G50L00
Maryland Supplemental Retirement Plans

Operating Budget Data

($ in Thousands)

	FY 12 Actual	FY 13 Working	FY 14 Allowance	FY 13-14 Change	% Change Prior Year
Special Fund	$1,483	$1,505	$1,529	$24	1.6%
Contingent & Back of Bill Reductions	0	0	-2	-2	
Adjusted Special Fund	**$1,483**	**$1,505**	**$1,527**	**$23**	**1.5%**
Adjusted Grand Total	**$1,483**	**$1,505**	**$1,527**	**$23**	**1.5%**

- The Maryland Supplemental Retirement Plan's (MSRP) fiscal 2014 allowance grows by 1.5%, or $22,632, over the fiscal 2013 working appropriation; modest increases in retirement costs and office supplies are partially offset by reductions to equipment purchases and travel.

- The contingent reduction of $1,541 reflects health insurance savings due to favorable cost trends.

Personnel Data

	FY 12 Actual	FY 13 Working	FY 14 Allowance	FY 13-14 Change
Regular Positions	13.00	13.00	13.00	0.00
Contractual FTEs	0.00	0.00	0.00	0.00
Total Personnel	**13.00**	**13.00**	**13.00**	**0.00**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	0.00	0.00%
Positions and Percentage Vacant as of 12/31/12	1.00	7.69%

- There is no change to the agency's staffing profile. One office secretary position became vacant in December 2012.

Note: Numbers may not sum to total due to rounding.

For further information contact: Michael C. Rubenstein Phone: (410) 946-5530

Analysis in Brief

Major Trends

Plan Participation Continues Gradual Decline, but Assets Are Growing: Total plan participation has been declining gradually for the last four calendar years, influenced by State employment trends and compensation policies. However, plan assets are still growing as equity and bond markets exhibit signs of sustained recovery. **The agency should discuss its strategies for reversing participation declines and the prospects for future growth.**

One-year Investment Returns Lag Benchmarks, but Long-term Returns Remain Strong: For the first time in recent years, MSRP's investment offerings did not surpass its composite one-year benchmark for the fiscal year ending June 30, 2012, although long-term performance continues to exceed benchmarks. The board made one change to its offerings to address performance. **The agency should comment on whether additional changes to plan offerings are warranted to improve overall performance relative to the composite benchmark.**

Issues

Management Fee Decreases, but Growing Fund Balance Warrants Agency Fee Reduction or Holiday: The agency's two-tiered fee structure is projected to continue generating a substantial operating surplus. **The Department of Legislative Services recommends that $50,000 of the agency's appropriation be withheld until the board adopts a fee relief plan that can be shown to reduce the projected fund surplus to no more than 25% of the agency's operating costs by the end of fiscal 2014.**

Recommended Actions

1. Add language to restrict $50,000 until the board adopts a plan to reduce agency fees such that the projected fund balance is no more than 25% of the agency's operating expenses.

Maryland Supplemental Retirement Plans

Operating Budget Analysis

Program Description

Title 35 of the State Personnel and Pensions Article established the Teachers' and State Employees' Supplemental Retirement Plans and a board of trustees to administer them. The board of trustees has the responsibility of administering the State's:

- Deferred Compensation Program pursuant to Internal Revenue Code (IRC) Section 457;
- Tax-deferred Annuity Program for Educational Employees under IRC Section 403(b);
- Savings and Investment Program under IRC Section 401(k); and
- Employer Matching Plan under IRC Section 401(a).

The Maryland Supplemental Retirement Plans (MSRP) staff provides education programs and support information to State employees and human resource personnel in State agencies. These efforts are designed to create awareness among State employees of the need and mechanisms available to save for their own retirement. Staff also supports the board's work in selecting investment options and overseeing the operation.

MSRP finances operations through a fee imposed on members' accounts, based on a percentage of assets in the plans and a flat-rate monthly charge. For fiscal 2013, the board fee is composed of two parts: a fee of 0.05% of assets and a monthly per account charge of $0.50 on every account with at least $500. In addition, the board contracts with Nationwide Retirement Solutions, Inc., (Nationwide) for administration of all four plans. The Nationwide contract, renewed for five years as of January 1, 2013, provides for a management fee of 0.09% of assets, for a total participant fee of 0.14% of assets.

Performance Analysis: Managing for Results

1. Plan Participation Continues Gradual Decline, but Assets Are Growing

As **Exhibit 1** shows, total participation in the retirement savings plans offered by MSRP has been declining gradually for the last four calendar years. The decline has not exceeded 2% each year and appears to be leveling off in 2012. Prolonged salary freezes by the State during this period, as well as the suspension of the employer match beginning in 2009, have undoubtedly played a role in this decline. However, total State employment also contracted during this period, and plan participation has remained largely constant as a percentage of total eligible employees, indicating that underlying employment trends in State government are also partially responsible for the decline.

Exhibit 1
Maryland Supplemental Retirement Plan Participation
Calendar 2007-2012

Year	Total Participants	% Change	% of Eligible	% Deferring	% Holding	% Payout
2007	61,101	3.5%	75%	68.5%	26.4%	5.1%
2008	61,522	0.7%	73%	67.7%	27.6%	4.8%
2009	60,722	-1.3%	75%	64.6%	31.1%	4.3%
2010	59,484	-2.0%	75%	62.5%	33.3%	4.1%
2011	58,477	-1.7%	75%	60.8%	33.6%	5.6%
2012*	57,945	-0.9%	76%	60.7%	33.9%	5.4%

*Calendar 2012 data is as of September 30, 2012.

Source: Maryland Supplemental Retirement Plans

The negative influence of the salary freeze and suspension of the match is more evident in the declining rate at which plan participants actively defer income into their accounts. Also shown in Exhibit 1, this rate began falling in calendar 2007 but accelerated its decline in 2009 as economic conditions worsened and the match was suspended. One possible explanation is that participants who stopped deferring retired and entered payout status. While this may be true in some limited cases, the rate of payouts also declined during that time. Instead, the data show that most people who stopped deferring simply went into a holding pattern, likely choosing to keep more of their compensation for current expenses until their incomes and economic conditions improved. The decline in deferral rates seems to have leveled off just below 61.0% in calendar 2011 and 2012. The 2.0% cost-of-living adjustment (COLA) that took effect in January 2013 is not likely to have a meaningful effect on deferral rates because the COLA was offset by the termination of the 2.0% federal payroll tax holiday. **The agency should discuss its strategies for reversing participation declines and the prospects for future growth.**

Although plan participation and deferrals have been in decline, plan assets have resumed steady growth following the financial market collapse of 2007/2008. After falling from a high of $2.5 billion in calendar 2007 to $2.0 billion in calendar 2009, plan assets have grown each year since, reaching a new high of $2.6 billion in calendar 2012. Given the drop in participation, this increase is largely attributable to the recovery of financial markets and the performance of the investment options made available by MSRP.

2. One-year Investment Returns Lag Benchmarks, but Long-term Returns Remain Strong

As shown in **Exhibit 2**, for the first time in several years, composite returns by MSRP's investment options underperformed their weighted benchmarks for the fiscal year ending June 30, 2012. For the year, MSRP funds lost 0.7%, compared with benchmark performance gaining 0.6%. However, 3-, 5-, and 10-year annualized returns for MSRP options continue to outperform plan benchmarks, as they have consistently in recent prior years. MSRP took one action in the past 12 months to address performance, closing the Neuberger Berman (large cap) fund in August 2012 and replacing it with an American Century fund with a much lower expense ratio. As of June 30, 2012, just prior to its closing, the Neuberger Berman fund's performance significantly trailed its 1-, 3-, 5-, and 10-year benchmarks, attributable largely to the fact that it had recently undergone changes to its fund manager and investment objectives. **Appendix 3** offers a fund-by-fund perspective, comparing the performance of each non-indexed fund available to participants against its own benchmark index, as of December 2012. **The agency should comment on whether additional changes to plan offerings are warranted to improve overall performance relative to the composite benchmark.**

Proposed Budget

As reflected in **Exhibit 3**, MSRP's fiscal 2014 allowance is essentially a maintenance budget, growing by just 1.5%, or $22,632, over the fiscal 2013 working appropriation. No new initiatives or significant changes to agency activities are planned. With regard to personnel, modest increases to employee compensation ($5,773) and retirement costs ($22,937) are partially offset by savings in employee/retiree health insurance (-$15,204). In other areas, slight increases in spending on office supplies ($5,000) and rent ($3,445) are matched by reductions in spending for travel (-$5,000), and office equipment (-$3,250). Savings on travel are achieved through more efficient scheduling of educational sessions for State personnel by agency staff around the State.

Exhibit 2
MSRP Average Rates of Return
Fiscal 2009-2012

	1 Year	3 Years	5 Years	10 Years
Annual Average Rates of Return as of June 30, 2012				
MSRP Options	-0.7%	13.4%	1.5%	7.1%
Benchmark Indices	0.6%	13.2%	0.9%	6.0%
Annual Average Rates of Return as of June 30, 2011				
MSRP Options	26.9%	5.3%	5.0%	6.5%
Benchmark Indices	26.3%	4.3%	4.0%	5.0%
Annual Average Rates of Return as of June 30, 2010				
MSRP Options	16.3%	-5.9%	2.2%	3.7%
Benchmark Indices	15.2%	-6.6%	1.3%	2.0%
Annual Average Rates of Return as of June 30, 2009				
MSRP Options	-21.0%	-4.9%	1.2%	3.2%
Benchmark Indices	-21.8%	-5.8%	0.2%	1.3%

MSRP: Maryland Supplemental Retirement Plans

Source: Maryland Supplemental Retirement Plans

Exhibit 3
Proposed Budget
Maryland Supplemental Retirement Plans
($ in Thousands)

How Much It Grows:	**Special Fund**	**Total**
2013 Working Appropriation	$1,505	$1,505
2014 Allowance	1,529	1,529
Amount Change	$24	$24
Percent Change	1.6%	1.6%
Contingent Reductions	-$2	-$2
Adjusted Change	23	23
Adjusted Percent Change	1.5%	1.5%

Where It Goes:	
Personnel Expenses	
Annualization of fiscal 2013 cost-of-living adjustment	$9
Employee and retiree health insurance, net of across-the-board reductions	-15
Employees' retirement	22
Turnover adjustments	9
Other fringe benefit adjustments	-2
Other Changes	
Office Supplies	5
Rent	3
Travel	-5
Office Equipment	-3
Communication	-2
Other	2
Total	**$23**

Note: Numbers may not sum to total due to rounding.

Issues

1. Management Fee Decreases, but Growing Fund Balance Warrants Agency Fee Reduction or Holiday

Plan participants pay separate fees to both the management company that administers the plans and to MSRP. Nationwide has served as the plan administrator for more than 20 years. Since January 2008, it has collected a management fee of 0.14% of assets from each account. Fee revenue paid to Nationwide is not reflected in the agency's budget because Nationwide collects the fees directly from account participants. Nationwide's previous contract terminated December 31, 2012; the agency procured a new contract, and Nationwide was the only responsible and responsive offeror to submit a proposal (a second offeror did not comply with minority business enterprise requirements). Under the new five-year contract, which took effect January 1, 2013, Nationwide has reduced its fee from 0.14 to 0.09%, which will generate an average of $2.6 million annually.

The agency fee currently has a two-tiered structure: the first tier consists of a 0.05% asset fee, which generates the bulk of the agency's revenue, and the second tier is a $0.50 per-account fee on every account with at least $500. This second fee was instituted in May 2010 on an *ad hoc* basis when asset amounts dropped below levels necessary to sustain agency operations due to the Great Recession. **Exhibit 4** shows that based on current and projected participation levels and asset growth, the combined fees will generate a fund surplus exceeding 60.0% of the agency's operating costs by the end of fiscal 2014. Although a fund balance is justified to mitigate against future asset fluctuations, the board and the Department of Legislative Services consider a surplus of 25% of operating expenses to be optimal. Fee relief for participants is clearly warranted.

Fee relief can take any number of forms. As the $0.50 per-account fee was instituted to stabilize revenues following a precipitous drop in assets, it is no longer needed for that purpose as asset levels have reached new all-time highs. Therefore, one approach would be to cancel the *ad hoc* fee. The agency, however, values the stability of revenue generated by the fee and wishes to maintain it. In that instance, the board may choose to either reduce the asset fee or grant a prolonged fee holiday until its fund balance drops to a reasonable level. **Therefore, DLS recommends that $50,000 of the agency's appropriation be withheld until the board adopts a fee relief plan that can be shown to reduce the projected fund surplus to no more than 25% of the agency's operating costs by the end of fiscal 2014.**

Exhibit 4
Assets and Participants' Fees and Agency Operating Budgets
Fiscal 2011-2014

	2011	2012	2013 (Est.)*	2014 (Est.)
Invested Assets ($ in Billions)	$2.62	$2.62	$2.70	$2.80
Plan Administrator Fees*	**$3,556,692**	**$3,668,000**	**$3,105,000**	**$2,520,000**
as Percent of Assets	*0.14%*	*0.14%*	*0.115%*	*0.09%*
Board Asset Fee	$1,229,892	$1,250,781	$1,350,000	$1,400,000
as Percent of Assets	*0.05%*	*0.05%*	*0.05%*	*0.05%*
$0.50 Monthly Charge May 2010 onward	$376,106	$368,354	$363,000	$363,000
Total Board Revenue	**$1,605,998**	**$1,619,135**	**$1,713,000**	**$1,763,000**
Operating Expenses	$1,525,132	$1,482,557	$1,504,513	$1,528,686
Carryover Balance	$363,868	$500,446	$708,933	$943,247
Carryover Balance as Percent of Operating Expenses	*23.9%*	*33.8%*	*47.1%*	*61.7%*

*Management fee of 0.115% represents 0.14% management fee for first six months of the fiscal year under expired contract and 0.09% for the final six months of the fiscal year under new contract that took effect January 1, 2013. Board asset fee remains 0.05% of assets.

Source: Maryland Supplemental Retirement Plans; Department of Legislative Services

Recommended Actions

1. Add the following language to the special fund appropriation:

   , provided that $50,000 of this appropriation may not be expended until the Board of Trustees of the Maryland Teachers & State Employees Supplemental Retirement Plans adopts a plan to reduce agency fees such that Maryland Supplemental Retirement Plans' projected fund balance does not exceed 25% of total operating expenses by the end of fiscal 2014. A report detailing the specific details of the adopted plan shall be submitted by September 30, 2013, and the budget committees shall have 45 days to review and comment. Funds restricted pending the receipt of a report may not be transferred by budget amendment or otherwise to any other purpose and shall be cancelled if the report is not submitted to the budget committees.

   Explanation: The Maryland Supplemental Retirement Plans' (MSRP) fund balance is projected to exceed 60.0% of its operating expenses by the end of fiscal 2014. The board currently collects an asset fee of 0.05% of invested assets and a per-account fee of $0.50 on every account with at least $500.00. This language gives the board flexibility to design a fee reduction plan that brings the projected fund balance down to an acceptable level.

Information Request	**Author**	**Due Date**
Description of fee reduction plan	MSRP	September 30, 2013

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Maryland Supplemental Retirement Plans
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2012					
Legislative Appropriation	**$0**	**$1,480**	**$0**	**$0**	**$1,480**
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	30	0	0	30
Reversions and Cancellations	0	-28	0	0	-28
Actual Expenditures	**$0**	**$1,483**	**$0**	**$0**	**$1,483**
Fiscal 2013					
Legislative Appropriation	$0	$1,496	$0	$0	$1,496
Budget Amendments	0	9	0	0	9
Working Appropriation	**$0**	**$1,505**	**$0**	**$0**	**$1,505**

Note: Numbers may not sum to total due to rounding.

Fiscal 2012

- The distribution of centrally budgeted funds for a one-time employee bonus of $750 increased the agency's appropriation by $10,492.

- A special fund budget amendment of $20,000 increased the agency's fiscal 2012 appropriation to pay for computer system upgrades begun in fiscal 2011.

Fiscal 2013

- The distribution of centrally budgeted funds for a 2.0% COLA increased the agency's appropriation by $8,781.

Appendix 2

Audit Findings

Audit Period for Last Audit:	January 8, 2009 – September 15, 2011
Issue Date:	May 2012
Number of Findings:	0
Number of Repeat Findings:	0
% of Repeat Findings:	%0
Rating: (if applicable)	

The audit did not disclose any findings.

MSRP Investment Performance Compared with Benchmark Indices as of December 2012

Funds	**One Year**	**Three Year**	**Five Year**
T. Rowe Price Small Cap Stock	✓	✓	✓
American Funds Euro Pacific	✓	✓	✓
Morgan Stanley Mid Cap	✗	✗	✗
T. Rowe Price Mid-Cap Value	✓	✗	✓
Parnassus Equity Income	✗	✗	✓
American Century Equity Growth	✓	✓	✓
American Funds Growth	✓	✗	✗
Goldman Sachs Large Cap Value	✓	✗	✗
Fidelity Puritan Fund	✓	✓	✗
PIMCO Total Return Fund	✓	✓	✓
T. Rowe Price Retirement Income	✓	✓	✓

✓ Fund Equaled or Beat Benchmark Index   ✗ Fund Underperformed Benchmark Index

Note: Vanguard Small Cap Value Index Fund, Vanguard Value Index Fund, Vanguard Small Cap Growth Index Fund, Vanguard Institutional Index Fund, Vanguard Total International Stock Index Fund, and Vanguard Mid Cap Index Fund are all designed to track indices, so benchmarking is inappropriate.

Object/Fund Difference Report
Maryland Supplemental Retirement Plans

Object/Fund	FY 12 Actual	FY 13 Working Appropriation	FY 14 Allowance	FY 13 - FY 14 Amount Change	Percent Change
Positions					
01 Regular	13.00	13.00	13.00	0.00	0%
Total Positions	**13.00**	**13.00**	**13.00**	**0.00**	**0%**
Objects					
01 Salaries and Wages	$ 1,035,681	$ 1,068,757	$ 1,093,634	$ 24,877	2.3%
02 Technical and Spec. Fees	630	1,500	1,500	0	0%
03 Communication	27,924	22,087	20,410	-1,677	-7.6%
04 Travel	20,447	14,000	9,000	-5,000	-35.7%
07 Motor Vehicles	9,701	11,760	11,760	0	0%
08 Contractual Services	229,351	252,904	254,212	1,308	0.5%
09 Supplies and Materials	11,563	6,000	11,000	5,000	83.3%
10 Equipment – Replacement	0	4,500	2,500	-2,000	-44.4%
11 Equipment – Additional	26,981	2,250	1,000	-1,250	-55.6%
13 Fixed Charges	120,279	120,755	123,670	2,915	2.4%
Total Objects	**$ 1,482,557**	**$ 1,504,513**	**$ 1,528,686**	**$ 24,173**	**1.6%**
Funds					
03 Special Fund	$ 1,482,557	$ 1,504,513	$ 1,528,686	$ 24,173	1.6%
Total Funds	**$ 1,482,557**	**$ 1,504,513**	**$ 1,528,686**	**$ 24,173**	**1.6%**

Note: The fiscal 2013 appropriation does not include deficiencies. The fiscal 2014 allowance does not include contingent reductions.

Appendix 4