G50L00

Maryland Supplemental Retirement Plans

Operating Budget Data

($ in Thousands)

	FY 13 Actual	**FY 14 Working**	**FY 15 Allowance**	**FY 14-15 Change**	**% Change Prior Year**
Special Fund	$1,502	$1,545	$1,648	$103	6.6%
Contingent & Back of Bill Reductions	0	0	-13	-13	
Adjusted Special Fund	**$1,502**	**$1,545**	**$1,635**	**$90**	**5.8%**
Adjusted Grand Total	**$1,502**	**$1,545**	**$1,635**	**$90**	**5.8%**

- After adjusting for contingent and back of the bill reductions, the fiscal 2015 allowance increases $90,000 compared to the fiscal 2014 working appropriation. The major increases in the allowance are for personnel-related expenditures and the increased cost of a shared assistant attorney general.

Personnel Data

	FY 13 Actual	**FY 14 Working**	**FY 15 Allowance**	**FY 14-15 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 12/31/13	0.00	0.00%

- The personnel complement in the fiscal 2015 allowance remains unchanged.

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

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Analysis in Brief

Major Trends

Plan Participation Continues Gradual Decline: Total participation in the retirement savings plans offered by the Maryland Supplemental Retirement Plan (MSRP) has been declining for the last five calendar years, largely mirroring the downturn in the economy and position reductions. In calendar 2013, it is estimated that 74% of eligible employees had an account with MSRP. Of the eligible employees with an account, 59.7% are actively deferring to that account, which is down from 67.7% in fiscal 2008. It appears employees have elected to stop deferring income for retirement to support ongoing household expenditures, as well as the end of the State $600 match. **The Department of Legislative Services (DLS) recommends that MSRP discuss what strategies are in place to recruit more employees into the plan and to have more employees actively defer to their retirement account.**

Investment Returns Generally Exceed Benchmarks: MSRP investment options have generally outperformed the benchmark indices in fiscal 2013. The one exception to this is the three-year return where the MSRP options return was 13.8% compared to 14.0% for the benchmark indices.

Issues

Is It Time for the $600 Employer Match to Return?: Statute required the State to provide a $600 match to employees who contributed to a MSRP offering. This requirement was eliminated as part of the broader effort to resolve the structural deficit. As noted in the Managing for Results section, the number of employees deferring to an account has been declining. Furthermore, the State made changes to the employee pension system that reduced the retirement benefit for new State employees. **Given the greater burden on new State employees to save for retirement as a result of the changes to the pension system and the overall lack of employee contributions to supplemental retirement plans, DLS recommends that the agency discuss whether the match is an important tool to attract contributions. In addition, it should discuss what role the supplemental retirement savings could have in helping to prepare employees, particularly new employees, for retirement after the changes to the pension benefit**.

Management Fees: Currently participants pay a 0.09% asset fee to Nationwide to administer the plan, a $0.50 charge per account to MSRP, and a 0.05% asset to MSRP. The fees collected by MSRP are intended to cover its operating expenditures with the goal of not having a carryover balance greater than 25.0% of the operating budget. The board received a settlement claim from Invesco funds relating to trading issues. It was decided that the best way to distribute the settlement funds and draw down the fund balance was to institute an asset fee holiday from April 1 through December 31, 2013. It is currently estimated that the fund balance will be just over 30.2% by the end of fiscal 2014. **DLS recommends that the agency discuss the settlement funds received in more depth and if there will be a fee holiday in fiscal 2015 given that the fund balance is expected to exceed 25% of the appropriation.**

Recommended Actions

1. Concur with Governor's allowance.

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 2015, 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

As **Exhibit 1** shows, total participation in the retirement savings plans offered by MSRP has been gradually declining for the last five calendar years, largely mirroring the downturn in the economy and position reductions. Since fiscal 2008, the plan has lost approximately 4,191 plan participants; however, it appears that the pace of the decline is slowing. Despite the decline in the overall number of participants, the percentage of eligible employees participating in the plan has remained relatively constant.

Exhibit 1
Maryland Supplemental Retirement Plan Participation
Calendar 2008-2013

Year	Total Participants	% Change	% of Eligible	% Deferring	% Holding	% Payout
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	57,786	-1.2%	76%	60.1%	34.0%	5.9%
2013	57,331*	-0.8%	74%	59.7%	34.5%	5.8%

*Calendar 2013 data is as of September 30, 2013.

Source: Maryland Supplemental Retirement Plans

While it is noteworthy that the percentage of eligible participants has remained relatively constant, the percentage of participants deferring to account has declined from 67.7% in calendar 2008 to 59.7% in calendar 2013. According to the agency's Managing for Results (MFR) data, 44% of all eligible State employees contributed to an account in fiscal 2013. The decline of employees deferring to a retirement plan in part is attributed to the ending of the mandated employer match of $600 and stagnant salaries in recent years. It appears that employees have elected to stop deferring for retirement to support ongoing household expenditures. As salary increases may occur in the coming fiscal years, one would expect the percentage of employees deferring to increase. **The Department of Legislative Services (DLS) recommends that MSRP discuss the strategies that are in place to recruit more employees into the plan and to have more employees actively defer to their retirement account.**

2. Investment Returns Generally Exceed Benchmarks

As shown in **Exhibit 2**, except for the three-year return, MSRP options outperformed the benchmark options. For the year, MSRP funds gained 16.5%, compared with benchmark performance gaining 16.3%. Compared to plan benchmarks, the 1-, 5-, and 10-year annualized returns for MSRP options continue to outperform plan benchmarks, as they have consistently in recent prior years. **Appendix 2** offers a fund-by-fund perspective, comparing the performance of each non-indexed fund available to participants against its own benchmark index, as of September 2013.

Exhibit 2
MSRP Average Rates of Return
Fiscal 2009-2013

	1-year	3-years	5-years	10-years
Annual Average Rates of Return as of June 30, 2013				
MSRP Options	16.5%	13.8%	6.5%	8.3%
Benchmark Indices	16.3%	14.0%	6.1%	7.7%
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

Proposed Budget

Exhibit 3 provides a summary of the major changes in the fiscal 2015 allowance compared to the fiscal 2014 working appropriation. There is one across-the-board reduction and one contingent reduction reflected in the Governor's spending plan for the fiscal 2015 allowance. This affects funding for employee/retiree health insurance and retirement reinvestment. The total reduction to MSRP is approximately $13,000. These actions are fully explained in the analyses of the Department of Budget and Management – Personnel and the State Retirement Agency.

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

How Much It Grows:	Special Fund	Total
2014 Working Appropriation	$1,545	$1,545
2015 Allowance	1,635	1,635
Amount Change	$90	$90
Percent Change	5.8%	5.8%

Where It Goes:	
Personnel Expenses	
Annualized salary increase	$33
Increments and other compensation	15
Retirement	6
Other personnel expenses	2
Employee and retiree health insurance	-23
Other Changes	
Higher costs for shared assistant attorney general	21
Travel costs to have more face-to-face meetings	11
Rent paid to the Department of General Services	7
Software licenses	7
Replace laptop computers	3
Data processing computers	3
Association dues	3
Staff training	2
Total	**$90**

Note: The fiscal 2014 working appropriation reflects negative deficiencies and contingent reductions. The fiscal 2015 allowance reflects back of the bill and contingent reductions. Numbers may not sum to total due to rounding.

The major changes in the allowance include personnel expenditures increasing approximately $33,000. The annualization of the fiscal 2014 general salary increase and increment for State employees account for $33,000 of the increase. Additional personnel changes include $15,000 for fiscal 2015 increments offset by the reduction to health insurance totaling $23,000. Nonpersonnel related increases include $21,000 for legal services to cover the new cost of a loaned assistant attorney general. The travel budget increases $11,000 to deal with attrition in the workforce and to conduct more event and other in-person meetings. There are several other smaller increases related to information technology upgrades.

Issues

1. Is It Time for the $600 Employer Match to Return?

In recent years, retirement offerings for State employees have changed. Prior to the recession, the State's pension system provided a generous defined benefit based upon an employee's salary and service and the defined contribution plan offered by MSRP. Statute provided that individuals who participated in the supplemental retirement plan could receive up to a $600 employer match.

With the recession, Chapter 484 of 2010 (the Budget and Reconciliation Act), eliminated the mandatory $600 employer match for the supplemental retirement plan as part of the broader effort to resolve the structural deficit. At the time, it was estimated that this would save the general fund $14.3 million and $23.9 million in all funds. During the 2011 session, changes were made to the State employee system that reduced the benefit provided to State employees hired after June 30, 2011, while increasing the amount all employees contribute to the pension system. While the State was able to produce savings to the State and improve the long-term financial solvency of the pension system, new State employees will bear a greater burden to save for their retirement.

As was noted earlier in the MFR section, only 44% of eligible employees actively contributed to a plan in fiscal 2013. The percentage of individuals contributing to a plan may increase now that salary increases are projected to occur, and the overall economy is projected to improve. While employees contribute 7% of their salary to the pension, which is a significant contribution, the pension benefit paid out is less for newer employees. Due to the greater burden on new State employees to save for retirement and the overall lack of active participation in supplemental retirement plans by State employees, the return of the State match may help increase participation in retirement saving. **DLS recommends that the agency discuss whether the match is an important tool to attract contributions and what role the match could have in helping to prepare employees for retirement after the recent changes to pension benefits.**

2. Management Fees

Plan participants pay separate fees to both the management company that administers the plans and to MSRP. Currently, Nationwide is the management company that administers the plan and has done so for more than 20 years. The asset fee that Nationwide collects directly from participants is 0.09%, which is anticipated to generate approximately $2.6 million annually. The fee that MSRP collects has two components: the agency collects a 0.05% asset fee from each plan and a $0.50 fee per account. The asset fee accounts for most of the agency's revenue but is subject to the volatility of changes in assets from market fluctuations. The flat fee is a more stable revenue source and generates approximately $30,000 a month.

In January 2013, the board decided to suspend the asset fee from each plan. The reason for this was that MSRP had received a one-time settlement of $533,700 from a class action proceeding against Invesco relating to the alleged market-timing, late trading, and short-term and excessive trading in the Invesco/AIM Funds. The board decided that the proceeds should be distributed to participants by instituting a fee holiday, in large part, because it was the easiest and cheapest way to administer rather than refunding the amount to those individuals who held those funds involved in the settlement. It was originally envisioned that the fee holiday would last four to five months; however, the board extended the fee holiday to December 31, 2013.

The reason that the board extended the fee holiday was that the board wanted to draw down its reserve balance to 25% of the fiscal 2014 appropriation. As shown in **Exhibit 4**, the fund balance at the end of fiscal 2013 was over 56% of the agency's appropriation. By extending the fee holiday, the fund balance is reduced. MSRP is currently estimating the reserve balance to be 30.2% of the fiscal 2014 appropriation. In fiscal 2015 the balance is expected to increase to 44.6%. While this is greater than the 25% target, a large portion of the revenue is derived from the level of assets the agency has, which fluctuates based upon market volatility, so this figure may change. **DLS recommends that the agency discuss the settlement funds received in more depth and if there will be a fee holiday in fiscal 2015 given that the fund balance is expected to exceed 25% of the appropriation.**

Exhibit 4
Assets and Participants' Fees and Agency Operating Budgets
Fiscal 2012-2015

	2012	2013*	2014 (Est.)	2015 (Est.)
Invested Assets ($ in Billions)	$2.64	$2.94	$3.00	$3.12
Plan Administrator Fees[1]	**$3,696,603**	**$3,376,326**	**$3,068,000**	**$2,806,470**
As Percent of Assets	0.14%	0.115%	0.09%	0.09%
Board Asset Fee	$1,251,220	$1,010,687	$799,000	$1,559,150
As Percent of Assets[2]	0.05%	0.05%	0.05%	0.05%
$0.50 Monthly Charge	$368,354	$362,996	$360,290	$358,000
One-time Settlement Revenue		$599,457		
Total Board Revenue	**$1,619,574**	**$1,973,140**	**$1,159,290**	**$1,917,150**
Operating Expenses	$1,444,892	$1,504,309	$1,544,820	$1,647,518
Carryover Balance	$382,656	$851,487	$465,957	$735,589
Carryover Balance as Percent of Operating Expenses	26.5%	56.6%	30.2%	44.6%

[1]Management fee of 0.115% represents 0.14% management fee for the 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.
[2]In fiscal 2013 and 2014, the board provided fee holidays so the amount of the fee is less than the 0.05%.

Source: Maryland Supplemental Retirement Plans; Department of Legislative Services

Recommended Actions

1. Concur with Governor's allowance.

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 2013					
Legislative Appropriation	$0	$1,496	$0	$0	$1,496
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	9	0	0	9
Reversions and Cancellations	0	-3	0	0	-3
Actual Expenditures	**$0**	**$1,502**	**$0**	**$0**	**$1,502**
Fiscal 2014					
Legislative Appropriation	$0	$1,527	$0	$0	$1,527
Budget Amendments	0	18	0	0	18
Working Appropriation	**$0**	**$1,545**	**$0**	**$0**	**$1,545**

Note: The fiscal 2014 working appropriation does not include deficiencies or contingent reductions. Numbers may not sum to total due to rounding.

Fiscal 2013

Fiscal 2013 special fund spending totaled $1.5 million. Spending increased by $8,781 to fund the cost-of-living adjustment (COLA) provided to State employees in fiscal 2013. There were cancellations of $2,616 in a number of areas to reflect actual spending.

Fiscal 2014

The fiscal 2014 appropriation has increased by $17,675. The specific increases include $13,883 to fund the fiscal 2014 COLA for State employees. There is also an additional $3,792 to fund the increment provided to State employees.

Appendix 2

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MSRP Investment Performance Compared with Benchmark Indices As of September 2013

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

MSRP: Maryland Supplemental Retirement Plans

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 13 Actual	FY 14 Working Appropriation	FY 15 Allowance	FY 14 - FY 15 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	$ 1,057,506	$ 1,109,768	$ 1,156,175	$ 46,407	4.2%
02 Technical and Spec. Fees	1,219	1,500	3,850	2,350	156.7%
03 Communication	14,315	20,410	20,422	12	0.1%
04 Travel	18,468	9,000	20,074	11,074	123.0%
07 Motor Vehicles	9,870	11,760	11,760	0	0%
08 Contractual Services	265,015	254,212	282,536	28,324	11.1%
09 Supplies and Materials	3,185	11,000	12,000	1,000	9.1%
10 Equipment – Replacement	3,839	0	3,300	3,300	N/A
11 Equipment – Additional	5,351	3,500	3,500	0	0%
13 Fixed Charges	123,129	123,670	133,901	10,231	8.3%
Total Objects	**$ 1,501,897**	**$ 1,544,820**	**$ 1,647,518**	**$ 102,698**	**6.6%**
Funds					
03 Special Fund	$ 1,501,897	$ 1,544,820	$ 1,647,518	$ 102,698	6.6%
Total Funds	**$ 1,501,897**	**$ 1,544,820**	**$ 1,647,518**	**$ 102,698**	**6.6%**

Note: The fiscal 2014 appropriation does not include deficiencies. The fiscal 2015 allowance does not include contingent reductions.