G50L00
Maryland Supplemental Retirement Plans

Operating Budget Data

($ in Thousands)

	FY 04 Actual	FY 05 Working	FY 06 Allowance	FY 05-06 Change	% Change Prior Year
Special Fund	$1,534	$1,480	$1,307	-$172	-11.7%
Total Funds	**$1,534**	**$1,480**	**$1,307**	**-$172**	**-11.7%**
Contingent & Back of Bill Reductions			-10	-10	
Adjusted Total	**$1,534**	**$1,480**	**$1,298**	**-$182**	**-12.3%**

- The fiscal 2006 reductions are almost exclusively due to position abolitions.
- The fiscal 2006 deferred compensation contribution funding ($9,600) of the State's match of up to $600 in 401(k) fund contributions is withdrawn through budget reconciliation legislation.

Personnel Data

	FY 04 Actual	FY 05 Working	FY 06 Allowance	FY 05-06 Change
Regular Positions	16.50	16.50	14.00	-2.50
Contractual FTEs	0.00	0.00	0.00	0.00
Total Personnel	**16.50**	**16.50**	**14.00**	**-2.50**
Vacancy Data: Regular Positions				
Turnover, Excluding New Positions		0.00	0.00%	
Positions Vacant as of 12/31/04		1.0	6.06%	

- In addition to one vacant position scheduled for abolition, 1.5 full-time equivalent currently filled positions are scheduled for abolition. One of those positions is a reduction from a full-time position to a part-time position; the other will be vacant as of June 30, 2005, at which time the abolition will take place.

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

For further information contact: Lori J. O'Brien Phone: (410) 946-5530

Analysis in Brief

Major Trends

Investment Plan Assets Are Up, but Employee Deferrals Are Down: Total assets increased by 15.6% from fiscal 2003 to 2004; over the same period, employee deferrals and transfers decreased by 3.4%.

Issues

Questions Remain about the Stability of the Board's Revenue Stream and of Agency Expenditures: In response to the accumulation of a large carryover revenue balance, the board decreased the agency fee as a percent of assets from 0.11% to 0.07% on January 1, 2005. **The Department of Legislative Services (DLS) recommends that the board and staff comment on how this decision was made and whether any new administrative policy has been established to ensure more stability in agency revenue and carryover balances in the future. DLS also recommends that the agency comment on what controls it has implemented to avoid the use of budget amendments to cover ongoing expenses in the remainder of fiscal 2005 and in fiscal 2006.**

Elimination of the State Deferred Compensation Match Has Again Been Proposed: Budgetary savings of $7.6 million in general funds and $14.3 million in total funds are attributable to this action. **The agency should comment on the effect of this action on enrollment and deferral levels.**

Recommended Actions

1. Add language limiting the capacity of the agency to add funding through budget amendment.

G50L00
Maryland Supplemental Retirement Plans

Operating Budget Analysis

Program Description

Title 35 of the State Personnel and Pension 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 operated 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 operated under IRC Section 401(a).

Maryland Supplemental Retirement Plan (MSRP) staff provide communications materials and education programs to State employees and support the activities of the board in selection of investment options and other activities.

The board finances its operations through a fee imposed on the employee participants, based on a percent of assets in the plans. As of January 1, 2005, the board imposed a .07% fee on assets to support its activities, reducing it from 0.11%.

The board has contracted with Nationwide Retirement Solutions, Inc., for administration of all available plans. Under a five-year contract that took effect January 1, 2003, the administrator imposes a 0.23% fee on assets in those plans (decreased from 0.28% in the previous contract). Member fees are capped at $1,800 per account during calendar 2005.

Performance Analysis: Managing for Results

Given that day-to-day administration and management of the plans are handled by the third-party administrator, the agency's two primary goals are to (1) provide clear and complete information about the plans to employees and cultivate informed decisions about participation; and (2) provide effective, long-term investment opportunities for participants.

As demonstrated in **Exhibit 1**, total assets of the plans increased 15.6% from fiscal 2003 to 2004. The Maryland Supplemental Retirement Plans (MSRP) reports that the increase is the result of a general recovery in the financial markets, particularly for equities (stocks). Total deferrals from employees have, however, fallen slightly. The 3.4% decrease in deferrals and transfers is attributable to the continued suspension of the State match of up to $600 in contributions and increased or stable levels of distributions in all four plans. The decrease in plan participation of 2.9% is also attributable to suspension of the State's match.

Exhibit 1
Total Assets, Deferrals, and Actively Deferring Accounts
Fiscal 2002 to 2006
($ in Millions)

	Actual FY 2002	Actual FY 2002	Actual FY 2003	Actual FY 2004	Projected FY 2005	Projected FY 2006	% Change 2003 - 2004
Plan Assets ($)	$1,617.3	$1,507.0	$1,614.6	$1,866.5	$2,020.5	$2,144.5	15.6%
Deferrals & Transfers ($)	128.1	139.5	148.3	143.3	n/a	n/a	-3.4%
Actively Deferring Participants	43,766	45,571	45,581	44,245	44,300	47,200	-2.9%

Source: Maryland Supplemental Retirement Plans

As demonstrated in **Exhibit 2**, the agency's mutual fund 5-year and 10-year averages have performed better than its composite index, while shorter-term returns have performed slightly less well than the index. **DLS recommends that the agency comment on the slightly less favorable short-term performance of its mutual fund options. As with last year's analysis, DLS also recommends that the agency use a more nationally recognized measure of mutual fund performance, such as Morningstar, rather than its own composite index to show the relative performance of State mutual fund options.**

Exhibit 2
Maryland Supplemental Retirement Plans
Annual Rates of Return as of June 30, 2004

Outcomes	1 Year	3 Years	5 Years	10 Years
Average Return for MSRP Investment Options	18.0%	2.7%	3.7%	11.0%
Benchmark: Average of All Investment Asset Class Indices	19.7%	3.0%	2.0%	9.6%

Source: Maryland Supplemental Retirement Plans

Finally, another component of the agency's performance that DLS has noted in the past is the agency's success in negotiating rebates from the providers of the mutual funds offered by the board.

This practice of receiving rebates from providers is common in the field of deferred compensation and reflects the argument of the administrator that the mutual fund provider's workload is reduced when it provides its product through the administrator rather than when it sells its fund directly to a retail customer. For example, Nationwide, rather than the mutual fund provider, prepares the members' quarterly statements, and both Nationwide and the agency provide communication material that might otherwise be provided by the mutual fund provider. **Exhibit 3** shows the value of these rebates in comparison to total plan assets.

Exhibit 3
Mutual Fund Rebates Negotiated by MSRP
Calendar 2000 – 2004

	2000	2001	2002	2003	2004[1]
Mutual Fund Rebates	$1,386,526	$3,165,781	$1,813,753	$1,974,228	$1,968,714
Invested Plan Asset[2] ($ in millions)	1,583.8	1,553.0	1,428.6	1,755.8	1,946.1
Rebates as a Percent of Assets	0.09%	0.20%	0.13%	0.11%	0.10%

[1]Values are from audited financial reports with the exception of 2004.
[2]"Invested" Plan Assets exclude values entered in financial reports as Plan Assets but do not generate earnings, and are not subject to fees (such as annuity reserves, outstanding loans, etc.)

Source: Maryland Supplemental Retirement Plans

The recent reduction in rebates is likely tied to the performance of the markets and not a lack of effort on the part of the plan administrator to negotiate rebates. **DLS recommends that the agency comment on this recent decrease in rebates as a percentage of assets**.

Governor's Proposed Budget

As demonstrated in **Exhibit 4**, the agency's special fund budget decreases by 12.3% from the fiscal 2005 working appropriation. Savings are found almost exclusively in personnel expenditures, reflecting the abolition of 2.5 full-time equivalent positions.

The agency intends to absorb the functions of 2.0 full-time equivalent abolitions and one reduction from a 1.0 FTE to a 0.5 FTE position by using existing personnel. All abolished positions will be vacant by June 30, 2005, when the abolitions will actually occur. The abolished positions are in the officials and administrators job family and are positions with policymaking responsibility. The reduced position is in a professional-level classification. Other efficiencies include reductions in travel expenditures.

Exhibit 4
Governor's Proposed Budget
Maryland Supplemental Retirement Plans
($ in Thousands)

How Much It Grows:	Special Fund	Total
2005 Working Appropriation	$1,480	$1,480
2006 Governor's Allowance	1,307	1,307
Contingent & Back of Bill Reductions	-10	-10
Adjusted Allowance	**1,298**	**1,298**
Amount Change	-$182	-$182
Percent Change	-12.3%	-12.3%

Where It Goes:	
Personnel Expenses	
2.5 FTE abolished positions	-207
Increments and other compensation	23
State employee retirement plan	7
Employee and retiree health insurance	-6
Other Changes	
Department of Budget and Management paid telecommunications	8
Travel	-6
Rent paid to Department of General Services	-3
Office and other supplies	2
Total	**-$182**

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

Issues

1. Questions Remain about the Stability of the Board's Revenue Stream and of Agency Expenditures

The agency finances its operations through an asset-based fee collection from plan members based on the members' account value. Revenues are extremely volatile given that they track the performance of the general investment markets. The agency charges a fee as a percentage of assets and in fiscal 2002 and 2003 also charged "one-time" fees to cover insufficient revenue due to market losses. As demonstrated in **Exhibit 5**, fees as a percentage of assets have ranged from .06% in fiscal 2001 to .11% from fiscal 2003 to 2005. While these two funding mechanisms have provided sufficient revenues to cover operating expenditures, they have resulted in widely varying carryover balances to cushion against future market losses. From fiscal 2003 to 2004, for example, the carryover balance increased by 206%. The board responded to this excessive carryover balance in late calendar 2004 by reducing the fee to .07% of assets. If this fee level is maintained and investment earnings grow as projected, the carryover balance as a percentage of assets will be 64.2% of operating expenses at the close of fiscal 2006. **DLS recommends that MSRP comment on how fee-level decisions are made and whether any new administrative policy has been established to ensure more stability in agency revenue and carryover balances in the future.**

Exhibit 5

Participants' Fees and Operating Budgets: Fiscal 2001-2006

	Actual FY 2001	Actual FY 2002	Actual FY 2003	Actual FY 2004	Projected FY 2005	Projected FY 2006
PEBSCO/Nationwide Fees	$3,509,524	$3,555,869	$3,242,450	$3,690,947	$4,470,050	$4,789,980
As % of Invested Assets	0.28%	0.28%	0.23%	0.23%	0.23%	0.23%
Board Fees + adj.	$1,363,330	$1,386,603	$1,586,478	$1,833,852	$1,721,115	$1,443,855
As % of Invested Assets	0.06%	$8 + 0.06%[1]	$6 + 0.11% [2]	0.11%	.11%/.07%	0.07%[3]
Operating Expenses	$1,391,409	$1,517,455	$1,464,572	$1,534,177	$1,479,592	$1,297,593[4]
Carryover Balance	$154,251	$23,399	$145,305	$444,990	$686,513	$832,775
Carryover Balance as Percent of Operating Exp.	11.09%	1.54%	9.92%	29.0%	46.4%	64.2%

[1] Special one-time board fee of $8 per account collected March 2002.
[2] Special one-time board fee of $6 per account collected March 2003.
[3] Assumes fees as a percentage of assets remain stable; the board intends to reassess the fee rate before he end of the fiscal year.
[4] Does not include the agency's portion of the State's match of up to $600 in 401(k) fund contributions proposed for withdrawal through budget reconciliation legislation.

Source: Maryland Teachers' and State Employees' Supplemental Retirement Plans, Department of Legislative Services

The instability of MSRP's revenue stream and its capacity to cover expenditures is exacerbated by the agency's recent use of budget amendments to cover regular operating expenditures. The agency submitted a budget amendment for $135,000 in September 2004, as it did in the summer of 2003 when it submitted a $115,000 amendment. Both these amendments were primarily used to cover normal operating expenses that could have been anticipated during the legislative session when the legislature had the opportunity to debate the merits of the agency's budget as a whole. **DLS recommends that the agency comment on what controls it has implemented to avoid the use of budget amendments to cover ongoing expenses in the remainder of fiscal 2005 and in fiscal 2006. DLS also recommends budget bill language to limit the use of this funding mechanism during fiscal 2006.**

2. Elimination of the State Deferred Compensation Match Has Again Been Proposed

Although the State's match of up to $600 in 401(k) fund contributions is funded in the fiscal 2006 budget, funding for Executive Branch agency employees is also withdrawn in Section 18 of the budget bill (House Bill 150/Senate Bill 125). Section 12 of the Budget Reconciliation Act of 2005 (House Bill 148/Senate Bill 127) provides the legal basis by which the administration can simultaneously fund and then withdraw funding for the benefit. Savings of $7.6 million in general funds and $14.3 million in total funds is attributed to this action.

The employer match program is operated under Internal Revenue Code 401(a). Participation in this plan, which became operational on July 1, 1999, is open to all State employee members of the Employees' Pension System (EPS). Upon the inception of the 401(a) deferral plan, the State contributed a dollar-for-dollar amount not to exceed $600 for each participant. In fiscal 2003, budget bill language reduced funding for the match to up to $500 per participant; in fiscal 2004 and 2005, funding was withdrawn altogether due to fiscal constraints.

The agency should comment on the effect of this action on enrollment and deferral levels.

Recommended Actions

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

   , provided that this appropriation may be increased by no more than $65,000 by approved budget amendment. Agency requirements in addition to this amount should be addressed by requesting a deficiency appropriation in the 2006 session.

   Explanation: The Maryland Supplemental Retirement Plan submitted budget amendments in 2003 and 2004 that represented more than 8.5% of its legislative appropriation. Expenditures funded through these amendments were primarily of an ongoing nature and could have been anticipated during the legislative session when the General Assembly had the opportunity to debate the merits of the agency's budget as a whole. This language caps fiscal 2006 amendments at 5% of the funding proposed in the 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 2004					
Legislative Appropriation	$0	$1,399	$0	$0	$1,399
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	135	0	0	135
Cost Containment	0	0	0	0	0
Reversions and Cancellations	0	0	0	0	0
Actual Expenditures	**$0**	**$1,534**	**$0**	**$0**	**$1,534**
Fiscal 2005					
Legislative Appropriation	$0	$1,480	$0	$0	$1,480
Budget Amendments	0	0	0	0	0
Working Appropriation	**$0**	**$1,480**	**$0**	**$0**	**$1,480**

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

Fiscal 2004

- A special fund amendment for $135,000 was approved in fiscal 2004. These funds were used to offset turnover that was not realized during the fiscal year, for a mandatory service contract associated with audit fees and investment services, and for payment of accrued leave to a deceased employee's estate.

Audit Findings

Audit Period for Last Audit:	January 30, 2001 – February 9, 2004
Issue Date:	October 2004
Number of Findings:	1
Number of Repeat Findings:	1
% of Repeat Findings:	100%
Rating: (if applicable)	0

Finding 1: Proper internal controls have not been established over the processing of purchasing and disbursement transactions. The Office of Legislative Audits recommends that MSRP use the available Financial Management Information System.

Object/Fund Difference Report
Maryland Supplemental Retirement Plans

Object/Fund	FY04 Actual	FY05 Working Appropriation	FY06 Allowance	FY05 - FY06 Amount Change	Percent Change
Positions					
01 Regular	16.50	16.50	14.00	-2.50	-15.2%
Total Positions	**16.50**	**16.50**	**14.00**	**-2.50**	**-15.2%**
Objects					
01 Salaries and Wages	$ 1,118,589	$ 1,139,726	$ 965,763	-$ 173,963	-15.3%
02 Technical & Spec Fees	9,047	4,500	3,500	-1,000	-22.2%
03 Communication	12,368	25,667	34,907	9,240	36.0%
04 Travel	23,076	11,600	5,500	-6,100	-52.6%
07 Motor Vehicles	14,520	15,552	15,552	0	0%
08 Contractual Services	249,439	186,550	186,871	321	0.2%
09 Supplies & Materials	11,245	3,800	6,000	2,200	57.9%
10 Equip - Replacement	3,794	870	800	-70	-8.0%
11 Equip - Additional	2,962	1,200	800	-400	-33.3%
13 Fixed Charges	89,137	90,127	87,500	-2,627	-2.9%
Total Objects	**$ 1,534,177**	**$ 1,479,592**	**$ 1,307,193**	**-$ 172,399**	**-11.7%**
Funds					
03 Special Fund	$ 1,534,177	$ 1,479,592	$ 1,307,193	-$ 172,399	-11.7%
Total Funds	**$ 1,534,177**	**$ 1,479,592**	**$ 1,307,193**	**-$ 172,399**	**-11.7%**

Note: The fiscal 2005 appropriation does not include deficiencies, and the fiscal 2006 allowance does not reflect contingent reductions.