday**
- **Contingencies**
  - Reserve balance sufficiently covers a minimum of operational expenses for six months
  - Market conditions permit the fee holiday without exhausting reserve balances too quickly

Organizational Chart



Member Services Team

- **THE TEAM**
  - Comprised of four (4) Certified Retirement Counselors & two (2) administrative professionals
  - Received numerous awards from Pensions & Investments and the National Association of Government Defined Contribution Administrators (NAGDCA).
- **THE TEAM MISSION**
  - To support, through education, all State employees on the benefits of retirement savings.
- **EVENTS** (over 194 held in 2022 with 13K employees in attendance):
  - In-person and virtual pre-retirement seminars, lunch and learn workshops, new employee orientations, and Maryland State Employee Save Week presentations.
  - "Make Every Hour Count" virtual Saving$ Symposium
    - Held in October as the fourth annual event
    - A 6-day format covering two weeks, with over 20 session options for State employees.
    - A collaboration of fund managers, state and federal agencies, and our plan administrator in support of Maryland State employees.

Webinars and Other Outreach Activities

- Weekly Webinars – including:
  - *Catch the Match*
  - *Borrowing Against Your Retirement*
  - *Understanding Investing and Your MSRP Options*
  - *Countdown to Retirement: Understanding Retirement Readiness*
  - Many webinars have an over 50% attendance rate
- Annual Virtual Saving$ Symposium (over 13,000 employees participating)
- Pre-Retirement webinars (online) and seminars (in-person)

Additional information

Annual Reports and Member Publications

https://msrp.maryland.gov/Public-Information/Annual-Reports

* * *

https://msrp.maryland.gov/Education/Educational-Publications

Performance Summary

https://msrp.maryland.gov/Public-Information/Investment-Performance-Reports

Board of Trustees Profiles

https://msrp.maryland.gov/About/Board-of-Trustees

MARYLAND SUPPLEMENTAL RETIREMENT PLANS

Thank you

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MARYLAND SUPPLEMENTAL RETIREMENT PLANS
The Honorable T. Eloise Foster, Board Chair
Ronda Butler Bell, Executive Director & Board Secretary
6 Saint Paul Street - Suite 200
Baltimore, Maryland 21202-1608
Tel: 410-767-8740 or 1-800-543-5605
Agency Website: www.msrp.maryland.gov
Plan Administrator Website: www.marylanddc.com

MSRP

Appendix 6

Maryland Supplemental Retirement Plans Automatic Enrollment Study Highlights

MSRP

Automatic Enrollment Study Highlights

Automatic Enrollment Quick Facts

Automatic Enrollment Has Been Used Since 2006

- This is an industry best practice that has been widely used by the private sector since the Pension Protection Act of 2006.

Maryland vs. Other States

- Maryland is one of 25 states that does not allow automatic enrollment in any public sector plan.
- Two of the states profiled in the study, Texas and South Dakota, passed automatic enrollment in 2007 and 2008, respectively.

Maryland's Employee Participation Rate in MSRP Benefit

- As of the second quarter of 2023, 38% of all eligible State employees were actively participating in the Maryland Supplemental Retirement Plans.

Research Findings

Social Security and a Pension May Not Be Sufficient

- This year, the Congressional Budget Office has projected that the Social Security trust funds will be depleted by 2033 and will, therefore, be paying out lower percentages (e.g., 25% less in 2034).

Vanguard Research reported the following from its 2021 study of 813,918 auto-enrolled new hires:

- Automatic enrollment triples the participation rates of new hires.
- After a 3-year period, 92% of auto-enrolled employees were still in the plans, while 29% of voluntary enrollees were still in the plans.

Voya conducted a study of 163,000 employees in 2022 that reported the following:

- Black and Latino employees with employers using automatic enrollment have rates of participation that are two to three times higher than their counterparts at employers that do not use automatic enrollment.

Principal Retirement Research conducted a 2021 survey that reported the following:

- 84% of employees indicated that being automatically enrolled is the reason they began saving for retirement and they wouldn't have started as soon if they had to enroll on their own.

Maryland & National Data

DBM’s Annual Statewide EEO Report for FY 2022 noted:

- 61% of State employees are female.
- 52% of State employees are Black (45%) or other non-white ethnicities (7.2%).
- State salaries are lower for women than men and are also lower for Black employees than white employees.

Numerous national research sources cited in the MSRP study found:

- Women make lower salaries than men, have lower net worth, and are less prepared to retire.
- Women are more likely than men to take time away from work to care for family members, which lessens the amount they’re able to contribute to their retirement savings and Social Security benefits.
- Black and Latino employees make lower salaries than white employees, have lower net worth, and are less prepared to retire. They also have a higher probability of carrying various types of debt than white employees.
- People of color are much more dependent upon Social Security for retirement income and are much less able to rely on family wealth transfers for future financial support. They also contribute a significantly smaller amount to their employer-sponsored retirement savings than white employees.

Closing Details

Effective Date and Eligibility

- If passed, this legislation will be effective as of January 25, 2025, and all eligible employees hired on or after this date will be auto-enrolled in MSRP.
- Eligible employees are regular and contractual employees from: the Executive Branch, Judicial Branch (excluding judges), Legislative Branch (excluding elected officials), and State higher education employing institutions.

Employee Opt-Out Feature

- All employees who are auto-enrolled in MSRP would have a maximum of 90-days from the date of the first automatic payroll deduction to elect to opt-out and be refunded the amount of the contribution as well as any earnings. 90-days is the industry standard opt-out period for automatic enrollment.
- At any time after the 90-days, employees have the option to cease all payroll deductions, increase their contributions, decrease their contributions, and can stop and start contributions at their discretion.

Maryland Teachers & State Employees Supplemental Retirement Plans

MSRP

Automatic Enrollment Study

August 2023

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AUTOMATIC ENROLLMENT STUDY
August 2023

EXECUTIVE SUMMARY

Historically, superior employer-sponsored benefits have served to attract and retain employees as well as provide them with essential support in the areas of health, dental, and retirement benefits. Trends in the financial planning and retirement sectors indicate that most employees, across public and private organizations, are not adequately prepared to retire. Current State of Maryland and national data further indicate that there are significant disparities in the financial health, salaries, and retirement readiness of female employees and employees of color when compared to male employees and white employees. State employee demographics reflect a large percentage of female employees and employees of color.

Defined contribution “supplemental” retirement plans were designed to supplement an eligible employee’s anticipated retirement income earned from pension and Social Security benefits. The Maryland Teachers & State Employees Supplemental Retirement Plans (“MSRP”) provides State employees with supplemental retirement savings vehicles and extensive education to help them prepare for a more secure retirement.

MSRP has conducted research and gathered data from a variety of sources, including leading authorities in the retirement and financial industry. The recommendation is to proceed with the implementation of automatic enrollment, which is supported by the research findings.

INTRODUCTION

The retirement industry has historically recognized automatic enrollment as a powerful tool for significantly increasing employees' retirement plan participation. The National Association of Government Defined Contribution Administrators ("NAGDCA") has studied and reported that the rate at which employees save for retirement is increased by automatic enrollment- so much so, that NAGDCA deems it an industry best practice. Private sector retirement plan sponsors have been deploying automatic enrollment for nearly two decades, since the Pension Protection Act of 2006 was passed[1], while public sector plans have consistently lagged behind due in large part to the need for statutory amendments. All organizations, public and private alike, should perform due diligence to ensure that everything possible is being done to offer and implement all feasible retirement resources.

On a national level, the average employee is either under-prepared or wholly unprepared to retire. In this regard, State of Maryland employees reflect the national trends. Employers have a duty to support employees by helping them retire with dignity and increase their future financial security as much as possible.

Research conducted by the Center for State & Local Government Excellence[2] indicates the following:

1. participation in employer-sponsored retirement savings plans is one of the most optimal ways to prepare for retirement, but public employees are reluctant to sign up for such plans even after undergoing education on their importance;
2. because the public sector relies so heavily on defined benefit plans, there is an erroneous and widespread perception that public employees do not need additional retirement savings and, therefore, the public sector has not adopted automatic enrollment into defined contribution plans at the same rate as the private sector;
3. a national Prudential Retirement survey revealed that 74% of working adults across all age groups would prefer that their employer automatically enroll them in their retirement savings plan rather than having to self-enroll; and
4. automatic enrollment is very effective, especially for younger employees who need to save as much as possible for as long as possible, because it does not require employees to take any action or make any investment decisions.

The State of Maryland will be able to assist all eligible newly-hired employees with immediate participation in its vital retirement savings benefit by authorizing automatic enrollment in MSRP, helping to shape the trajectory of their retirement outcomes in a meaningful way.

MARYLAND OVERVIEW

Pursuant to Md. Code Annotated, State Personnel and Pensions Article §§ 35-401, 501, and 601, MSRP administers the voluntary defined contribution supplemental retirement savings plans that provide all eligible State employees (both permanent and contractual) with the option to enroll in: 1) the 403(b) tax sheltered annuity plan; 2) the 401(k) salary reduction savings plan; or 3) the 457 deferred compensation plan (the "Plans"). State employees must elect to enroll in

1 *Automatic Enrollment Toolkit.* National Association of Government Defined Contribution Administrators, Inc., 2022.
2 *Using Automatic Enrollment in Local Government Retirement Plans to Increase Savings.* Center for State & Local Government Excellence, June 2014.

the Plans to receive this benefit. MSRP is consistently improving and expanding its outreach to State benefit coordinators and provides a variety of educational seminars and webinars to State employees each month. Despite these efforts, there are still many State employees who are simply unaware that the Plans are an option. The multiple email platforms utilized by State agencies create a significant communication challenge to MSRP's Member Services Team, as it is not possible for the team to send direct emails to employees on all platforms.

MARYLAND STATUTORY AMENDMENT REQUIRED

Current State law does not authorize automatic enrollment in the Plans. Implementing automatic enrollment will require amendments to State Personnel and Pensions Article §§ 35-101 and 206.

MSRP – A VITAL SUPPLEMENTAL RETIREMENT SAVINGS BENEFIT

Replacement of Pre-retirement Income

MSRP's primary goal is to promote and provide retirement readiness for State employees. There is a gap that typically exists between employees' pre-retirement income and their anticipated post-retirement income, which consists of the combination of Social Security benefits and the pension administered by the Maryland State Retirement Agency ("MSRA"). The Plans are "supplemental" and were created to bridge this gap to help State retirees reach their income replacement goals. The recommended income replacement percentage for State retirees is 85% of their pre-retirement income. Only State employees who voluntarily enroll in the Plans can receive the significant support provided by this benefit. Without authorization of automatic enrollment, thousands of eligible State employees hired each year miss out on the opportunity for a more secure retirement income.

Social Security May Not Help Enough

Trends in retirement planning research show that Social Security benefits combined with a pension do not generate sufficient income to support the average State employee after s/he retires. In fact, the Congressional Budget Office's *2023 Long Term Projections for Social Security*[3] predicts that the Social Security trust funds will be depleted by 2033:

> CBO projects that if Social Security outlays were limited to what is payable from annual revenues after the combined trust funds' exhaustion in fiscal year 2033, Social Security benefits would be 25 percent smaller than scheduled benefits in 2034. They would be 30 percent smaller in 2097 and later years. After the combined trust funds' exhaustion in the payable benefits scenario, average retirement benefits in the first year of claiming resume their growth, but those benefits are smaller than scheduled benefits for people born after 1968 (that is, those who turn 65 after 2033).

3 *CBO's 2023 Long-Term Projections for Social Security.* Congressional Budget Office, June 2023.

Unforeseeable Emergencies and Hardships – Participant Access to MSRP Funds

A 2022 Voya study[4] found that 60% of employees reported that their *only* source of emergency savings is their employer-provided retirement plan. MSRP participants are able to access their funds in certain plans for unforeseeable emergency and hardship withdrawals, in accordance with IRS statutory authorizations.

MSRP's Member Services Education Team – Employee Training and Information

The MSRP Member Services Education ("MSE") Team provides retirement education to State employees about saving for retirement with supplemental retirement plans, and the broader topic of financial planning and wellness, via webinars, in-person seminars, new employee orientations, and one-on-one sessions. MSE Team members have extensive financial backgrounds and must hold and maintain (with annual mandatory continued education units) the Accredited Certified Retirement Counselor ® (CRC®) designation.

In 2022, approximately 21,000 State employees attended MSRP education events. So far, more than 14,000 have attended events in 2023. Webinar topics include the following:

- *Catch the Match! It's Back!* (focused on the reinstatement of the 401(a) Match Plan)
- *Success in Planning: Understanding Your MSRP Plans*
- *Social Security: One Piece of the Puzzle!*
- *Countdown to Retirement: Understanding Retirement Readiness*
- *Are you a Contractual Employee? This Webinar is for You!*
- *How Much is Enough?*
- *Borrowing Against YOUR Future: What You Need to Know*
- *Managing Market Volatility*
- *Can We Talk? A Conversation about Long-Term Care.*

The MSE Team closely coordinates with more than 700 State benefit coordinators to ensure that MSRP communications are disseminated to State employees. The MSE Team also works with the Member Services team at MSRA to ensure a free flow of vital State employee educational information between the agencies. Additionally, the MSE Team regularly works with the team assigned to MSRP accounts at the Plan Administrator (currently Nationwide Retirement Solutions) to coordinate on education campaigns and messaging to Plan participants.

Two key events are held annually. The MSRP Saving$ Symposium is a multi-day event with webinars presented by guest speakers who provide education to help State employees reach their retirement goals. Maryland State Employees Save Month is a campaign that involves creating and sending State employees short, meaningful videos designed to motivate them to act (including enrolling in the Plans, increasing deferrals/contributions, attending a webinar, or meeting with their MSRP representative) to improve their financial outcomes. Both MSRP events coincide with national events in April and October to raise awareness about the importance of financial education and saving for retirement.

4 *Bringing Greater Financial Equity to the Workplace to Support Everyone's Opportunity for a Better Financial Future: How Diversity, Equity and Inclusion Best practices Can Help Close Retirement Savings Gaps to Improve Financial Outcomes.* Voya-Thought Leadership Council, April 2023.

MSRP is very proud of the work done by the MSE Team in support of State employees. It is high-quality work, as evidenced by the national awards that have been won for their education program content and innovation. Most recently, MSRP received an award in the 2023 Pensions & Investments Participant Education & Communication category for a very creative "How Much? How Long?" tortoise and hare themed campaign to encourage Plan participants to reach a $100k retirement milestone. This education campaign was also responsible for MSRP receiving a 2022 award from NAGDCA in its Participant Education & Communication category. The MSE Team's partnership and collaborative work with MSRP's Plan Administrator was a contributing factor in winning these awards.

STAKEHOLDER ENGAGEMENT

AFSCME Maryland – Largest Employee Union in Maryland

MSRP has reached out and confirmed a meeting for early September 2023 with the President of AFSCME Maryland, Council 3 to discuss the union's perspective on automatic enrollment and ensure there are no unanswered questions. The objective is for MSRP and AFSCME to coalesce around the common goal of providing State employees with the best possible retirement savings support.

Other State Employee Unions

MSRP will be reaching out to the other State employee unions in September 2023 to gather their feedback and perspective on automatic enrollment. Meetings will be set with all unions that would like to meet.

STATE EMPLOYEE PARTICIPATION IN RETIREMENT SAVINGS AND DEMOGRAPHICS

Active State Employee Participation in MSRA and MSRP

The current State employee contribution rate for the pension administered by MSRA is 7%.

As of the second quarter of 2023, 38% of all eligible State employees were actively participating in their supplemental retirement savings by deferring/contributing to MSRP Plan accounts. "All eligible State employees" includes the following: Executive Branch, Judicial Branch (excluding judges), Legislative Branch (excluding elected officials), State higher education employing institutions, and contractual employees.

Maryland Department of Budget and Management Employee Data

DBM Annual Statewide EEO Report FY 2022 Statistics on State Employees	
Percentage of female employees	61%
Percentage of male employees	39%
Percentage of white employees	48%
Percentage of Black/African American employees	45%
Percentage of "other ethnicity" non-white employees	7.2%
Percentage who are age 30-39	23%
Percentage who are age 40-49	24%
Percentage who are age 50-59	28%
Average employee salary across all cohorts	$68,405

STATE AND NATIONAL DATA – RACE & GENDER

Given that approximately 45% of State employees are Black, 7.2% are members of other non-white ethnicities, and 61% are female, we gathered more detailed State and national data relative to these cohorts vis-à-vis retirement savings, financial health, and overall net worth.

Maryland Data on Race

The Maryland Department of Budget and Management's Annual Statewide Equal Employment Opportunity Report for Fiscal Year 2022 (the "2022 DBM Report")[5] reported the following State employee data on race:

1. the average State salary across all cohorts was $68,405, but white employees were paid an average of $11,483 more than African American employees in FY 2022 ($71,776 was the average white employee salary and $60,293 was the average African American employee salary);
2. white male employees had an average salary of $75,452, while African American male employees had an average salary of $61,561; and
3. white female employees had an average salary of $68,100, while African American female employees had an average salary of $59,025.

Maryland Data on Gender

The 2022 DBM Report includes the following State employee data on gender:

1. the average State salary across all cohorts was $68,405, but male employees were paid an average of $6,540.00 more than female employees in FY 2022 ($71,675 was the average male salary and $65,135 was the average female salary);
2. the salary gap between men and women of the same race increased from 2017 to 2022 for white and African American employees;
3. the salary of white men exceeded the salary of white women by $5,233 in 2017 and by $7,352 in 2022; and
4. the salary gap between African American males and females rose from $1,861 in 2017 to $2,536 in 2022.

National Data on Race

1. The *2019 Survey of Consumer Finances*[6] found that white families had a median net worth of $188,200 and a mean net worth of $983,400. Black families had a median net worth of $24,100 and a mean net worth of $142,500. Hispanic families had a median net worth of $36,100 and a mean net worth of $165,500.

2. A 2021 T. Rowe Price Retirement Savings and Spending Study[7] revealed the following:

    a. 38% of white employees started saving for retirement before age 30, while18% of Black employees did the same;

5 https://dbm.maryland.gov/eeo/Documents/Publications/AnnualEEO-ReportFY2022.pdf
6 Bhutta, Neil, Andrew C. Chang, Lisa J. Dettling, and Joanne W. Hsu. *Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finances*. FEDS Notes. Washington: Board of Governors of the Federal Reserve System, September 28, 2020.
7 Banerjee, Sudipto, *Race, Retirement, and the Savings Gap*. T. Rowe Price, March 2022.

b. Black and Hispanic retirement plan participants have a higher probability of carrying various types of debt (*i.e.*, credit cards, student loans, medical debt, home equity loans, and payday loans) than white participants; and
c. 18% of white participants carried student loan debt, while 41% of Black participants had student loan debt.

3. An AARP report[8] disclosed that studies indicate "people of color depend disproportionally on Social Security for their retirement income and are less able to rely on family wealth transfers such as inheritances for financial support later in life." Because of this, Black and Hispanic employees will need to save for retirement independently, as the overwhelming absence of intergenerational wealth is a significant barrier to future financial health.

4. Data collected by economists from MIT, Harvard, Yale, and the U.S. Census Bureau[9] indicate that, while Black and Hispanic employees contribute a significantly smaller amount to their employer-sponsored retirement savings accounts than white employees, Black employees in particular have a greater probability of taking early withdrawals.

National Data on Gender

1. The 2022 Goldman Sachs retirement survey and insights report entitled *Navigating the Financial Vortex: Women & Retirement Security*[10] noted the following findings:

   a. working women are more likely than men to take time away from their careers to be caregivers to children or elderly family members, thereby stalling their earned income, retirement savings, and contributions to their Social Security benefits;
   b. women are more likely than men to enter into retirement early to become caregivers of family members;
   c. women are more likely than men to suspend retirement savings for a year or more due to financial strain; and
   d. 80% of retired women reported that they receive less than 70% of their pre-retirement income.

2. T. Rowe Price's 2022 Retirement Savings and Spending Study[11] revealed the following:

   a. women's median income equated to ⅔ of men's median income (the median for men was $73,700 and the median for women was $49,300);
   b. women participate in retirement plans at a rate that lags behind the rate for men;
   c. the median 401(k) balance for women was 65% lower than the median balance for men;
   d. women carry higher debt than men, across all categories examined *(i.e.*, credit cards, student loans, car loans, medical debt, payday loans, personal loans, and miscellaneous debt), with the exception being home equity loans (men were 0.4% higher than women in this category); and
   e. 25% of female retirement plan participants reported having a negative net worth compared to 10% of male retirement plan participants reporting a negative net worth.

8 Salmon, Jacqueline, *Studies Spotlight Racial, Ethnic Gaps in Retirement Savings*. AARP, September 2022.
9 Salmon, Jacqueline, *Studies Spotlight Racial, Ethnic Gaps in Retirement Savings*. AARP, September 2022.
10 *Navigating the Financial Vortex: Women & Retirement Security*. Goldman Sachs Asset Management, 2022.
11 Banerjee, Sudipto *Closing the Gender Gap in Retirement Savings*. T. Rowe Price, March 2023.

AUTO ENROLLMENT RESEARCH FINDINGS

1. Vanguard Research conducted a 2021 study[12] focused on 813,918 new hires who had been automatically enrolled into their employers' defined contribution plans. The study noted, "Automatic enrollment triples the participation rates among new hires. Over the entire period of our study, the participation rate for new hires was 91% under automatic enrollment versus 28% under voluntary enrollment. After three years, 92% of participants hired under automatic enrollment were still participating versus 29% of participants under voluntary enrollment." Additionally, the study yielded the following:

    a. approximately ⅔ of the plans that adopted automatic enrollment without adding an annual increase designated a deferral rate of 4% or more;
    b. the rate at which employees chose to opt out was not impacted by the initial deferral rate designated by their employers - employees with annual salaries between $15,000 and $29,999 had a steady participation rate of 85% whether their introductory deferral rate was 2% or 6%;
    c. the use of automatic enrollment increases plan participation most significantly among younger employees and employees who make lower salaries – these two cohorts typically have very low participation when they must voluntarily enroll;
    d. 90% of employees who were younger than 25 participated when automatic enrollment was used versus less than 20% of employees in this age group when voluntary enrollment was required;
    e. automatic enrollment also benefits employees making higher salaries - employees with salaries in excess of $150,000 show higher rates of participation compared to voluntary enrollment;
    f. ⅓ of participants who were automatically enrolled chose to increase their deferral/contribution rate after 3 years in the plan; and
    g. ¼ of participants who were automatically enrolled made the choice to increase their deferral/contribution rate and to enroll in automatic deferral/contribution rate increases.

2. The Voya study[13] conducted in 2022 included 163,000 employees from multiple sectors (government, retail, financial services, utilities, and consumer goods) found that Black and Latino employees at employers that use automatic enrollment have rates of participation that are two to three times higher than their counterparts at employers that do not use automatic enrollment.

3. Principal Retirement Research conducted a 2021 survey[14] of 2,000 participants (employees and retirees) and found that 84% of employees indicated that being automatically enrolled in their retirement savings plan is the reason they began saving for retirement, and they would not have begun saving as soon if they would have had to enroll voluntarily.

AUTO ENROLLMENT NATIONAL LANDSCAPE

Maryland is one of 25 states that does not authorize auto enrollment in any public sector plan.[15] The table below illustrates which states authorize auto enrollment.

12 Clark, Jeffrey W., Jean A. Young, *Automatic enrollment: The power of the default.* February 2021, The Vanguard Group, Inc.
13 *Bringing Greater Financial Equity to the Workplace to Support Everyone's Opportunity for a Better Financial Future: How Diversity, Equity and Inclusion Best practices Can Help Close Retirement Savings Gaps to Improve Financial Outcomes.* Voya-Thought Leadership Council, April 2023.
14 https://www.principal.com/about-us/news-room/news-releases/principal-survey-84-workers-say-auto-enrollment-key-saving-earlier
15 https://www.nagdca.org/data-center/ auto enrollment-map/

States that Authorize Auto Enrollment in *All* Public Sector Plans	States that Authorize Auto Enrollment in *Some* Public Sector Plans
1. Colorado	1. Arkansas
2. Connecticut	2. Illinois
3. Georgia	3. Indiana
4. Kansas	4. Iowa
5. Michigan	5. Kentucky
6. Tennessee	6. Louisiana
7. Utah	7. Maine
8. Virginia	8. Missouri
9. West Virginia	9. Nevada
	10. New Hampshire
	11. Ohio
	12. South Dakota
	13. Texas
	14. Washington
	15. Wisconsin
	16. Wyoming

STATES THAT HAVE RECENTLY AUTHORIZED AUTO ENROLLMENT FOR STATE EMPLOYEES – TWO EXAMPLES

Ohio

In 2021, the Ohio General Assembly passed Senate Bill 27, which authorized automatic enrollment of all eligible state employees in the Ohio Deferred Compensation ("ODC") benefit. The bill was signed into law by Ohio's governor on 6/8/2021 and applies to employees hired on or after 10/1/2022. ODC offers eligible employees a 457(b) supplemental retirement savings plan as the sole option. As of 1Q 2023 ODC had ≈ $17.7 billion in assets under management and a total of 264,900 participants.

Start of Auto Enrollment in Ohio Deferred Comp.	Auto Enrolled Employees Also Participate in Defined Benefit Pension?	Default Plan and Vehicle	Default Amount Deducted	Total Employees Auto Enrolled Since Start of Auto Enrollment (As of 3/31/2023)	Total of 90-day Opt-out Refunds Processed (As of 3/31/2023)	Employee Education	Annual Auto Increase Feature Included?
10/1/2022	Yes Current contribution rate is 10% (Ohio is a non-Social Security state).	457(b) Target Date Funds	$25/pay An independent consultant provided ODC guidance on the designated default amount.	3,419	270 (7.9% of all auto enrolled employees)	Worked closely with HR teams.	Yes

Kentucky

In 2019, the General Assembly of the Commonwealth of Kentucky passed Senate Bill 107, which authorized automatic enrollment of all eligible state employees in the Kentucky Public

Employees' Deferred Compensation Authority ("KDC") benefit. The bill was signed into law by Kentucky's governor on 3/22/2019 and applies to employees hired on or after 7/1/2019. KDC offers eligible employees 401(k) and 457(b) supplemental retirement savings plan options. As of 1Q 2023 KDC had ≈ $3.36 billion in assets under management and a total of 82,330 participants.

Start of Auto Enrollment in Kentucky Deferred Comp.	Auto Enrolled Employees Also Participate in Defined Benefit Pension?	Default Plan and Vehicle	Default Amount Deducted	Total Employees Auto Enrolled Since Start of Auto Enrollment (As of 3/31/2023)	Total of 90-day Opt-out Refunds Processed (As of 3/31/2023)	Employee Education	Annual Auto Increase Feature Included?
7/1/2019	Yes Current contribution rate is 9%.	401(k) Target Date Funds	$15/pay	13,989	867 (6.2% of all auto enrolled employees)	Onboarding, video, website, and employee handbook	No

STATES THAT AUTHORIZED AUTO ENROLLMENT FOR STATE EMPLOYEES AT LEAST TEN YEARS AGO – TWO EXAMPLES

South Dakota

In 2008, the South Dakota Legislative Assembly passed House Bill 1020, which authorized automatic enrollment of all eligible state employees in the South Dakota Supplemental Retirement 457 Plan ("SDSR") benefit. The bill was signed into law by South Dakota's governor on 2/6/2008 and applies to employees hired on or after 7/1/2009. SDSR offers eligible employees a 457(b) supplemental retirement savings plan as the sole option. As of 5/31/2023, SDSR had ≈ $593 million in assets under management and a total of 42,625 participants.

Start of Auto Enrollment in South Dakota Deferred Comp.	Auto Enrolled Employees Also Participate in Defined Benefit Pension?	Default Plan and Vehicle	Default Amount Deducted	Total Employees Auto Enrolled Since Start of Auto Enrollment (As of 5/31/2023)	Total of 90-day Opt-out Refunds Processed (As of 5/31/2023)	Employee Education	Annual Auto Increase Feature Included?
7/1/2009	Yes Current contribution rate is 6%.	457(b) Target Date Funds	$25/month	28,417	1,498 (5.3% of all auto enrolled employees)	Worked closely with plan administrator.	Not initially. SDSR added auto increase in 2015, so this affects employees hired on or after 7/1/2015.

Texas

In 2007, the Texas Legislature passed House Bill 957, which authorized automatic enrollment of all eligible state employees in the Texa$aver Plan ("TSP") 401(k) benefit. The bill was signed into law by Texas' governor on 6/15/2007 and applies to employees hired on or after 9/1/2008. TSP offers eligible employees 401(k) and 457(b) supplemental retirement savings plan options. As of 1Q 2023, TSP had ≈ $4.6 billion in assets under management and a total of 268,879 participants.

Start of Auto Enrollment in Texa$aver.	Auto Enrolled Employees Also Participate in Defined Benefit Pension?	Default Plan and Vehicle	Default Amount Deducted	Total Employees Auto Enrolled Since Start of Auto Enrollment (As of 3/31/2023)	Total of 90-day Opt-out Refunds Processed (As of 3/31/2023)	Employee Education	Annual Auto Increase Feature Included?
9/1/2008	Yes Current contribution rate is 6%.	401(k) Target Date Funds	1% of salary/pay	418,445	1,068 (0.26% of all auto enrolled employees)	In-house communications team. Also worked with plan administrator on messaging.	No

PROPOSED DESIGNATED MSRP DEFAULT PLAN & CONTRIBUTION AMOUNT

The proposed designated default Plan for auto-enrolled new State employees will be the 457 deferred compensation plan (the "457(b)"), and employees will be enrolled into target date fund investment vehicles that correspond to their anticipated retirement date range (which is based upon their year of birth). A 2021 Vanguard Research study[16] found that 99% of the 520 plans surveyed chose target date funds as the designated default investment vehicle for automatic enrollment. In the retirement industry, 457(b) plans are known to provide employees with a high level of flexibility. MSRP notes below the following advantages:

1. the 457(b) Plan is available to all State employees who are eligible to participate in MSRP;
2. there is no 10% IRS pre-retirement withdrawal penalty assessed to an employee who leaves State service and chooses to take a withdrawal and *not* roll the account into a new employer's 457(b) plan; and
3. there is an increased deferral/contribution limit to allow for "catch up" retirement savings during the last 3 years before the employee reaches the standard retirement age.

In designating a default deferral/contribution amount, the MSRP Board of Trustees' (the "Board") objective is to determine a balanced deferral/contribution amount that is neither burdensome to State employees nor too low to yield a meaningful amount of retirement savings. The Board has a preference to designate a percentage as a payroll deduction rather than an actual dollar amount, in recognition of the variance in State employee salaries. The State's current payroll system cannot deduct percentages, however, so for now, the deductions must be

16 Clark, Jeffrey W., Jean A. Young, *Automatic enrollment: The power of the default.* February 2021, The Vanguard Group, Inc.

in whole-dollar form. The actual proposed deferral/contribution amount is still being considered by the Board. The chart below illustrates examples of annual payroll deduction totals at several default amounts. The default deductions would be done on a pre-tax basis, so they will reflect a slightly smaller amount deducted on employees' paystubs.

Examples of Payroll Default Deductions in Whole Dollars	**Examples of Annual Raw Totals in Whole Dollars**	**Examples of Approximate Annual Adjusted Pre-tax Totals Reflected on Paystub** ***(Examples below are based upon average State employee salary of $68,405 and aggregate of average federal, State, and local tax rates. Higher salaries will have slightly higher totals, and lower salaries will have slightly lower totals).***
$25 per paycheck x 26 checks	$650	$511.23
$30 per paycheck x 26 checks	$780	$613.47
$35 per paycheck x 26 checks	$910	$715.72

EMPLOYEE OPT-OUT FEATURE

All employees who are auto-enrolled in MSRP would have a maximum of 90-days from the date of the first automatic payroll deduction to elect to opt-out and be refunded the amount of the contribution as well as any earnings, which would then become taxable income and any State match amounts may be forfeited. The 90-day timeframe for opting out is the industry standard for automatic enrollment.

FISCAL ANALYSIS & IMPLICATIONS

Overview of Fiscal Analysis

According to Governor Moore's FY 2024 Budget Highlights, the State has a staggering 14% overall vacancy rate[17], and for some State agencies, this rate is much higher. In the Department of Health and Department Public Safety & Correctional Services, these rates exceed 20%. This fiscal analysis incorporates the Governor's priority to fill these vacant positions and the impact of auto-enrollment, if enacted. It includes the provisions of the Speaker's bill, HB 982, which was passed in the 2023 Legislative Session of the Maryland General Assembly and reinstated the State employee deferral/contribution 401(a) Match Plan for State supplemental retirement plans and also provided funding for State agencies seeking to hire high school students and others in targeted positions, by granting scholarships, internships, and other opportunities that could attract potential State employees to public service.

General Operations and Fiscal Impact

On April 24, 2023, the Governor signed HB 982. This legislation became effective on July 1, 2023. Since then, enrollment in the MSRP Plans has increased by over 1,100 individuals, not including more than 1,300 workers who decided to increase deferrals/contributions. The match program demonstrates the importance of providing employees with additional financial security during and post-State employment. If authorized, automatic enrollment will increase both the number of individuals participating in MSRP and the State's cost of matching eligible employee deferrals/contributions.

17 https://dbm.maryland.gov/budget/Documents/operbudget/2024/proposed/FY2024MarylandStateBudgetHighlights.pdf

State Revenue – Impact

There is no State revenue impact if auto-enrollment is authorized.

State Expenditures – Impact

If authorized, auto-enrollment will increase costs to the State as a direct result of matching funds for eligible employee deferrals/contributions to MSRP. The 401(a) Match Plan was reinstated by HB 0982, which authorizes a $600-per-fiscal-year State match for eligible and participating State employees. Accordingly, the State should expect to provide the dollar-for-dollar match to all eligible newly-hired State employees who will be auto-enrolled if legislation is passed by the General Assembly and approved by Governor Moore.

Basis for Assumptions and Estimated Costs

Governor Moore's Budget Highlights for FY 2024 emphasized the continued acceleration of vacancies within the State for targeted positions. The State has over 88,000[18] positions eligible for the State supplemental retirement plans deferral/contribution match; many of these eligible positions fall within the number of vacancies noted in the budget report. The Governor's priority enhances the impact of increasing participation in MSRP through auto-enrollment to leave no one behind and provide incentives to attract and retain State employees.

Assuming a 14% vacancy rate, auto-enrollment could help fill over 3,000 vacancies[19] during the next three to five fiscal years. Over time, as the State fills these vacancies, new enrollments will increase and State supplemental retirement plans deferral/contribution match contributions will also increase proportionately, except for employees who opt out within the required 90-day period. The State supplemental retirement plans deferral/contribution match for eligible employees will not exceed $600 per employee per fiscal year, in accordance with the statute. Considering the estimated vacancies of 3,000 State positions, if filled over time, the cost to the State would result in additional State supplemental retirement plans deferral/ contribution match costs of **$1.8M** annually.

MSRP's Plan administration fees would increase in direct proportion to the increase in asset values because of the automatic enrollment of eligible new State employees. MSRP collects per-account fees and asset-based fees directly from participants. These fees have no fiscal impact on the State's annual operating budget. Fees charged by MSRP to participants include 0.034% basis point fee (*value of assets at the end of each month, not to exceed $2,000 per participant each calendar year*) and a $.50 per account fee, (*waived for accounts under $500*) which resulted in $2.3M in revenues in FY 2022 and $1.6M in FY 2023. Any revenue increase from auto-enrollment is estimated to be $60,000 yearly, depending on market conditions. Auto-enrollment will increase MSRP expenditures for Plan consultants at 0.0775% basis points (based on assets under management), estimated to be $139,500 annually.

18 https://dbm.maryland.gov/budget/FY2024FiscalDigest/FY24-Fiscal-Digest.pdf
19 https://dbm.maryland.gov/budget/Documents/operbudget/2024/proposed/FY2024MarylandStateBudgetHighlights.pdf

REVENUES										
Fund		Fiscal 2025		Fiscal 2026		Fiscal 2027		Fiscal 2028		Fiscal 2029
General										
Special		60,000		60,000		60,000		60,000		60,000
Federal										
Local										
Other:										
Total	$	60,000	$	60,000	$	60,000	$	60,000	$	60,000

Other Information

Automatic enrollment may permit the Board to consider reductions in asset-based participant fees. The Board and MSRP staff review fees each year to determine whether fee holidays are necessary to reduce the MSRP reserve amount. During the past three years, the Board approved several 3-month fee holidays, resulting in savings exceeding $500,000 to participants.

Small Business and Local Government – Impact

The auto-enrollment provision, if authorized, will not have any impact on small businesses or local governments.

FINDINGS AND RECOMMENDATIONS

Research has demonstrated that:

1. the retirement industry's best practice of automatic enrollment serves to dramatically increase employees' level of participation in employer-sponsored defined contribution plans;

2. a large majority of employees prefer being automatically enrolled by their employer versus having to voluntarily enroll;

3. employees who are automatically enrolled are not only more prone to remain in their retirement savings plans but are also prone to voluntarily increase their deferral/contribution amounts;

4. it is very likely that the combination of a State pension and Social Security will not be sufficient to provide the level of pre-retirement income replacement necessary for typical State employees to retire with dignity and a reasonable level of confidence regarding their financial future;

5. automatic enrollment has proven to work well for analogous states (where employees are deferring/contributing to defined benefit pension plans);

6. the active MSRP participation rate of 38% indicates that an overwhelming majority of State employees are not adequately prepared for retirement;

7. the current State employee demographic profile includes a high percentage of women (61%) as well as African Americans and other non-white ethnicities (52.2%), and the data have indicated that these cohorts are generally prone to have lower salaries, fewer financial resources, and lower overall levels of retirement readiness; and

8. it follows that current State employee demographics will continue to hold true for new hires, and these cohorts as well as *all* eligible new State employees are very likely to reap significant benefits by being enrolled in MSRP upon being hired into State service.

The State has an important opportunity to reverse previous financial wellness and retirement readiness trends by authorizing automatic enrollment of all eligible newly-hired State employees at a default level that will likely yield meaningful results in support of their post-retirement income. To adequately prepare State employees with every possible retirement readiness resource, it is necessary to authorize automatic enrollment in MSRP.