G20J01
State Retirement Agency

Executive Summary

The State Retirement Agency (SRA), under the direction of the board of trustees, is responsible for administering the State Retirement and Pension System (SRPS). SRA is responsible for policy development, legislation, and legal affairs related to the State's retirement systems as well as investments, benefit payments, and employer/employee contributions.

Operating Budget Data

($ in Thousands)

	FY 18 Actual	FY 19 Working	FY 20 Allowance	FY 19-20 Change	% Change Prior Year
Special Fund	$22,410	$21,630	$21,152	-$479	-2.2%
Adjustments	0	81	304	224	
Adjusted Special Fund	**$22,410**	**$21,711**	**$21,456**	**-$255**	**-1.2%**
Nonbudgeted Fund	0	12,623	13,486	863	6.8%
Adjusted Nonbudgeted Fund	**$0**	**$12,623**	**$13,486**	**$863**	**6.8%**
Reimbursable Fund	11,544	10,901	10,515	-387	-3.5%
Adjustments	0	43	164	121	
Adjusted Reimbursable Fund	**$11,544**	**$10,945**	**$10,679**	**-$266**	**-2.4%**
Adjusted Grand Total	**$33,954**	**$45,278**	**$45,621**	**$342**	**0.8%**

Note: The fiscal 2019 appropriation includes deficiencies, a one-time $500 bonus, and general salary increases. The fiscal 2020 allowance includes general salary increases.

- The fiscal 2020 allowance increases by $342,000 (0.8%) over fiscal 2019 when including costs associated with statewide salary actions. Personnel increases of $1.8 million are partially offset by decreases in funding for phase three of the Maryland Pension Administration System (MPAS-3) major information technology (IT) project ($1.6 million). The fiscal 2020 allowance is within the agency's statutory cap of $38.3 million for budgeted administrative expenses, largely due to costs associated with the Investment Division being taken off-budget.

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

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Personnel Data

	FY 18 Actual	FY 19 Working	FY 20 Allowance	FY 19-20 Change
Regular Positions	197.00	197.00	202.00	5.00
Contractual FTEs	8.07	8.00	8.00	0.00
Total Personnel	**205.07**	**205.00**	**210.00**	**5.00**

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	10.40	5.28%
Positions and Percentage Vacant as of 12/31/18	18.00	9.14%

- SRA gains 5 IT-related positions in fiscal 2020 associated with implementation of MPAS-3. The positions are budgeted at 5% turnover, which does not adhere to fiscal 2020 budget instructions that require 25% budgeted turnover for new positions. **The Department of Legislative Services recommends raising the turnover expectancy for these new positions to reflect 25% as required by fiscal 2020 budget instructions.**

- The agency's overall budgeted turnover rate is lowered to 5.3% in fiscal 2020, primarily reflecting the elimination of budgeted turnover for the Investment Division. Removing the Investment Division, the budgeted turnover for the agency is 6.7%, assuming approximately 11 vacancies year-round. Generally, SRA's vacancies are higher than budgeted turnover due to issues with retention.

Key Observations

- ***State's Retirement System Exceeds Funded Ratio Expectations:*** The State's retirement system is projected to reach 80% actuarial funding by fiscal 2026 and 100% funding by fiscal 2039. The actual funded ratio in fiscal 2018 was 71.6% for all State plans, exceeding the projected ratio of 69% for that year, following comprehensive pension reform in 2011.

- ***Investment Division Is Nonbudgeted Starting in Fiscal 2019:*** The Joint Committee on Pensions sponsored legislation during the 2018 session to give the board of trustees of SRPS independent authority to create and eliminate positions in the Investment Division and establish compensation levels for those positions, including performance bonuses. As of fiscal 2019, the Investment Division has been formally taken off-budget. According to the division, 8 new positions have been approved by the board and funding has been provided, but no additional positions are reflected in the budget.

Operating Budget Recommended Actions

		Funds
1.	Reduce authorization to spend overbudgeted reimbursable funds for the Investment Division health insurance and the statewide cost allocation.	
2.	Reduce authorization to spend overbudgeted reimbursable funds to reflect 25% turnover expectancy for new positions.	
3.	Reduce overbudgeted special funds for the Investment Division health insurance and the statewide cost allocation.	$ 450,803
4.	Reduced overbudgeted special funds to reflect 25% turnover expectancy for new positions.	58,103
5.	Reduce overbudgeted reimbursable funds for the Investment Division health insurance and the statewide cost allocation.	
6.	Reduce overbudgeted reimbursable funds to reflect 25% turnover expectancy for new positions.	
	Total Reductions	**$ 508,906**

Updates

- The MPAS-3 project, initiated in 2006, is in its final phase. The agency plans to go live with the Member Self-Portal by September 2019. The agency is receiving 5 new IT positions to assist with implementation of the project.

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 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 to optimize long-term returns while controlling risk through the excellence in execution of investment objectives and strategies of the system;

- to effectively communicate to all retirement plan participants the benefits provided by the system and to educate them about planning and preparing for all aspects of their defined benefit;

- 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 contributions 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 of agency operations (represented as reimbursable funds), and revenue from local school boards and participating governmental units pay for the remaining two-thirds (represented as special funds). Based on the Governor's allowance and certified membership of 192,093, participating employers will pay approximately $167 per member in fiscal 2020; however, the final per member fee is based on the budget enacted by the General Assembly. The agency is subject to a statutory spending cap of 0.22% of the active member payroll, retiree benefits, and compensation of vested former members, as codified by Chapters 723 and 724 of 2018. The calculated cap for fiscal 2020 is $38.3 million.

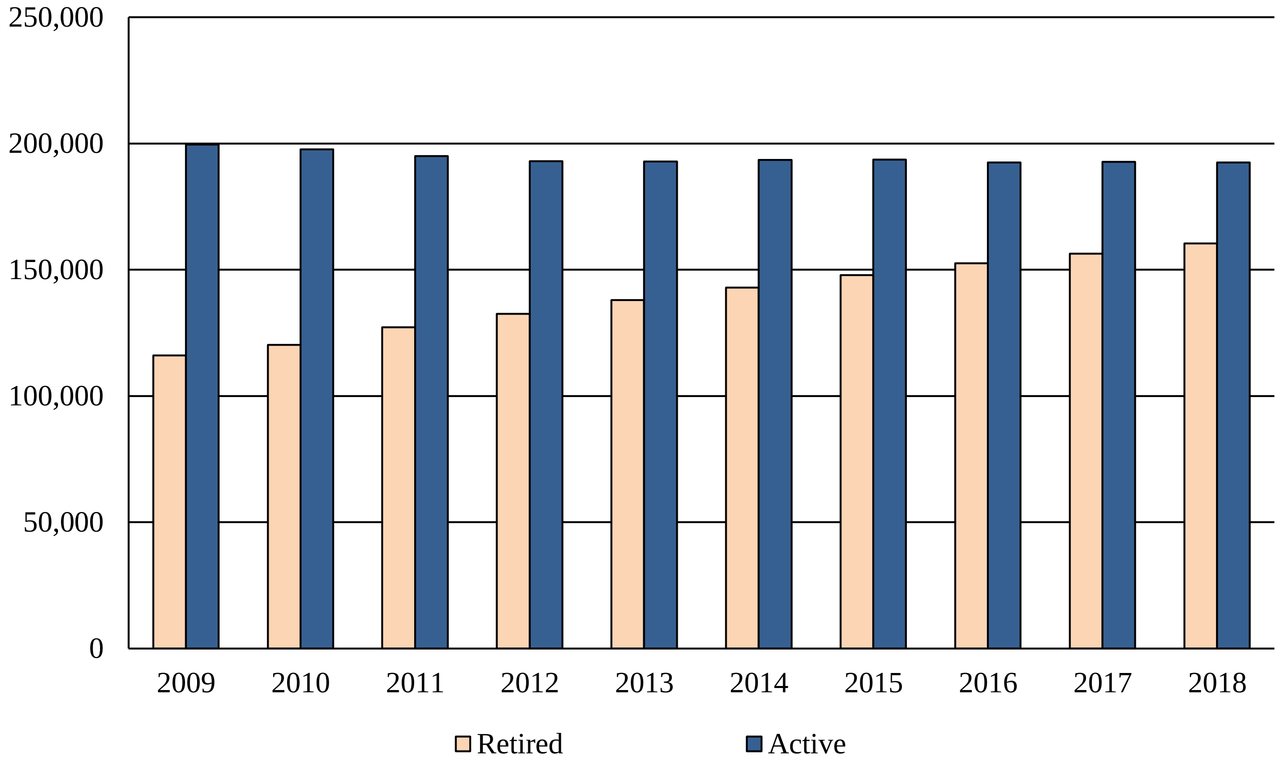
Chapters 727 and 728 of 2018 specified that compensation and other operational expenses for the Investment Division would be paid out of the accumulation of funds of the State's retirement systems (the "pension trust fund") instead of from special or reimbursable funds representing administrative fees collected from participating employers for agency expenses. This effectively took the division off-budget starting in fiscal 2019, and costs associated with the Investment Division no longer count against SRA's expense cap.

Performance Analysis: Managing for Results

1. Retirees Increasing While Active Membership in State Pension Stays Flat

As shown in **Exhibit 1,** active membership in the State's retirement system has remained flat since fiscal 2012, totaling 192,431 members in fiscal 2018. During this same time period, retired members have increased from 132,483 to 160,374, an increase of 3.2% annually. In fiscal 2018, retirees represent 45.5% of the State's pension plan participation. The flattening of active participation means that less payroll is supporting retiree benefits, resulting in higher employer contribution rates.

Exhibit 1
State Pension System Membership
Fiscal 2009-2018

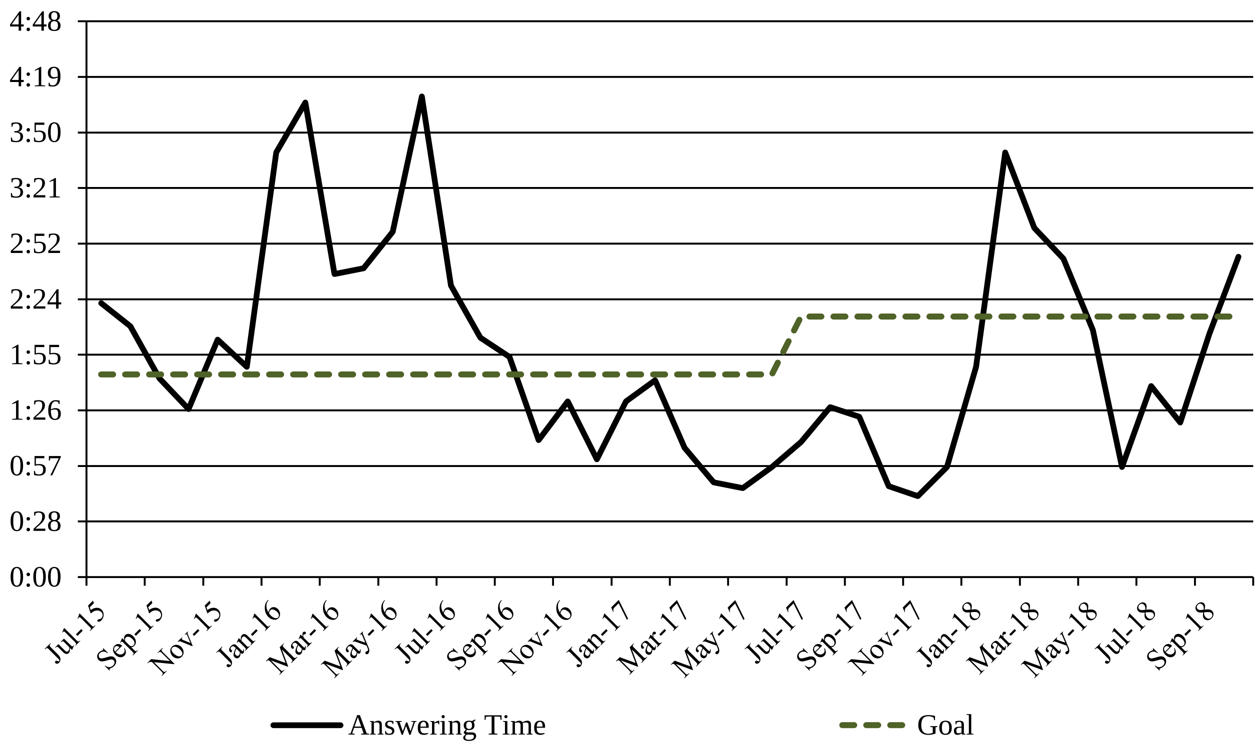


Source: State Retirement Agency

2. SRA Continues to Meet Revised Call Center Goals

As the administrator of retirement benefits, SRA's performance measures focus on customer service that the agency provides to participants of the State's pension plans. After struggling for several years to meet its dual goals of fewer than 6% of calls being dropped and callers waiting no more than 1:45 minutes for a counselor to pick up their call, the agency raised its call center goals to no more than 7.5% of calls being dropped and callers waiting no more than 2:15 minutes, starting in fiscal 2018. In fiscal 2017, dropped calls were below 6% and wait times were under 1:45 minutes, meeting the old goals. In fiscal 2018, dropped calls were 6.5% and wait times were 1:44 minutes, meeting the revised goals. However, as shown in **Exhibit 2**, there were 4 months in calendar 2018 where wait times exceeded the 2:15 minute mark: February, March, April, and October. SRA attributes the increased waiting times to increased call volume in response to upcoming changes in Medicare-eligible retirees' prescription drug coverage as well as vacancies and other workplace situations outside of the agency's control.

Exhibit 2
Member Services Call Answering Time
July 2015 to October 2018
(in Minutes)



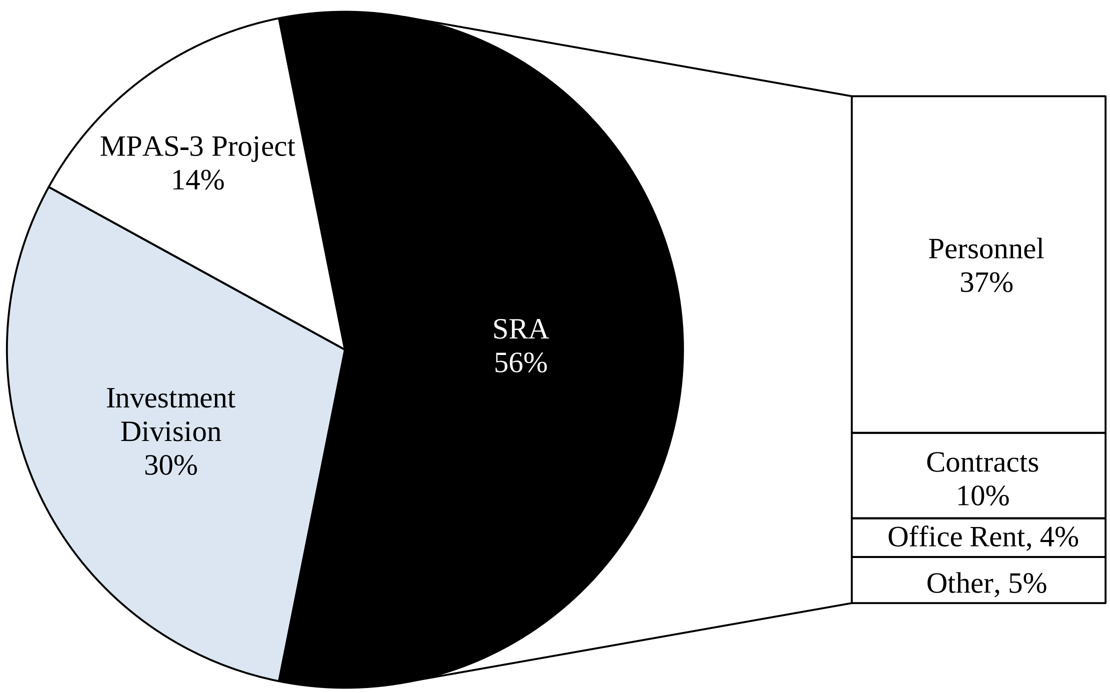
Source: State Retirement Agency

Fiscal 2020 Allowance

Overview of Agency Spending

The agency's fiscal 2020 budget totals $45.6 million. The budget is comprised of three components: SRA's operations (56%); the Investment Division (30%); and the cost of phase three of the Maryland Pension Administration System (MPAS-3) project (14%), as shown in **Exhibit 3**. Personnel is the largest expenditure for SRA's budget (37%), while various contracts make up the second largest expenditure (10%).

Exhibit 3
Fiscal 2020 Allowance



Fiscal 2020 Allowance: $45.6 Million

MPAS-3: Maryland Pension Administration System – phase three
SRA: State Retirement Agency

Source: Governor's Fiscal 2020 Budget Books

Proposed Budget Change

As shown in **Exhibit 4**, the fiscal 2020 allowance for SRA increases by a net $342,000 over the fiscal 2019 working appropriation. Increases of $1.9 million in the agency are offset by a decrease of $1.6 million for the MPAS-3 project.

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

How Much It Grows:	Special Fund	Nonbudgeted Fund	Reimb. Fund	Total
Fiscal 2018 Actual	$22,410	$0	$11,544	$33,954
Fiscal 2019 Working Appropriation	21,711	12,623	10,945	45,278
Fiscal 2020 Allowance	21,456	13,486	10,679	45,621
Fiscal 2019-2020 Amount Change	-$255	$863	-$266	$342
Fiscal 2019-2020 Percent Change	-1.2%	6.8%	-2.4%	0.8%

Where It Goes:	
Personnel Expenses	
Regular earnings, including general salary increases	$444
5 new information technology positions for MPAS-3	414
Health insurance, including the Investment Division funds provided in error	384
Employee retirement	140
One-time $500 bonus to State employees in fiscal 2019	-107
Other fringe benefit adjustments	65
Investment Division	
Regular earnings, including technical funding adjustment	672
Investment accounting system and consultant contracts	567
Eliminate budgeted turnover	256
Legal fees	-200
Missing health insurance funding	-454
Other personnel changes	22
Other	
Information technology costs	300
Contracts for LPGU audits, investment audits, and financial audits	230

Where It Goes:

Office rent	204
Medical consultation for disability cases	-31
Office equipment	-45
Postage and communication costs	-282
Other contracts and shared costs	-593
MPAS-3 major information technology project costs	-1,630
Other	-14
Total	**$342**

LPGU: local participating government units
MPAS-3: Maryland Pension Administration System – phase three

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

Investment Division Health Insurance Incorrectly Budgeted

The fiscal 2020 allowance includes funding in SRA for health insurance costs associated with the Investment Division staff. This funding is budgeted as reimbursable and special funds instead of the nonbudgeted funds (*i.e.*, pension trust fund revenue) that are allocated for the Investment Division. **The Department of Legislative Services (DLS) recommends reducing $454,047 ($302,849 in special funds and $151,198 in reimbursable funds) associated with the Investment Division staff's health insurance costs.**

Statewide Cost Allocation Overbudgeted

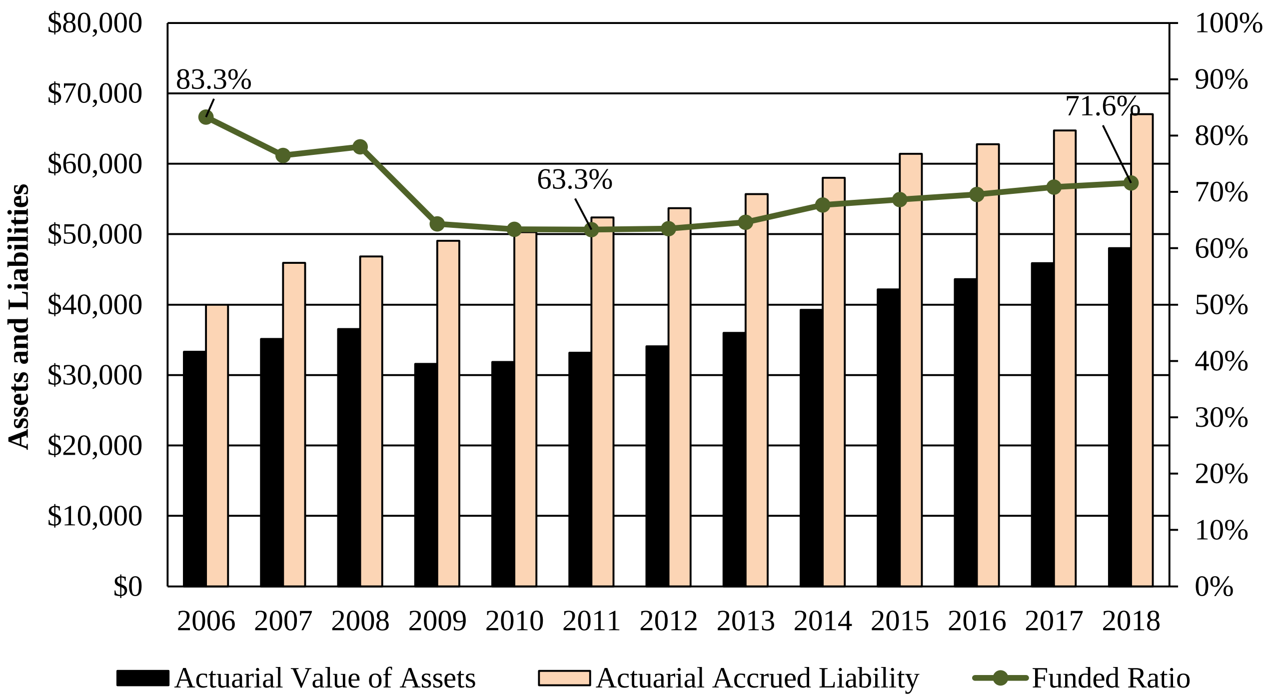
The fiscal 2020 allowance also includes $382,426 in funds for the statewide cost allocation. These costs are budgeted to reflect the agency's indirect cost recovery for centralized services provided by the State. This funding is higher than what the agency actually paid last year ($160,606), and there appears to be no justification for the higher amount in fiscal 2020. **DLS recommends reducing the statewide cost allocation to reflect funding actually paid last year, resulting in a reduction of $221,820 ($147,954 in special funds and $73,866 in reimbursable funds).**

Issues

1. State's Retirement System Exceeds Funded Ratio Expectations

In 2011, the General Assembly passed comprehensive pension reform (Chapter 397) aimed at addressing the long-term sustainability of the State's defined benefit pension plans and the affordability of the State's contributions to those plans. At that time, the State's retirement system had only 64% of assets necessary to cover its liability. Based on the reforms and supplemental funding, the State's retirement system is projected to achieve 80% actuarial funding by fiscal 2026 and 100% by fiscal 2039. As shown in **Exhibit 5**, the actual funded ratio in fiscal 2018 was 71.6% for all State plans, exceeding the projected ratio of 69% when pension reform was enacted.

Exhibit 5
State Plans' Pension Assets, Liabilities, and Funded Ratio
Fiscal 2006-2018
($ in Millions)

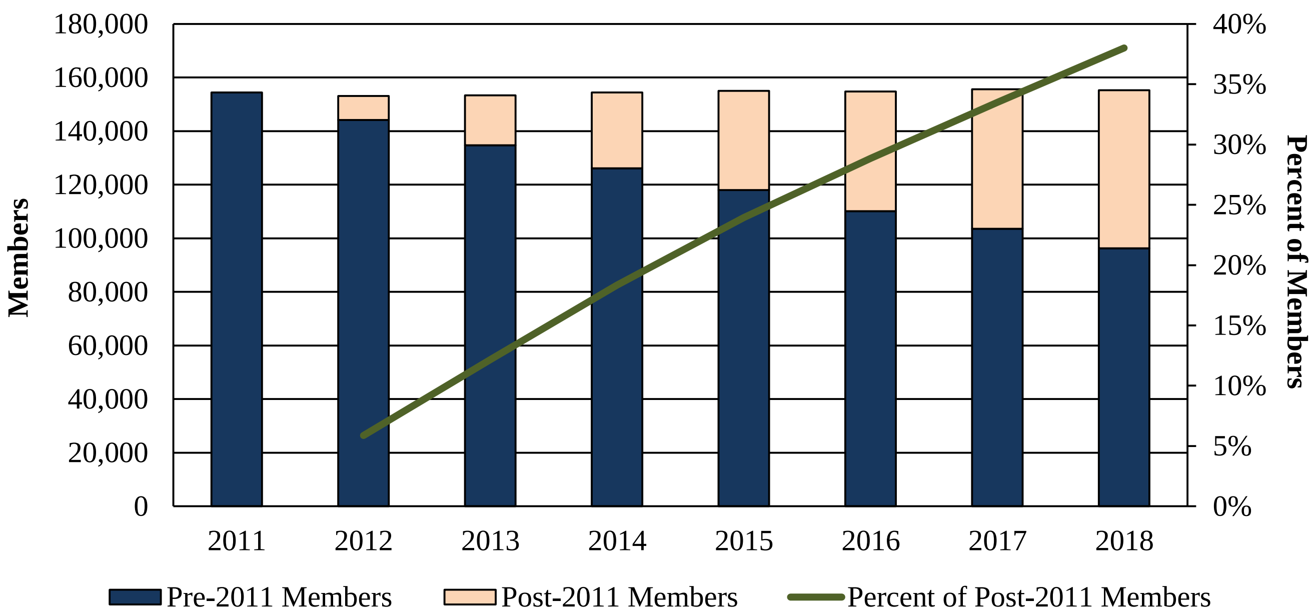


Source: State Retirement Agency

Other legislative actions have also resulted in a positive impact on the funded status of the State's retirement system. Chapter 489 of 2015 accelerated the repeal of the corridor funding method (enacted during the 2002 legislative session) to fiscal 2017, which effectively restored full actuarial funding. Chapter 489 also required that, from fiscal 2017 to 2020, 50% of any budget surplus would be provided as additional contributions to the pension system (known as the pension sweeper) up to $50 million, but these payments were only made in fiscal 2017 and 2020. Chapter 557 of 2017 further modified the sweeper so that, beginning in fiscal 2021 and continuing until the State's retirement systems are 85% actuarially funded, 25% of any budget surplus in excess of $10 million, up to a maximum of $25 million, is to be transferred into SRPS as a supplemental payment. **Appendix 4** provides the funding history of SRPS from fiscal 2013 to 2020, including supplemental and sweeper payments.

Due to employee turnover, 38% of members in the Teachers' Pension System/Employees' Pension system are in the reformed pension system as of fiscal 2018, as shown in **Exhibit 6**. Per Chapter 397, all members hired on or after July 1, 2011, are part of the reformed pension system, which requires a longer vesting period (10 years instead of 5 years) and provides a less generous benefit calculation. Increasing membership in the reformed pension system results in a positive impact on the State's pension liabilities due to fewer employees vesting and reduced future benefits for employees who do vest. Employees who leave the State's service without vesting receive their contributions and a guaranteed return on their contributions (5%), but the State's contributions for the employee stay in the system.

Exhibit 6
Pre- and Post-2011 Pension Reform Members
State Employees' and Teachers' Retirement Systems
Fiscal 2011-2018



Source: State Retirement Agency

Investment Performance

By two key measures, the system's investment portfolio exceeded expectations in both fiscal 2017 and 2018, but it continues to underperform relative to its peers. For the third time in the last five years, the system's investment return (8.06%) exceeded its actuarial target of 7.50% as well as its policy benchmark, as shown in **Exhibit 7**. The policy benchmark is the expected return if all the system's investments meet their respective benchmarks, so excess performance indicates that the system's active management of its portfolio generates positive results, net of fees. Due to lower returns in fiscal 2015 and 2016, the five-year annualized returns of 7.15% (net of fees) did not meet the actuarial target.

Exhibit 7
State Pension Fund Investment Performance
Fiscal 2014-2018

	2014	2015	2016	2017	2018
One-year Actual Returns	14.37%	2.63%	1.16%	10.02%	8.06%
Five-year Annualized Returns	11.68%	9.36%	5.68%	7.64%	7.15%
Actuarial Target	7.65%	7.55%	7.55%	7.55%	7.50%
Policy Benchmark	14.16%	0.88%	1.69%	9.88%	7.60%

Note: One-year returns are net of fees; five-year returns since fiscal 2015 are also net of fees.

Source: State Street Bank; State Retirement Agency; Department of Legislative Services

Despite favorable returns in fiscal 2018, the system's investment program continues to underperform its public pension peers, based on rankings of the Wilshire Trust Universe Comparison Service (TUCS). The TUCS analysis compares investment performance of similar large pension plans, where one-hundredth percentile represents the lowest investment return, and the first percentile represents the highest. According to the TUCS rankings for fiscal 2018, the system's investment performance was rated in the seventy-fifth percentile among public pension funds with at least $25 billion in assets, as shown in **Exhibit 8**. While this ranking is an improvement from the fiscal 2017 ranking (ninety-fifth percentile), this still places the State in the bottom quartile.

Exhibit 8
TUCS Percentile Rankings for Periods Ending June 30
Fiscal 2014-2018

	2014	2015	2016	2017	2018
1 Year	94	81	57	95	75
3 Years	94	88	95	91	94
5 Years	84	88	95	87	84
10 Years	99	91	95	100	94

TUCS: Wilshire Trust Universe Comparison Services

Note: Rankings are for systems greater than $25 billion.

Source: Wilshire Trust Universe Comparison Service

The system's low TUCS ranking is largely due to the low allocation to public equities in comparison to its peers. Low TUCS rankings will likely continue during times when public equity markets experience strong growth as was the case in fiscal 2017 and 2018. The Board of Trustees for SRPS is responsible for setting the allocation of assets to each investment class and monitoring the appropriateness of the allocation in light of investment objectives. The asset allocation is structured into the following categories:

- ***Growth Equity:*** public equity (domestic, international developed, and international emerging markets) and private equity investments;
- ***Rate Sensitive:*** long-term governmental bonds, securitized bonds, corporate bonds, and inflation-linked bonds;
- ***Credit:*** high yield bonds and bank loans and emerging market debt;
- ***Real Assets:*** real estate and natural resources and infrastructure investments; and
- ***Absolute Return:*** consists of investments that are expected to exceed U.S. treasuries with low correlation to public stocks.

The board desires to balance the goal of higher long-term returns with the goal of minimizing contribution volatility, recognizing that these are often competing goals. As of June 30, 2018, the public equity allocation approved by the board was 37.5%, while private equity was increased to 12.5%. As shown in **Exhibit 9**, both public and private equity investments exceeded their policy benchmarks in fiscal 2018 and were the primary drivers of the State's investment return.

Exhibit 9
State Retirement and Pension System
Benchmark Performance as of June 30, 2018

	Return	Benchmark	Difference
Growth/Equity			
Public Equity	10.66%	10.62%	0.04%
Private Equity	19.64%	15.88%	3.76%
Rate Sensitive			
Nominal Fixed Income	0.10%	-0.14%	0.24%
Inflation Sensitive	2.10%	2.26%	-0.16%
Credit	**2.31%**	**2.34%**	**-0.03%**
Real Assets			
Real Estate	9.02%	7.75%	1.27%
Natural Resources and Infrastructure	5.55%	16.26%	-10.71%
Absolute Return	**3.26%**	**5.16%**	**-1.90%**
Cash and Cash Equitization	**8.80%**	**1.33%**	**7.47%**
Total Fund	**8.06%**	**7.60%**	**0.46%**

Source: State Street; State Retirement Agency

The board's asset allocation does not take full advantage of surges in public equity markets but mitigating volatility does reduce the likelihood of large swings in employer contributions. A system's asset allocation is impacted by a system's risk tolerance that factors in the ratio of retirees to active members, funded status, assumed rate of return, benefit structure, regularity of full contributions, and other considerations. According to TUCS, the State's level of risk is below the median in comparison to other public funds with assets greater than $25 billion, which is consistent with the system's low allocation to public equity. 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.

The absolute return portfolio was among the lower performing asset classes in fiscal 2018, underperforming its benchmark by 190 basis points with a return of 3.26%. The absolute return asset class is defined as "investments whose performance is expected to exceed the three month U.S. Treasury bill by 4-5% over a full market cycle and exhibit low correlation to public stocks." Only four investments within the absolute return class achieved returns above the asset class benchmark. Absolute return has returned below benchmarks from the one-, three-, and five-year periods ending on June 30, 2018. The 10-year return did exceed its benchmark by 122 basis points but returned only 2.76%. The agency has indicated that vacancies in positions associated with the absolute return portfolio may have contributed to some of the underperformance.

SRA should comment on the absolute return portfolio performance and discuss actions that the agency is taking to improve performance of these funds.

Actuarial Assumed Rate of Return Lowered

As shown earlier in Exhibit 7, the actuarial investment return target for SRPS has been adjusted downward from 7.55% in fiscal 2017 to 7.50% in fiscal 2018. The board has approved a further downward adjust to 7.45% for fiscal 2019. According to the Pew Charitable Trusts, 33 states have lowered their assumed rates of return to prepare for a future with lower annual earnings. Lowering the assumed rate of return requires increased State contributions into the retirement system. State contributions are already expected to increase through fiscal 2022 due to deferred asset losses smoothed over a five-year period.

SRA should discuss the recent decision of the board to lower the assumed rate of return to 7.45% and what lowering the assumed rate of return means for employer contributions in the near future.

2. Investment Division Nonbudgeted Starting in Fiscal 2019

At the request of the board of trustees, the Joint Committee on Pensions agreed to sponsor legislation during the 2018 session to grant the board authority to set compensation and establish positions within the Investment Division subject to certain limitations (Chapters 727 and 728). The stated purpose of the legislation was twofold. First, SRA's chief investment officer noted that the ability to create positions and set compensation would reduce compensation-related turnover and improve recruitment as well as free up senior staff from administrative duties, resulting in an increased focus on investments. The second purpose was to expand and begin moving externally managed assets to internal management in order to reduce fees paid for asset management.

The legislation as enacted granted the board this authority and specified that compensation and other operational expenses for the Investment Division would be paid out of the accumulation of funds of the several systems (pension trust fund) instead of from special or reimbursable funds representing administrative fees collected from participating employers for agency expenses. This effectively took the division off-budget starting in fiscal 2019, and costs associated with the Investment Division no longer count against SRA's expense cap.

Objective Criteria Committee

In order to assist the board with compensation decisions, the legislation created the Objective Criteria Committee (OCC), charged with making recommendations on compensation criteria and performance incentives. Since enactment of the legislation, OCC has met three times and has entered into a contract with CBIZ Consultants to assist with development of the proposed compensation and financial incentive policies. On November 29, 2018, an OCC governance charter was approved by the board that outlines the duties and goals of OCC.

The OCC charter specifies that compensation recommendations would distinguish positions with discretion over investment-related decisions and positions without that discretion. The compensation and financial incentive recommendations provided by CBIZ Consultants and approved by the board are summarized in **Appendix 5**. It was agreed that noninvestment-related positions with comparable State functions should mimic the State's salary schedule.

At the time of the legislation, DLS estimated that total compensation for the division may increase up to $8 million from $3.1 million, assuming that all employees currently projected to be added earn a maximum bonus. **Exhibit 10** provides the salary increases proposed by CBIZ Consultants for 11 position types identified as below revised salary range minimums. Raising the salaries of these positions to the revised minimums would cost $298,000.

Exhibit 10
Preliminary Compensation Study Results for Investment Division Staff
Salaries Below Minimum Proposed Salary Ranges
Effective January 1, 2019

Job Title	Position	Annualized Salary	Market 50th Percentile	Range Minimum	Range Maximum	Actual Below Minimum
Deputy Chief Investment Officer	1.00	$177,977	$261,472	$207,419	$331,871	$29,442
Managing Director – Private Equity	1.00	153,532	238,040	188,563	301,700	35,031
Managing Director – Absolute Return	1.00	138,632	238,040	188,563	301,700	49,931
Managing Director – Public Equity	1.00	143,176	238,040	188,563	301,700	45,387
Managing Director – Real Estate/Natural Resources	1.00	153,532	238,040	188,563	301,700	35,031
Senior Portfolio Manager – Absolute Return	1.00	120,097	179,232	147,642	221,463	27,545
Senior Portfolio Manager – Private Equity	1.00	109,151	163,256	128,384	192,576	19,233
Senior Portfolio Manager – Fixed Income	1.00	117,821	163,256	128,384	192,576	10,563
Senior Portfolio Manager – Public Equity	1.00	109,151	163,256	128,384	192,576	19,233
Senior Portfolio Manager – Private Equity	1.00	109,151	144,973	116,713	175,069	7,562
Senior Risk Manager	1.00	109,151	163,256	128,384	192,576	19,233
Total	**11.00**	**$1,441,371**	**$2,190,861**	**$1,739,562**	**$2,705,507**	**$298,191**

Source: CBIZ Consultants

New Positions Not Reflected in Position Counts

According to Investment Division staff, 8 additional positions were approved by the board, and funding for these positions is reflected in the fiscal 2020 budget. **Exhibit 11** lists the 8 new positions and estimated salaries. Despite the division confirming that funding for these positions has been provided, position counts and position data submitted do not reflect these new positions. **DLS recommends that updated budget data be submitted to the budget committees to reflect accurate personnel data for the Investment Division.**

Exhibit 11
New Investment Division Positions Approved by the Board
Fiscal 2020

Title	Position	Target Salary
Managing Director – Fixed Income	1.00	$150,000
Senior Investment Analyst – Real Assets	1.00	103,743
Senior Investment Analyst – Compliance	1.00	103,743
Associate	1.00	73,946
Associate	1.00	73,946
Associate	1.00	73,946
Assistant Director – Administration	1.00	60,815
Accountant Lead Specialized	1.00	60,815
Total	**8.00**	**$700,954**

Source: State Retirement Agency

Operating Budget Recommended Actions

1. Add the following language:

    Provided that authorization to expend reimbursable funds is reduced by $225,064 to reflect overbudgeted funding for health insurance and the statewide cost allocation expense.

    Explanation: Funding was provided for the Investment Division health insurance that should be funded with revenue from the Pension Trust Fund instead of from administrative fees. The statewide cost allocation for indirect cost recovery is overbudgeted in fiscal 2020. These two adjustments result in a reduction of $225,064 in reimbursable funds.

2. Add the following language:

    Further provided that authorization to expend reimbursable funds is reduced by $29,008 to reflect 25% turnover expectancy for new positions.

    Explanation: The fiscal 2020 budget includes 5 new positions with a budgeted turnover rate of 5%. This language raises the turnover expectancy to 25% per fiscal 2020 budget instructions for new positions.

		Amount Reduction	
3.	Reduce overbudgeted special funds for the Investment Division health insurance, which should be nonbudgeted funds, and the statewide cost allocation, which is overbudgeted in fiscal 2020.	$ 450,803	SF
4.	Reduce overbudgeted special funds to reflect 25% turnover expectancy for new positions as provided in the fiscal 2020 budget instructions. Currently, turnover for the new positions is set at 5%.	58,103	SF

5. Add the following section:

Section XX Reduce Health Insurance Costs for Investment Division and Statewide Cost Allocation

SECTION XX. AND BE IT FURTHER ENACTED, That the reimbursable fund appropriation in the State Retirement Agency, G20J01.01, shall be reduced by $225,064. The Governor shall develop a schedule for allocating this reimbursable fund reduction across State agencies. The reduction shall equal at least the amount indicated for the funds listed:

Fund	Amount
General	$135,040
Special	$45,012
Federal	$45,012

Explanation: The fiscal 2020 allowance includes funding for the Investment Division health insurance costs that should be nonbudgeted funding. The fiscal 2020 allowance also includes costs for the statewide cost allocation that is overbudgeted. This language reduces reimbursable funds for these items.

6. Add the following section:

Section XX Reduce Turnover Expectancy for New Positions

SECTION XX. AND BE IT FURTHER ENACTED, That the reimbursable funds appropriation in the State Retirement Agency, G20J01.01, shall be reduced by $29,008. The Governor shall develop a schedule for allocating this reimbursable fund reduction across State agencies. The reduction shall equal at least the amount indicated for the funds listed:

Fund	Amount
General	$17,404
Special	$5,802
Federal	$5,802

Explanation: The fiscal 2020 budget includes 5 new positions budgeted at a turnover rate of 5%. This language raises the turnover expectancy to 25% per fiscal 2020 budget instructions.

Total Special Fund Reductions $ 508,906

Updates

1. Phase Three of the Maryland Pension Administration System

Initiated in 2006, the Maryland Pension Administration System (MPAS) project is in its last phase. In 2010, the agency completed the first phase, which entailed replacement of its more than 30-year-old legacy information technology (IT) system with MPAS, a more modern, agile computer platform, but the system was configured to replicate the system's traditional business practices to minimize the need for new staff training at that time. Competing IT demands within the agency delayed the start and completion of phase two of the project that entailed verifying and correcting the service credit and salary data in the system and establishing protocols to ensure that new data entered into the system is accurate. Phase two of MPAS was completed in July 2017, setting the stage for phase three.

The focus of MPAS-3 is on modernizing the agency's business practices to take full advantage of the power and agility of the new technology installed during phase one. In addition to automating internal practices and transactions, it includes establishing online user interfaces that allow members to check their accrued service and retirement balances and to project their future benefit payments. Phase three is projected to cost a total of $19.4 million over a period of five years. **Appendix 3** has additional information about the project timeline, status, and cost. The project funding for MPAS-3 declines by $1.6 million in fiscal 2020 after a surge in project costs in fiscal 2019. SRA has completed the planning phase of the business process re-engineering of the MPAS-3 project. Review and revision of the Code of Maryland is ongoing. The agency is on target to launch the Member Self-Portal with a go-live date of September 2, 2019. The fiscal 2020 allowance includes 5 new positions associated with the MPAS project, including 2 IT technical support specialists, 2 computer network specialists, and 1 IT functional analyst supervisor.

Appendix 1
Current and Prior Year Budgets
State Retirement Agency
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2018					
Legislative Appropriation	$0	$22,818	$0	$11,998	$34,816
Deficiency/Withdrawn Appropriation	0	-186	0	0	-186
Cost Containment	0	0	0	0	0
Budget Amendments	0	27	0	-27	0
Reversions and Cancellations	0	-249	0	-427	-676
Actual Expenditures	**$0**	**$22,410**	**$0**	**$11,544**	**$33,954**
Fiscal 2019					
Legislative Appropriation	$0	$21,545	$0	$10,901	$32,446
Budget Amendments	0	86	0	0	86
Working Appropriation	**$0**	**$21,630**	**$0**	**$10,901**	**$32,532**

Note: The fiscal 2019 appropriation does not include deficiencies, a one-time $500 bonus, or general salary increases. Numbers may not sum to total due to rounding.

Fiscal 2018

The fiscal 2018 appropriation for the State Retirement Agency (SRA) decreased by $862,000. Reimbursable funds decreased by $454,000, while special funds decreased by $408,000. Budget amendments and deficiencies realigned funding for phase three of the Maryland Pension Administration System major information technology project, which nets out to an overall increase of $27,000 in special funds and a corresponding decrease in reimbursable funds. Special funds decrease by $186,000, reflecting an across-the-board cut in health insurance per Section 19 of the fiscal 2019 Budget Bill. SRA canceled $249,000 in special funds and $427,000 in reimbursable funds, further reducing the fiscal 2018 appropriation. Cancellations were due to surplus health insurance funding and lower than expected expenses for medical evaluation consulting, telecommunications, travel, and other administrative expenses. SRA states that the surplus health insurance funds were due to vacant positions and employees receiving health insurance through other means such as through a spouse.

Fiscal 2019

The fiscal 2019 legislative appropriation increases by $86,000 in special funds to reflect a 2% general salary increase effective January 1, 2018. The funding for this increase was previously budgeted in the Department of Budget and Management – Personnel statewide program.

Appendix 2
Audit Findings

Audit Period for Last Audit:	April 2, 2014-May 7, 2017
Issue Date:	June 2018
Number of Findings:	5
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: The agency did not always perform documented and timely supervisory reviews to ensure the propriety of employer contributions received from the Central Payroll Bureau.

Finding 2: The agency identified a significant instance in which the retiree earnings limitation established by law was not enforced at the time of our audit, resulting in overpayments of retirement benefits.

Finding 3: The agency did not address a longstanding issue regarding certain system members' eligibility for service credit for unused sick leave in instances in which the system members were also compensated for the same unused sick leave upon retirement.

Finding 4: Controls had not been established to ensure the propriety of the agency payroll, including adjustments to employee pay.

Finding 5: The agency lacked assurance that sensitive personally identifiable information provided to and maintained by the death match service provider was properly secured against operational and security risks.

Appendix 3
Major Information Technology Projects
Business Process Reengineering and Support Technology (MPAS-3)

Project Status	Implementation.	**New/Ongoing Project:**	Ongoing.
Project Description:	To automate the business practices of the agency and provide real-time member account services.		
Project Business Goals:	To create operational efficiencies and establish real-time viewing of existing records and online transactions.		
Estimated Total Project Cost:	$19.4 million	**Estimated Planning Project Cost:**	$975,000
Project Start Date:	July 1, 2018.	**Projected Completion Date:**	December 31, 2021.
Schedule Status:	This project is in the last phase of a three-phase initiative that began in 2006. Phase three will take place over a four- to five-year period. This phase of the project is on schedule with considerable refinement of planned solutions during the first initial six months. Over 50 business processes have been reconceptualized, and an overall staged work plan has been developed and initiated. Plans are currently beginning for engaged participating governmental units in changes in process that directly impact them.		
Cost Status:	Funding for the first two years of the project was provided in fiscal 2018 and 2019.		
Scope Status:	Major customers include over 400,000 active and retired members and beneficiaries of the Maryland State Retirement and Pension System, approximately 150 employers, and agency staff. The scope of this project has not changed since initiation.		
Project Management Oversight Status:	Procurement of a project manager was completed in fall 2017.		
Identifiable Risks:	Project objectives have not been updated for 12 years, since initiation of phase one. The MPAS application may present inconsistencies of data and coding, and integrating new information technology tools can present risks.		
Additional Comments:	n/a		

Fiscal Year Funding ($ in Thousands)	**Prior Years**	**FY 2020**	**FY 2021**	**FY 2022**	**FY 2023**	**FY 2024**	**Balance to Complete**	**Total**
Professional and Outside Services	$10,573.5	$6,266.4	$1,896.0	$693.2	$0.0	$0.0	$8,855.6	$19,429.1
Total Funding	**$10,573.5**	**$6,266.4**	**$1,896.0**	**$693.2**	**$0.0**	**$0.0**	**$8,855.6**	**$19,429.1**

MPAS: Maryland Pension Administration System – phase three

Appendix 4
State Pension Contributions
Fiscal 2013-2020
($ in Millions)

	2013	2014	2015	2016	2017	2018	2019	2020
State Employer Base	$1,221.3	$1,319.4	$1,388.6	$1,440.1	$1,533.8	$1,547.5	$1,569.8	$1,627.1
Supplemental	190.8	100.0	100.0	75.0	75.0	75.0	75.0	75.0
Sweeper	0.0	0.0	0.0	0.0	50.0	0.0	0.0	50.0
Governor	0.0	0.0	0.0	0.0	25.0	0.0	0.0	0.0
Total State	**$1,412.1**	**$1,419.4**	**$1,488.6**	**$1,515.1**	**$1,683.8**	**$1,622.5**	**$1,644.8**	**$1,752.1**
Local School Boards	$136.6	$173.2	$221.6	$254.8	$279.8	$280.5	$283.8	$288.6
Total Employer	**$1,548.7**	**$1,592.6**	**$1,710.2**	**$1,769.9**	**$1,963.6**	**$1,903.0**	**$1,928.6**	**$2,040.7**

Source: State Retirement Agency; Department of Budget and Management; Department of Legislative Services

Appendix 5
Compensation and Financial Incentive Criteria Adopted

	Compensation		Financial Incentive	
Position	**Requirement**	**Objective Criteria**	**Requirement**	**Objective Criteria**
Chief Investment Officer	Comparative qualifications and compensation of employees serving in similar positions at comparable public pension funds	Base salary and total cash compensation market data at the twenty-fifth, fiftieth, and seventy-fifth percentile; compare to external job descriptions; education and certifications; employee salary range placement	Objective benchmarks of investment performance met or exceeded	Performance versus policy benchmark and performance versus actuarial assumed rate of return
	Objective benchmarks of investment performance met or exceeded	Positive fund return relative to benchmark	Objective criteria used by comparable public pension funds awarding financial incentives to chief investment officers	Performance versus policy benchmark and performance versus actuarial assumed rate of return
Investment-related	Comparative qualifications and compensation of employees serving in similar positions at comparable public pension funds	Base salary and total cash compensation market data at the twenty-fifth, fiftieth, and seventy-fifth percentile; compare to external job descriptions; education and certifications; chief investment officers performance rating; and employee salary range placement	Objective benchmarks of investment performance met or exceeded by an individual, including benchmarks for the asset class in which investments are under direction of the individual	Performance versus policy benchmark, performance versus actuarial assumed rate of return, and performance versus asset class
	Objective benchmarks of investment performance met or exceeded by an individual	Positive fund return relative to benchmark		

Source: CBIZ Consultants; Objective Criteria Committee; State Retirement Agency

Appendix 6
Object/Fund Difference Report
State Retirement Agency

Object/Fund	FY 18 Actual	FY 19 Working Appropriation	FY 20 Allowance	FY 19 - FY 20 Amount Change	Percent Change
Positions					
01 Regular	197.00	197.00	202.00	5.00	2.5%
02 Contractual	8.07	8.00	8.00	0.00	0%
Total Positions	**205.07**	**205.00**	**210.00**	**5.00**	**2.4%**
Objects					
01 Salaries and Wages	$ 19,529,124	$ 20,168,254	$ 21,653,505	$ 1,485,251	7.4%
02 Technical and Special Fees	690,008	758,056	733,424	-24,632	-3.2%
03 Communication	739,838	992,579	796,430	-196,149	-19.8%
04 Travel	205,817	233,624	245,694	12,070	5.2%
06 Fuel and Utilities	125	0	0	0	0.0%
07 Motor Vehicles	131,219	135,324	135,640	316	0.2%
08 Contractual Services	9,846,555	18,770,938	18,221,056	-549,882	-2.9%
09 Supplies and Materials	124,535	122,982	134,127	11,145	9.1%
10 Equipment – Replacement	105,347	115,251	65,520	-49,731	-43.2%
11 Equipment – Additional	306,350	1,465,000	572,589	-892,411	-60.9%
12 Grants, Subsidies, and Contributions	382,426	382,426	382,426	0	0%
13 Fixed Charges	1,872,879	2,009,901	2,211,999	202,098	10.1%
14 Land and Structures	19,639	0	0	0	0.0%
Total Objects	**$ 33,953,862**	**$ 45,154,335**	**$ 45,152,410**	**-$ 1,925**	**0%**
Funds					
03 Special Fund	$ 22,409,549	$ 21,630,266	$ 21,151,659	-$ 478,607	-2.2%
07 Nonbudgeted Fund	0	12,622,759	13,485,998	863,239	6.8%
09 Reimbursable Fund	11,544,313	10,901,310	10,514,753	-386,557	-3.5%
Total Funds	**$ 33,953,862**	**$ 45,154,335**	**$ 45,152,410**	**-$ 1,925**	**0%**

Note: The fiscal 2019 appropriation does not include deficiencies, a one-time $500 bonus, or general salary increases. The fiscal 2020 allowance does not include general salary increases.

Appendix 7
Fiscal Summary
State Retirement Agency

Program/Unit	FY 18 Actual	FY 19 Wrk Approp	FY 20 Allowance	Change	FY 19 - FY 20 % Change
01 State Retirement Agency	$ 31,276,862	$ 24,635,045	$ 25,400,002	$ 764,957	3.1%
02 Major Information Technology Development	2,677,000	7,896,531	6,266,410	-1,630,121	-20.6%
43 Investment Division	0	12,622,759	13,485,998	863,239	6.8%
Total Expenditures	**$ 33,953,862**	**$ 45,154,335**	**$ 45,152,410**	**-$ 1,925**	**0%**
Special Fund	$ 22,409,549	$ 21,630,266	$ 21,151,659	-$ 478,607	-2.2%
Nonbudgeted Fund	0	12,622,759	13,485,998	863,239	6.8%
Total Appropriations	**$ 22,409,549**	**$ 34,253,025**	**$ 34,637,657**	**$ 384,632**	**1.1%**
Reimbursable Fund	$ 11,544,313	$ 10,901,310	$ 10,514,753	-$ 386,557	-3.5%
Total Funds	**$ 33,953,862**	**$ 45,154,335**	**$ 45,152,410**	**-$ 1,925**	**0%**

Note: The fiscal 2019 appropriation does not include deficiencies, a one-time $500 bonus, or general salary increases. The fiscal 2020 allowance does not include general salary increases.