

G20J01
State Retirement Agency

Operating Budget Data

(\$ in Thousands)

	<u>FY 14</u> <u>Actual</u>	<u>FY 15</u> <u>Working</u>	<u>FY 16</u> <u>Allowance</u>	<u>FY 15-16</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Special Fund	\$17,347	\$18,162	\$18,532	\$371	2.0%
Contingent & Back of Bill Reductions	0	0	-340	-340	
Adjusted Special Fund	\$17,347	\$18,162	\$18,192	\$30	0.2%
Reimbursable Fund	9,385	9,916	9,839	-77	-0.8%
Adjusted Reimbursable Fund	\$9,385	\$9,916	\$9,839	-\$77	-0.8%
Adjusted Grand Total	\$26,732	\$28,077	\$28,031	-\$46	-0.2%

Note: The fiscal 2015 working appropriation reflects deficiencies and the Board of Public Works reductions to the extent that they can be identified by program. The fiscal 2016 allowance reflects back of the bill and contingent reductions to the extent that they can be identified by program.

- After factoring in contingent and back of the bill reductions, the State Retirement Agency's fiscal 2016 operating budget shrinks by 0.2% compared with fiscal 2015 levels. Absent those reductions, the budget grows by just 1.0%.
- The costs associated with the addition of 12.0 regular positions are offset by reductions in almost all other major budgeted categories.

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

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Personnel Data

	<u>FY 14</u> <u>Actual</u>	<u>FY 15</u> <u>Working</u>	<u>FY 16</u> <u>Allowance</u>	<u>FY 15-16</u> <u>Change</u>
Regular Positions	192.00	192.00	204.00	12.00
Contractual FTEs	<u>15.50</u>	<u>16.50</u>	<u>9.50</u>	<u>-7.00</u>
Total Personnel	207.50	208.50	213.50	5.00

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	9.56	4.98%
Positions and Percentage Vacant as of 12/31/14	n/a	n/a

- The fiscal 2016 allowance adds 12.0 regular positions, including 4.0 resulting from contractual conversions.
- Contractual full-time equivalents (FTE) are reduced by 7.0, reflecting 5.0 FTEs lost due to the conversion to regular positions, and 2.0 additional contractual FTEs that were never filled due to delays in Phase II of the Maryland Pension Administration System (MPAS-II).
- Of the 8.0 new regular positions, 4.0 replace outside contractors providing MPAS-II operations and maintenance, and 4.0 are assigned to the Benefits Administration to alleviate backlogs and service deficiencies.

Analysis in Brief

Major Trends

Investment Returns Continue to Exceed Targets, but Asset Allocation Results in Underperformance Relative to Peers: As domestic and international equities continued to lead world financial markets, the State Retirement and Pension System’s (SRPS) conservative asset allocation held back its performance.

Call Center Performance Struggled in Fiscal 2014, Then Rebounded: Long waits for benefit counselors and abandoned calls plagued the agency’s call center.

Issues

Backlog in Processing Retirement Benefit Estimates Has Grown: Staffing shortages have contributed to the backlog, but new staff should help alleviate the problem. **The agency should explain the reasons for the backlog and provide a plan to address it.**

The System’s Disability Benefit Structure and Process Have Not Been Reviewed in Almost 15 Years: The SRPS process for awarding disability benefits has inherent conflicts of interest, and the benefits themselves may be excessive. **The agency and the Department of Legislative Services should conduct a joint study of disability benefits available to members of SRPS.**

Recommended Actions

	<u>Funds</u>	<u>Positions</u>
1. Delete 1.0 full-time equivalent administrative specialist III (new position).	\$ 35,892	1.0
2. Adopt committee narrative requesting a report on disability benefits processing and appropriateness.		
Total Reductions	\$ 35,892	1.0

Updates

Local Governments Should Continue to Plan for a Higher-than-forecast Normal Cost Rate in Fiscal 2017: Although the forecasted payments for fiscal 2017 are still higher than those originally forecast in 2012, they are lower than more recent estimates due to positive investment and other experience.

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MPAS-II Projected to Be Completed by June 30, 2016: No new expenditures for MPAS-II are authorized for fiscal 2016, but the project should be completed using resources budgeted in prior fiscal years.

Report on Alternatives to Board of Trustees Elections Is Delayed: An extension was granted to January 31, 2015; the Joint Committee on Pensions will take up the report during the 2015 interim.

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State Retirement Agency

Operating Budget Analysis

Program Description

The State Retirement Agency (SRA), under the direction of the 15-member Board of Trustees for the State Retirement and Pension System (SRPS), is responsible for administering the State's retirement and pension systems. The fifteenth position on the board, which represents local governments, was added as a result of legislation adopted during the 2013 session. The board-appointed executive director is responsible for policy development, legislation, and legal affairs.

The agency has identified four fundamental goals for its operation:

- to prudently invest system assets in a well-diversified manner that optimizes long-term returns while controlling risk through excellence in the execution of the investment objectives and strategies of the system;
- to effectively communicate with all retirement plan participants to inform them about the benefits provided by the system and to educate them about planning and preparing for all aspects of their defined benefit system;
- to pay all retirement allowances provided by State pension law to the system's retirees and their beneficiaries in an accurate and timely manner; and
- to efficiently collect the required employer and employee contribution necessary to fund the system.

An administrative charge to all employers for whom the agency administers retiree benefits provides the revenue to fund the agency. In proportion to total system membership, administrative charge revenue from State agencies pays for roughly one-third (35%) of agency operations, and revenue from local employers pays for the remaining two-thirds (65%). The new approach allows the agency to keep, and therefore invest, all member and employer contributions and investment proceeds for the direct benefit of members. Participating employers will pay approximately \$147 per member in fiscal 2016. Reimbursable fund revenues represent State agency payments for administrative costs, and special fund revenues represent administrative payments by local school boards and participating governmental units.

As of June 30, 2014, the system's assets totaled \$45.42 billion, a \$5.2 billion increase from the end of fiscal 2013, which is attributable to revenues from investments exceeding expenses and benefits paid.

Performance Analysis: Managing for Results

1. Investment Returns Continue to Exceed Targets, but Asset Allocation Results in Underperformance Relative to Peers

The system's investment return for fiscal 2014 was 14.4% net of management fees, exceeding its investment return target (7.70%) for the fourth time in the last five years. The pension fund's return also exceeded its plan benchmark by 21 basis points. Public equity markets, especially domestic equities, continued climbing as U.S. and European central banks maintained accommodative monetary policies that held down interest rates. Broad indices of public equities were all strongly higher: the U.S. Standard & Poor's 500 index rose 24.6%, and the Morgan Stanley Capital International non-U.S. equity index rose 21.8%. With public equities making up 38.9% of the portfolio, this impressive performance propelled the system to generate returns well in excess of its target.

Exhibit 1 shows that the system has made significant progress in reaching its strategic allocation targets that were adopted beginning in fiscal 2008. The primary purpose of these changes has been to diversify the fund's holdings in order to both maximize long-term returns and reduce volatility in annual returns.

Exhibit 1 State Retirement and Pension System Asset Allocation Fiscal 2012-2014

	Strategic Target <u>6/30/2014</u>	Actual <u>6/30/2014</u>	Actual <u>6/30/2013</u>	Actual <u>6/30/2012</u>
Equity				
Domestic Stocks		10.3%	11.6%	13.0%
International Stocks		12.1%	13.8%	15.0%
Global Equity		16.5%	17.0%	14.4%
Total Public Equity	35.0%	38.9%	42.4%	42.4%
Private Equity	10.0%	7.0%	6.2%	5.7%
Real Estate	10.0%	6.8%	5.8%	6.4%
Fixed Income	10.0%	14.8%	16.2%	19.2%
Real Return Strategies	14.0%	12.0%	12.6%	10.0%
Absolute Return	10.0%	9.4%	7.3%	6.8%
Credit/Debt	10.0%	10.0%	8.4%	7.8%
Cash and Other	1.0%	1.1%	1.3%	1.7%
Total Assets	100.0%	100.0%	100.0%	100.0%

Note: Data reflects all system assets held at State Street. Columns may not add to total due to rounding.

Source: State Retirement Agency

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In the year from June 2013 to June 2014, the system achieved its strategic targets for allocation to credit/debt strategies and very nearly achieved its target allocation for absolute return. It also made progress toward reaching its strategic targets in all other major asset classes. Most notably, public equity dropped from 42.4% to 38.9%, approaching its target of 35.0%, and fixed income dropped from 16.2% to 14.8%, moving closer to its target of 10.0%. There were corresponding increases to alternative asset classes, including private equity.

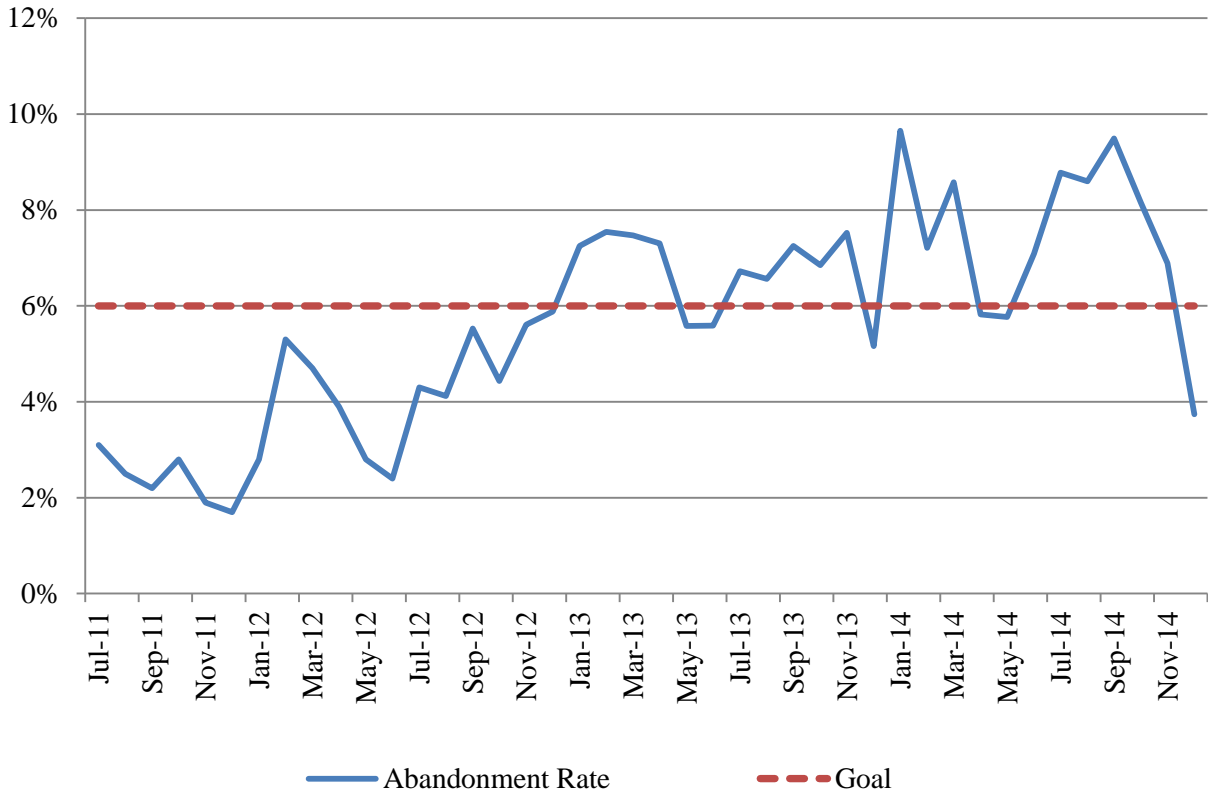
Although the system's investment returns exceeded both the actuarial target and its plan benchmark, it continues to vastly underperform its peer pension plans. According to the Trust Universe Comparison Service (TUCS), the system's fiscal 2014 investment performance was among the worst of 25 public pension funds with at least \$25 billion in assets. The system's fiscal 2014 performance placed it at the ninety-fourth percentile. In the TUCS analysis, the one-hundredth percentile is the lowest ranking, and the first percentile is the highest. Long-term performance rankings place SRPS in the bottom quartile for every timeframe examined. The TUCS rankings are based on returns gross of fees.

The persistent strength of the public equity markets raises legitimate questions about the extent to which the system has implemented its asset allocation plan. Specifically, the long-term strategic target of 35% for public equity is among the lowest of large public pension plans and has resulted in bottom-tier performance compared with peer funds. Although the Department of Legislative Services (DLS) supports the system's diversification into alternative asset classes to reduce reliance on volatile public equities, especially since their volatility has been on clear display for the past several months, it may be the case that the board has opted for a public equity allocation that is too low. **SRA should comment on the appropriateness of the system's 35.0% target for public equities in light of persistent underperformance relative to large state pension funds.**

2. Call Center Performance Struggled in Fiscal 2014, Then Rebounded

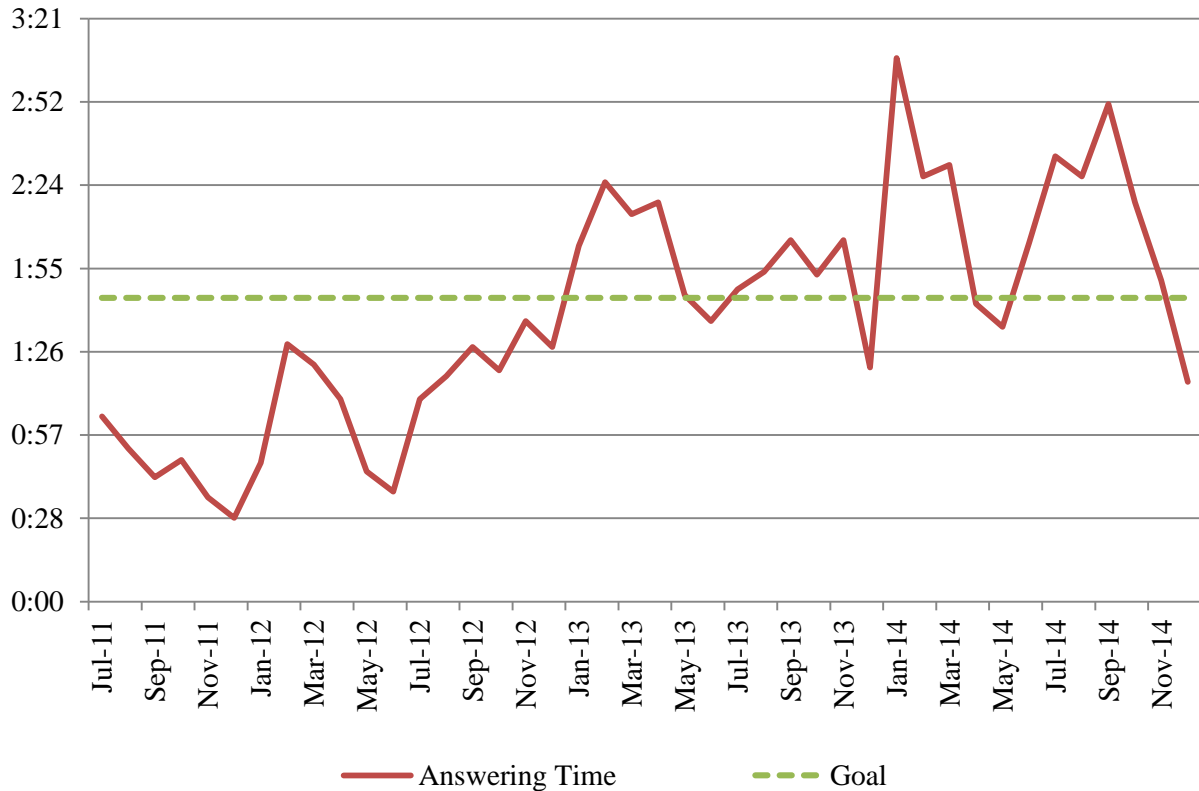
The agency typically receives between 15,000 and 20,000 phone call inquiries each month from members, retirees, and beneficiaries; roughly one-half of those calls are handled by an automated response system, but one-half are handled by retirement benefit counselors. The agency's call center failed to meet its key performance targets for most of fiscal 2014, as shown in **Exhibits 2 and 3**. The unit's targets are that fewer than 6% of calls will be abandoned by callers and that the wait time for a counselor to answer a call will not exceed 1:45 minutes. As the exhibits show, the call center achieved each of those goals in just three months of fiscal 2014. However, performance dramatically improved in December 2014, in part due to the lowest volume of calls in almost two years.

Exhibit 2
State Retirement and Pension System
Member Services Call Abandonment Rate
July 2011 – December 2014



Source: State Retirement Agency

Exhibit 3
State Retirement and Pension System
Member Services Call Answering Time (in minutes)
July 2011 – December 2014



Source: State Retirement Agency

Historically, poor call center performance has been caused by turnover and/or reassignment of retirement benefit counselors. This was the case in fiscal 2013 when several vacancies resulted in subpar performance. Some of those vacancies persisted into fiscal 2014, again contributing to the underperformance, but another issue has been reassignment of benefit counselors to other functions to address acute shortages in those areas. However, beginning in January 2015, the member services unit should have a full complement of staff with the arrival of two new hires. Although intensive training is necessary before these new counselors can handle incoming calls independently, performance should begin to show noticeable improvement in the coming months.

Proposed Budget

The addition of 12 full-time equivalent (FTE) positions results in personnel costs increasing sharply, but that increase is more than offset by reductions to other operating costs, especially in the areas of information technology (IT), contractual support, and rent. Of the 12 new positions, 8 are budget neutral: 4 are contractual conversions, and 4 are funded by reducing spending for an outside contractor that provides IT operations and maintenance support. The function and justification for the new staff are described in greater detail below. **Exhibit 4** shows that overall, the agency’s budget shrinks by 0.2% after the across-the-board reductions for cost-of-living adjustments (COLA) and increments. Additional savings for IT-related services and equipment beyond those necessary to fund the new positions stem from one-time purchases in fiscal 2015. Reductions in expenditures for rent and parking result from a renegotiated lease that allowed the agency to add 11,000 square feet of office space while reducing annual costs substantially; high commercial vacancy rates in Baltimore City have made office space very affordable.

**Exhibit 4
Proposed Budget
State Retirement Agency
(\$ in Thousands)**

How Much It Grows:	Special <u>Fund</u>	Reimb. <u>Fund</u>	<u>Total</u>
Fiscal 2014 Actual	\$17,347	\$9,385	\$26,732
Fiscal 2015 Working Appropriation	18,162	9,916	28,077
Fiscal 2016 Allowance	<u>18,192</u>	<u>9,839</u>	<u>28,031</u>
Fiscal 2015-2016 Amt. Change	\$30	-\$77	-\$46
Fiscal 2015-2016 Percent Change	0.2%	-0.8%	-0.2%

Where It Goes:

Personnel Expenses

12.0 FTE new positions	\$821
Increments and other compensation (prior to cost containment)	294
Section 20: across-the-board reduction for the 2% general salary increase.....	-198
Section 21: across-the-board reduction of employee increments.....	-142
Employee and retiree health insurance	506
Retirement.....	155
Workers’ compensation premium assessment	9
Turnover adjustments.....	-63
Other fringe benefit adjustments.....	49

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Where It Goes:

Other Changes

IT operations and maintenance	-625
IT equipment and software	-317
7.0 FTE contractual positions eliminated (including turnover and fringe).....	-300
Rent and parking	-197
No board elections	-122
Postage	-55
Travel	-26
Retirement seminars.....	14
Staff development	30
Actuarial and banking services	86
Other	35
Total	-\$46

FTE: full-time equivalent
IT: information technology

Note: Numbers may not sum to total due to rounding. The fiscal 2015 working appropriation reflects deficiencies and the Board of Public Works reductions to the extent that they can be identified by program. The fiscal 2016 allowance reflects back of the bill and contingent reductions to the extent that they can be identified by program.

New Personnel

Regular Positions

The agency’s fiscal 2016 allowance adds 12.0 FTE regular positions, including 4.0 contractual conversions, as demonstrated in **Exhibit 5**. One contractual FTE in the data control unit is lost due to the contractual conversion, which requires a swap of 1.25 FTE contractual positions for every 1.0 FTE regular position.

Exhibit 5 New Regular Positions

<u>Classification</u>	<u>Salary and Fringes</u>	<u>Function</u>	<u>Rationale</u>
Information Technology			
4.0 FTE Technical Support Specialist II	\$304,648	Operate and maintain Maryland Pension Administration System and perform similar functions for other applications.	Reduce agency reliance on external contractors to administer critical business operations. Budget neutral; funding for outside contractors is reduced by commensurate amount. Expands IT staffing; 2.0 contractor positions converted to 4.0 FTE regular positions.
Benefits Processing Division (New Positions)			
3.0 FTE Accountant Adv. 1.0 FTE Admin. Spec. III	235,145	Calculate retirement estimates and final retirement benefits. Process domestic relations orders, levies, and liens.	Resolve backlog of 2,000 estimates. Increasingly complex federal tax code requires additional accountant support and review.
Benefits Processing Division (Contractual Conversions)			
1.0 FTE Administrator II 2.0 FTE Admin. Spec. III	204,338	Administer and process benefit estimates and final benefits.	Provide more stable and permanent leadership and workforce in critical agency function.
1.0 FTE Admin. Officer I	76,839	Audit employer payroll and contribution data.	Long-serving contractual employee serving in a key internal control position.
Total Budgeted	\$820,970		

FTE: full-time equivalent
IT: information technology

Source: State Retirement Agency

Cost Containment

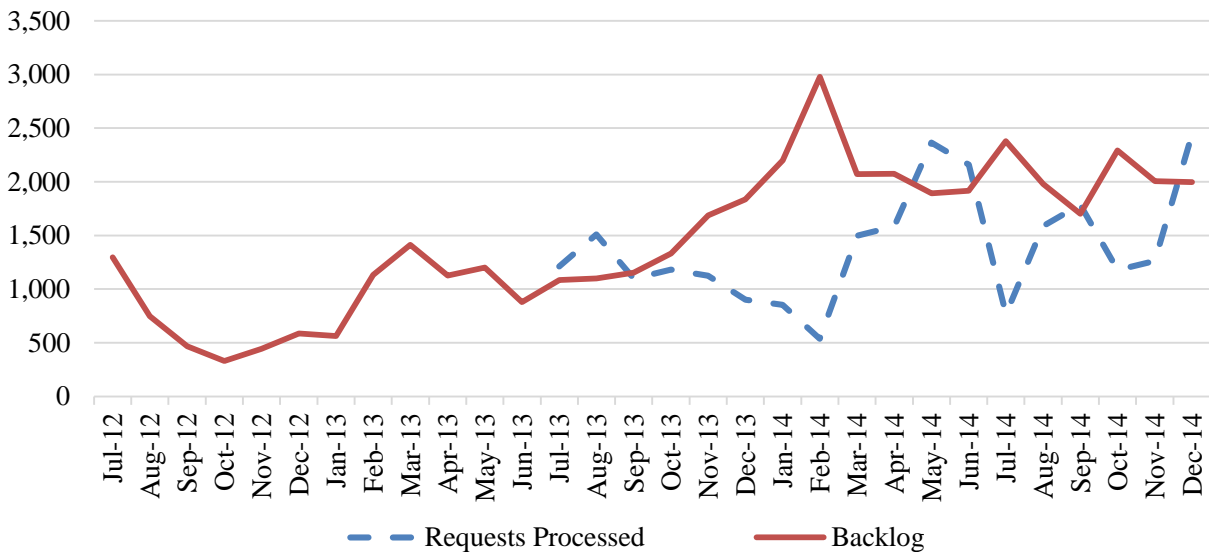
There are two across-the-board reductions in the Governor’s spending plan for the fiscal 2016 allowance, which affects funding for COLAs and increments for State employees. The agency’s share of these reductions totals \$340,420 in fiscal 2016. These actions are fully explained in the analysis of the Department of Budget and Management – Personnel.

Issues

1. Backlog in Processing Retirement Benefit Estimates Has Grown

Within one year of retirement eligibility, SRPS members may request an estimate of the benefit payment they will receive when they retire. In many cases, members request multiple estimates based on different retirement dates and/or optional survivor benefit selections. The agency’s goal is to process each request within four to six weeks of its receipt, but it has been unable to meet this goal for many requests. A backlog of benefit estimate requests has accumulated, with the average request taking 10 to 12 weeks to process. **Exhibit 6** shows the number of benefit estimates processed over the past 1.5 years, and the backlog that has developed and persisted over the past 2.5 years.

Exhibit 6
Maryland State Retirement Agency
Benefit Estimates Processed and Backlog
July 2012 – December 2014



Source: State Retirement Agency

The exhibit clearly shows that the backlog was at a manageable level early in fiscal 2013, but that it grew substantially in the middle of fiscal 2014 as the agency processed many fewer benefit estimate requests. Delays in processing benefit estimate requests can disrupt members’ retirement plans, and hence affect their benefits. The addition of staff to the Benefits Processing Unit outlined above may help alleviate the backlog, but only if they are assigned to that function. **SRA is asked to explain the reasons for the accumulation of a backlog of requests over the past year and a half and to provide the committees with a plan for reducing the backlog.**

2. The System’s Disability Benefit Structure and Process Have Not Been Reviewed in Almost 15 Years

Statute provides for three distinct types of benefits for SRPS members who become disabled while employed by a participating employer. “Ordinary” disability is available to a member with at least five years of eligibility service and if the medical board certifies (1) that the member is mentally or physically incapacitated for further performance of normal duties of the member’s position; (2) the incapacity is likely to be permanent; and (3) the member should be retired. “Accidental” disability benefits are available to a member of the Teachers’ or Employees’ Pension Systems (TPS/EPS) who is totally and permanently incapacitated for duty as the result of an accident that occurred in the actual performance of duty at a definite time and place without willful negligence by the member. “Special or accidental” disability benefits are available only to a member of the State Police Retirement System (SPRS) or Law Enforcement Officers’ Pension System (LEOPS) if the member is totally and permanently incapacitated for duty arising from the actual performance of duty without willful negligence by the member (*i.e.*, the incapacity need not arise from a distinct incident or accident).

In TPS/EPS and LEOPS, the ordinary disability allowance is:

- the full service pension allowance if the member is at least 62 years of age (age 50 for LEOPS); or
- the full service pension allowance computed as though the member had continued to accrue service credits until age 62 (age 50 for LEOPS) without any change in earnable compensation.

For SPRS, the ordinary disability allowance is the greater of (1) a full service retirement allowance computed on the basis of the member’s accumulated service and average final salary, or (2) 35% of the member’s average final salary.

For TPS/EPS, LEOPS, and SPRS, an accidental or special disability allowance is equal to the lesser of (1) the sum of an annuity determined as the actuarial value of the member’s accumulated contributions and two-thirds of the member’s average final salary, or (2) the member’s average final salary.

The awarding of disability benefits has wide-ranging effects on agency expenditures and the system’s financial health. From a budgetary standpoint, the agency must fund medical boards and independent medical evaluations to assess a member’s eligibility for disability benefits. The fiscal 2016 allowance includes \$288,000 for these purposes, up from \$238,000 in fiscal 2014, a 21% increase in just two years. In addition, statute allows members to appeal the decisions of the medical board and/or the Office of Administrative Hearings regarding their eligibility for benefits to the Board of Trustees, which requires substantial administrative and legal staff time that could be spent on other critical functions.

From the perspective of the pension fund, disability benefits are generally more generous than normal service retirement benefits, and the vast majority of applications for disability benefits are

awarded. To the extent that disability benefits are awarded without adequate safeguards against ineligible applicants receiving benefits, or if the benefits are overly generous, greater strain is placed on the health of the pension fund. Unfortunately, the process of awarding benefits has not been systematically reviewed since 2003, and DLS could find no evidence of a systematic review of the appropriateness of the disability benefit structure. The 2003 review by DLS found several inherent flaws in the process, including the conflict of interest involved in the Board of Trustees reviewing decisions made by its own medical board, but the General Assembly took no action on recommended changes to the process.

Fiscal 2015 witnessed a noticeable decline in the number of submitted and approved disability applications. It is not clear what is responsible for this decline, and it is too early to determine if it is part of a trend, especially in light of steady increases in both State and Social Security disability claims prior to this year, but the agency has taken steps in recent years to tighten up its review of disability applications. Among the steps taken are the expansion of the number of medical boards and an increase in funding for independent medical evaluations of medical claims by applicants. However, given the absence of any recent assessment of the disability award process or the appropriateness of benefits, a more systematic review of the process and the benefits available to disabled members is warranted. **Therefore, DLS recommends that SRA and DLS conduct a joint study of disability benefits available to SRPS members. As statute prohibits the board from reviewing benefit structures except for the purpose of making technical corrections, DLS should examine the appropriateness of disability benefits, including comparisons with benefits provided by other states and by Social Security. SRA should examine trends in the application for and granting of disability benefits and the procedures for reviewing and making disability award determinations. Its review should identify potential conflicts of interest or any other inappropriate or redundant features inherent in the process. DLS and SRA should submit their report, including findings and recommendations, to the House Appropriations Committee, Senate Budget and Taxation Committee, and the Joint Committee on Pensions by October 30, 2015.**

Recommended Actions

- | | <u>Amount
Reduction</u> | <u>Position
Reduction</u> |
|---|------------------------------------|--------------------------------------|
| 1. Delete 1.0 full-time equivalent administrative specialist III (new position). The agency has been holding an identical position in the same unit vacant since July 2014. | \$ 35,892 SF | 1.0 |

2. Adopt the following narrative:

Disability Benefits Processing and Appropriateness: Disability benefits paid by the State Retirement and Pension System have grown at a faster pace than normal service retirement benefits but are not closely tracked. The last systematic assessment of the process for reviewing and granting disability benefits was completed almost 15 years ago, and there is no recent record of any systematic review of the appropriateness of the benefits awarded. The committees request that the State Retirement Agency (SRA) conduct a review of recent trends in the application for and award of disability benefits and of its process for reviewing and awarding disability benefits. They also request that the Department of Legislative Services (DLS) review the level of disability benefits awarded, including how they compare with benefits awarded by other states and by Social Security. SRA and DLS should submit a joint report, including findings and recommendations to the House Appropriations Committee, Senate Budget and Taxation Committee, and the Joint Committee on Pensions by October 30, 2015.

Information Request	Authors	Due Date
Report on disability benefits	State Retirement Agency Department of Legislative Services	October 30, 2015
Total Special Fund Reductions		\$ 35,892
		1.0

Updates

1. Local Governments Should Continue to Plan for a Higher-than-forecast Normal Cost Rate in Fiscal 2017

The board of trustees voted in spring 2012 to adopt the recommendations of its actuary to change a variety of demographic assumptions used to calculate pension liabilities. The new assumptions related to rates of retirement, disability, withdrawal, and mortality were first applied to the June 30, 2012 actuarial valuation and have been carried through to each successive valuation since then. The changes vary extensively across different plans within SRPS, as well as by age and accumulated service credit, reflecting actual trends in those rates identified by an experience study completed in 2011. The net effect, however, was an increase in the value of service credit earned by SRPS members. This is reflected in an increase in the normal cost, which is the value of pension benefits earned in a given year by members.

In the case of the Teachers' Retirement System and Teachers' Pension System (TRS/TPS), the employer share of the normal cost increased from 4.62% in fiscal 2013 to 5.12% in fiscal 2016. Absent the board's actions, the employer's normal cost rate had been projected to decrease to 4.32%, which is shown in **Exhibit 7**.

Exhibit 7 **Projected Local Share of Teacher Pension Costs**

	<u>2012 Projection</u>	<u>Current Projection</u>	<u>Difference</u>
TCS Normal Cost			
Fiscal 2013 (actual)	4.62%	4.62%	0.00
Fiscal 2016	4.32%	5.12%	0.80
Fiscal 2017	4.05%	5.05%	1.00
Pension Contributions			
Fiscal 2016 School Boards	\$254,754,588	\$307,262,309	\$52,507,721
Fiscal 2017 School Boards	\$249,299,915	\$305,944,058	\$56,644,143

TCS: Teachers' Combined Systems

Source: State Retirement Agency; Department of Legislative Services

Chapter 1 of the first special session of 2012 requires local school boards to pay a portion of the normal cost for their employees who are members of TRS/TPS. Prior to that, the State paid 100% of the annual employer contribution on behalf of teachers in the State. Based on 2012 projections of the normal cost, local school boards paid 50% of the normal cost in fiscal 2013, phasing up to 100% of the

projected normal cost by fiscal 2016. For those four years, Chapter 1 specifies the exact dollar amount to be paid by each local school board based on projected salary growth, the projected normal cost, and the local share of that cost. Beginning in fiscal 2017, however, local school boards must pay 100% of the *actual* normal cost. It bears noting that beginning in fiscal 2013, Chapter 1 also requires county governments and Baltimore City to adjust their maintenance of effort (MOE) payments to local school boards to compensate them for teacher pension costs. Beginning in fiscal 2017, the fiscal 2016 payments by the counties are included in subsequent years' MOE calculations, so local school boards are responsible for any increase in normal cost payments between fiscal 2016 and each succeeding year.

The increase in the normal cost prompted by the board's action, as well as salary actions taken by local school boards, means that, beginning in fiscal 2017, local school board contributions will increase by a projected \$56.6 million over what was originally forecast, also shown in Exhibit 7. **Appendix 3** contains a breakdown of the increased costs in fiscal 2017 for each county. Local variation in the effect of the increased normal cost stems from differences in salary growth among local school boards. Had the local school boards not been held harmless by Chapter 1, their fiscal 2016 payment would have increased by \$52.5 million over the initial projections. Instead, the State is making up the difference through its continued payment on behalf of TRS/TPS members.

2. MPAS-II Projected to Be Completed by June 30, 2016

Phase 2 of the Maryland Pension Administration System (MPAS-II) is devoted to data scrubbing to verify that members' salary and service credit data currently in the agency's information system are accurate and that appropriate filters are in place to improve the accuracy of new data entered into the system. It is the necessary precursor to future service upgrades, including more interactive customer services such as web-based personalized benefit calculators. In fiscal 2014, \$634,000 was budgeted for MPAS-II, allocated as follows:

Contracted programming services	\$450,000
Equipment	116,548
2 full-time equivalent contractuels	53,452
Software	14,000
Total	\$634,000

The fiscal 2015 allowance included an additional \$450,000 for programming services, which was reduced to \$200,000 by the General Assembly because the project had fallen behind schedule. The fiscal 2016 allowance does not include any new funding for MPAS-II and, in fact, eliminates the 2 contractual FTEs awarded in fiscal 2014 because they are not necessary. To date, agency expenditures on MPAS-II have totaled \$529,325. With the elimination of funding for the contractual FTEs that leaves approximately \$251,000 to complete the project.

The agency's approach entails writing and executing a series of data filters to identify irregularities that exist in individual records, as well as incoming payroll data, and then either correcting or flagging the data for future reconciliation. The agency has increased the programming resources

devoted to the project from 1 programmer in fiscal 2014 to the current complement of 3 programmers. It has also conceptually divided the project into two components: Part A entails completing certain limited data cleansing activities that will support the Part B objectives for cleansing the service and salary data in the individual records. As of December 2014, the agency advises that Part A is 60% complete, and Part B is 20% complete. Originally scheduled to be completed by the end of fiscal 2015, the agency now projects a completion date of June 30, 2016, for MPAS-II.

3. Report on Alternatives to Board of Trustees Elections Is Delayed

The 2014 *Joint Chairmen's Report* requested a report from the agency by December 1, 2014, on possible alternatives to holding elections for the five individuals who represent active and retired members on the Board of Trustees. The 2014 DLS analysis found that the elections are expensive to run and have extremely low participation rates, typically under 10%. The report was to include information on whether other state pension boards include member and retiree representatives and how they are selected. SRA requested and was granted an extension to January 31, 2015, to complete the report. Given the timing, the report's findings and recommendations will be taken up by the Joint Committee on Pensions during the 2015 interim.

Current and Prior Year Budgets

Current and Prior Year Budgets **State Retirement Agency** **(\$ in Thousands)**

	<u>General</u> <u>Fund</u>	<u>Special</u> <u>Fund</u>	<u>Federal</u> <u>Fund</u>	<u>Reimb.</u> <u>Fund</u>	<u>Total</u>
Fiscal 2014					
Legislative					
Appropriation	\$0	\$18,008	\$0	\$9,727	\$27,735
Deficiency					
Appropriation	0	-239	0	0	-239
Budget					
Amendments	0	-229	0	-186	-415
Reversions and					
Cancellations	0	-193	0	-156	-349
Actual					
Expenditures	\$0	\$17,347	\$0	\$9,385	\$26,732
Fiscal 2015					
Legislative					
Appropriation	\$0	\$18,062	\$0	\$9,862	\$27,924
Cost					
Containment	0	0	0	0	0
Budget					
Amendments	0	99	0	54	153
Working					
Appropriation	\$0	\$18,162	\$0	\$9,916	\$28,077

Note: Numbers may not sum to total due to rounding. The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies.

Fiscal 2014

The distribution of centrally budgeted funds for a 3% employee COLA beginning January 1, 2014, and additional increments increased expenditures of special funds by \$189,963. Special fund appropriations were subsequently reduced by a total of \$418,975, including \$370,758 for unexpended health care costs, \$31,611 for unexpended funds associated with the State's personnel management system, and \$16,606 for unexpended funds associated with fees assessed by the Department of Information Technology (DoIT). This resulted in a net special fund reduction of \$229,012.

The distribution of centrally budgeted funds for the COLA and increments increased expenditures of reimbursable funds by \$118,280. Reimbursable funds were subsequently reduced by a total of \$304,241 due to unexpended funds, including \$278,142 for health care, \$17,129 for the State personnel management system, and \$8,970 for DoIT fees. This resulted in a net reimbursable fund reduction of \$185,961.

Deficiency appropriations contained in the fiscal 2015 budget reduced fiscal 2014 special fund expenditures by \$161,316 for retirement costs and \$78,177 for health care costs, for a total reduction of \$239,493.

Fiscal 2015

The distribution of centrally budgeted funds for a 2% employee COLA beginning January 1, 2015, increased expenditures of special funds by \$99,373 and reimbursable funds by \$53,777, for a total increase of \$153,150.

Audit Findings

Audit Period for Last Audit:	May 20, 2011 – April 1, 2014
Issue Date:	December 2014
Number of Findings:	2
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: The agency’s procedures for reviewing certain critical security events were not sufficient. The agency agreed with the finding and implemented processes to improve its review.

Finding 2: The agency’s intrusion detection prevention system was not properly protecting the network. The agency agreed with the finding and will conduct a risk assessment of its network security by June 30, 2015.

**Local Share of Projected Increase in Teacher Pension Payments
Fiscal 2017**

<u>County</u>	<u>2012 Projection</u>	<u>2015 Projection</u>	<u>Difference</u>
Allegany	\$2,714,289	\$3,137,434	\$423,145
Anne Arundel	20,969,486	26,154,356	5,184,870
Baltimore City	23,576,930	27,914,887	4,337,957
Baltimore	28,745,445	35,302,819	6,557,374
Calvert	5,173,986	6,025,610	851,624
Caroline	1,448,482	1,814,692	366,210
Carroll	7,308,290	8,543,839	1,235,548
Cecil	4,487,780	5,407,475	919,695
Charles	7,181,921	8,903,937	1,722,016
Dorchester	1,197,820	1,500,594	302,774
Frederick	10,752,240	13,555,471	2,803,231
Garrett	1,212,728	1,310,950	98,223
Harford	10,088,656	11,530,896	1,442,240
Howard	17,917,902	23,037,553	5,119,651
Kent	668,012	727,770	59,759
Montgomery	49,674,917	63,662,323	13,987,406
Prince George's	35,676,071	42,230,709	6,554,639
Queen Anne's	2,016,962	2,449,921	432,958
St. Mary's	4,534,994	5,532,026	997,032
Somerset	875,955	1,067,337	191,382
Talbot	1,146,578	1,422,801	276,223
Washington	5,645,009	6,976,412	1,331,403
Wicomico	3,965,581	4,970,432	1,004,851
Worcester	2,319,881	2,763,814	443,933
Total	\$249,299,915	\$305,944,058	\$56,644,144

Source: Department of Legislative Services

**Object/Fund Difference Report
State Retirement Agency**

<u>Object/Fund</u>	<u>FY 14 Actual</u>	<u>FY 15 Working Appropriation</u>	<u>FY 16 Allowance</u>	<u>FY 15 - FY 16 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	192.00	192.00	204.00	12.00	6.3%
02 Contractual	15.50	16.50	9.50	-7.00	-42.4%
Total Positions	207.50	208.50	213.50	5.00	2.4%
Objects					
01 Salaries and Wages	\$ 16,495,437	\$ 17,980,452	\$ 19,751,755	\$ 1,771,303	9.9%
02 Technical and Spec. Fees	780,959	1,053,890	766,009	-287,881	-27.3%
03 Communication	538,276	589,848	540,628	-49,220	-8.3%
04 Travel	111,640	160,000	134,215	-25,785	-16.1%
07 Motor Vehicles	193,945	183,939	137,248	-46,691	-25.4%
08 Contractual Services	5,401,775	5,230,394	4,500,329	-730,065	-14.0%
09 Supplies and Materials	153,555	164,077	175,338	11,261	6.9%
10 Equipment – Replacement	766,955	330,151	154,163	-175,988	-53.3%
11 Equipment – Additional	66,581	70,000	66,148	-3,852	-5.5%
12 Grants, Subsidies, and Contributions	382,926	382,426	382,426	0	0%
13 Fixed Charges	1,840,047	1,932,224	1,763,216	-169,008	-8.7%
Total Objects	\$ 26,732,096	\$ 28,077,401	\$ 28,371,475	\$ 294,074	1.0%
Funds					
03 Special Fund	\$ 17,346,777	\$ 18,161,517	\$ 18,532,251	\$ 370,734	2.0%
09 Reimbursable Fund	9,385,319	9,915,884	9,839,224	-76,660	-0.8%
Total Funds	\$ 26,732,096	\$ 28,077,401	\$ 28,371,475	\$ 294,074	1.0%

Note: The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies. The fiscal 2016 allowance does not reflect contingent or across-the-board reductions.

**Fiscal Summary
State Retirement Agency**

<u>Program/Unit</u>	<u>FY 14 Actual</u>	<u>FY 15 Wrk Approp</u>	<u>FY 16 Allowance</u>	<u>Change</u>	<u>FY 15 - FY 16 % Change</u>
01 State Retirement Agency	\$ 26,732,096	\$ 28,077,401	\$ 28,371,475	\$ 294,074	1.0%
Total Expenditures	\$ 26,732,096	\$ 28,077,401	\$ 28,371,475	\$ 294,074	1.0%
Special Fund	\$ 17,346,777	\$ 18,161,517	\$ 18,532,251	\$ 370,734	2.0%
Total Appropriations	\$ 17,346,777	\$ 18,161,517	\$ 18,532,251	\$ 370,734	2.0%
Reimbursable Fund	\$ 9,385,319	\$ 9,915,884	\$ 9,839,224	-\$ 76,660	-0.8%
Total Funds	\$ 26,732,096	\$ 28,077,401	\$ 28,371,475	\$ 294,074	1.0%

Note: The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies. The fiscal 2016 allowance does not reflect contingent or across-the-board reductions.