G20J01
State Retirement Agency

Operating Budget Data

($ in Thousands)

	FY 06 Actual	FY 07 Working	FY 08 Allowance	FY 07-08 Change	% Change Prior Year
Special Fund	$27,595	$22,016	$22,280	$264	1.2%
Total Funds	**$27,595**	**$22,016**	**$22,280**	**$264**	**1.2%**

- On a one-time basis, some health insurance costs for all State agencies are being paid out of the surplus in the State's health insurance account, resulting in a one-time savings of $492,577 for the State Retirement Agency (SRA). Similarly, other one-time allocations in fiscal 2007 are discontinued in the fiscal 2008 allowance. Adjusted for these factors, the agency's budget would grow by 4.1%.

- Due to an oversight by the Office of Administrative Hearings (OAH), the Governor's allowance does not include $247,226 for administrative hearings for appeals of denied disability benefit claims. SRA does not expect to be billed by OAH for any hearings in fiscal 2008.

Personnel Data

	FY 06 Actual	FY 07 Working	FY 08 Allowance	FY 07-08 Change
Regular Positions	172.00	187.00	189.00	2.00
Contractual FTEs	19.74	16.00	16.00	0.00
Total Personnel	**191.74**	**203.00**	**205.00**	**2.00**
Vacancy Data: Regular Positions				
Turnover, Excluding New Positions		10.62	6.00%	
Positions Vacant as of 12/31/06		12.00	6.86%	

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

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- In fiscal 2007, the agency secured Board of Public Works (BPW) approval to convert 13.0 full-time equivalent (FTE) contractual positions in its Administrative Division into 10.0 FTE regular positions. Also, under the "Rule of 50," the agency secured BPW approval to add 2.0 FTE regular positions to its investment division, although funds for these positions are not included in the allowance. The Department of Legislative Services expects funding to be included in a supplemental budget.

- Also in fiscal 2007, SRA added 2.0 FTE contractual positions to its information technology division to assist in clearing a data processing backlog. In fiscal 2007, the agency absorbed the cost of these positions, but the Governor's allowance for fiscal 2008 includes $125,539 for them.

- The Governor's allowance provides funding for 2.0 FTE new regular positions in the agency's Human Resources division to assist with employee recruitment, development of staff training programs, and updating of personnel policies and procedures.

- The agency's turnover rate increases from 5.0 to 6.0%, more accurately reflecting the agency's vacancy rate.

Analysis in Brief

Major Trends

Short-term Investment Returns Improve, but Long-term Returns Still Lag Behind Other Funds: Retirement funds in neighboring states consistently earn higher investment returns than the State Retirement and Pension System.

Call Center Performance Worsens: For the fourth year in a row, telephone wait times and the percentage of dropped calls both increased. The dramatic increases in both areas in fiscal 2006 occurred despite the addition of new regular positions and the installation of a new automated telephone system to handle the increasing volume of telephone calls.

Benefits Processing Remains an Agency Strength: Benefit payments are processed accurately and on time.

Issues

Board Governance and Administrative Structures Hamper the System's Investment Performance: Lack of investment expertise on the board's investment committee, combined with restrictions on staffing and salaries within the agency's investment division, are contributing to the system's consistent underperformance.

Board Again Recommends Ending the Corridor Funding Method: Pension enhancement legislation enacted in 2006 further eroded the funded status of the teachers' and employees' combined systems. The board responded by strongly urging the General Assembly to immediately end the corridor funding method and resume full actuarial funding of the system to return it to full funding.

Recommended Actions

		Funds
1.	Delete 2.0 FTE contractual positions from the Information Technology Division.	$ 125,539
2.	Reduce travel allowance by $128,000.	128,000
3.	Add language limiting the agency's authority to add funding through budget amendments.	
4.	Add language making $5,762,456 of the deficiency appropriation contingent on independent verification and validation of Phase 1 of the Maryland Pension Administration System design and architecture and on the hiring of a regular project manager and Chief Information Officer.	
	Total Reductions	**$ 253,539**

Operating Budget Analysis

Program Description

The State Retirement Agency (SRA), under the direction of the 14-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 excellence in the execution of the 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 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.

- To efficiently collect the required employer and employee contribution necessary to fund the system.

The agency's administrative budget is funded solely through special funds drawn from the pension trust fund based on statutory authority. Its annual spending is capped at 0.22% of members' payroll, or approximately $31 million in fiscal 2008.

Performance Analysis: Managing for Results

The agency's Managing for Results provides measures illustrating its progress in achieving three of its four goals.

Short-term Investment Returns Improve, but Long-Term Returns Still Lag Behind Other Funds

SRPS ended fiscal 2006 with a 10.4% return on its investment portfolio, the third straight year it has exceeded its 7.75% targeted rate of return following several years of sluggish or negative returns. Unfortunately, those years of poor performance continue to weigh heavily on the system's actuarial rate of return, a dynamic five-year average of investment returns used in calculating employer contribution rates. The actuarial rate of return for fiscal 2006 was 6.7%; because that figure trails the system's target of 7.75%, it was a factor in the significant increase in State contribution rates from fiscal 2007 to 2008.

According to the Trust Universe Comparison Service (TUCS), the system's one-year investment returns as of September 30, 2006, surpassed median performance achieved by other large public pension funds. The system's investment return ranks in the thirty-seventh percentile compared with other pension funds with at least $1 billion in assets, as shown in **Exhibit 1**. TUCS is a collaboration of 19 major banks, Wilshire Associates, and Greenshire Associates that tracks public pension performance. In the TUCS analysis, the ninety-ninth percentile is the lowest ranking and the first percentile is the highest. Maryland's ranking in the thirty-seventh percentile, therefore, represents a substantial improvement from its ranking in the fifty-ninth percentile just one year earlier. The long-term TUCS comparison shows significant improvement in the relative standing of the State's five-year investment return, from the eighty-eighth percentile in September 2005 to the fifty-ninth percentile in September 2006. Meanwhile, the 10-year return ranks in the ninetieth percentile, which is unchanged from a year ago.

Exhibit 1
TUCS Comparison to Public Funds > $1.0 Billion
Investment Return
Rolling Years Ending September 30, 2006

	3 Months		1 Year		5 Years		10 Years	
5th Percentile	5.49		13.15		11.11		10.13	
25th Percentile	4.34		11.30		9.98		9.14	
Median	4.02		10.61		9.20		8.60	
75th Percentile	3.63		9.20		8.61		8.12	
95th Percentile	2.59		4.65		6.45		7.32	
SRPS	4.23	35th	10.81	37th	8.99	59th	7.54	90th

TUCS: Trust Universe Comparison Service

Source: State Street Analytics (TUCS Master Trust Report)

While these figures indicate that SRPS and SRA have made strides in improving both short- and long-term investment returns by adjusting strategic asset allocations and instituting management reforms, long-term returns are still noticeably below the median. **Exhibit 2** demonstrates that on a regional basis, the Maryland pension fund's investment returns consistently under-perform the pension plans in neighboring states, even during lean years. Indeed, on average, State employees investing their own money in the Maryland Supplemental Retirement Program (MSRP) outperformed the Retirement System's investment returns in three of the past six years.[1]

Exhibit 2
Annual Investment Returns in Selected Public Pension Plans
Fiscal 2000-2006

	2000	2001	2002	2003	2004	2005	2006
Maryland	**11.9**	**-9.4**	**-7.6**	**3.2**	**16.2**	**9.5**	**10.4**
Maryland Supplemental Ret. Plan	**n/a**	**-2.2**	**-7.3**	**4.3**	**14.2**	**6.5**	**8.0**
Delaware	16.8	-5.1	-6.3	3.1	15.9	9.6	12.4
Pennsylvania Teachers	12.2	-7.2	-5.2	2.7	19.7	12.9	15.3
Virginia	n/a	-7.4	-7.3	2.5	17.9	12.0	12.4

Source: Department of Legislative Services

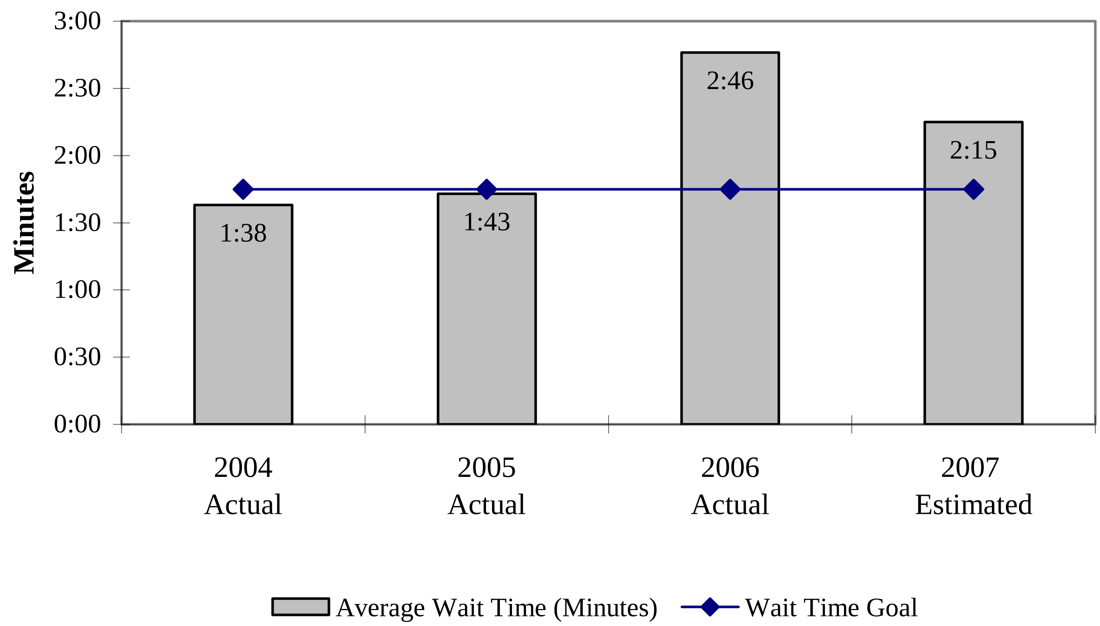
Call Center Performance Worsens

SRA's call center is the agency's primary vehicle for communicating with system members about benefits to which they are entitled. In fiscal 2006, the call center handled 119,196 incoming calls, representing 58% of interactions between members and benefit counselors. The number of incoming calls was an all-time high, exceeding the number of calls in fiscal 2005 by 3,199. To accommodate the growing number of incoming calls, the agency's fiscal 2006 budget included 2.0 full-time equivalent new regular benefit counselor positions to answer member calls. Also, the agency installed a more sophisticated interactive voice response telephone system in January 2006. The new system enables callers to have more questions answered by the automated system, thereby reducing the number of callers needing to speak directly to a counselor.

[1] MSRP cautions that asset allocations, and therefore returns, vary widely among its members, and that there is no such thing as an average investor. The results presented are weighted annual averages based on returns and assets invested for all investment options available under the program.

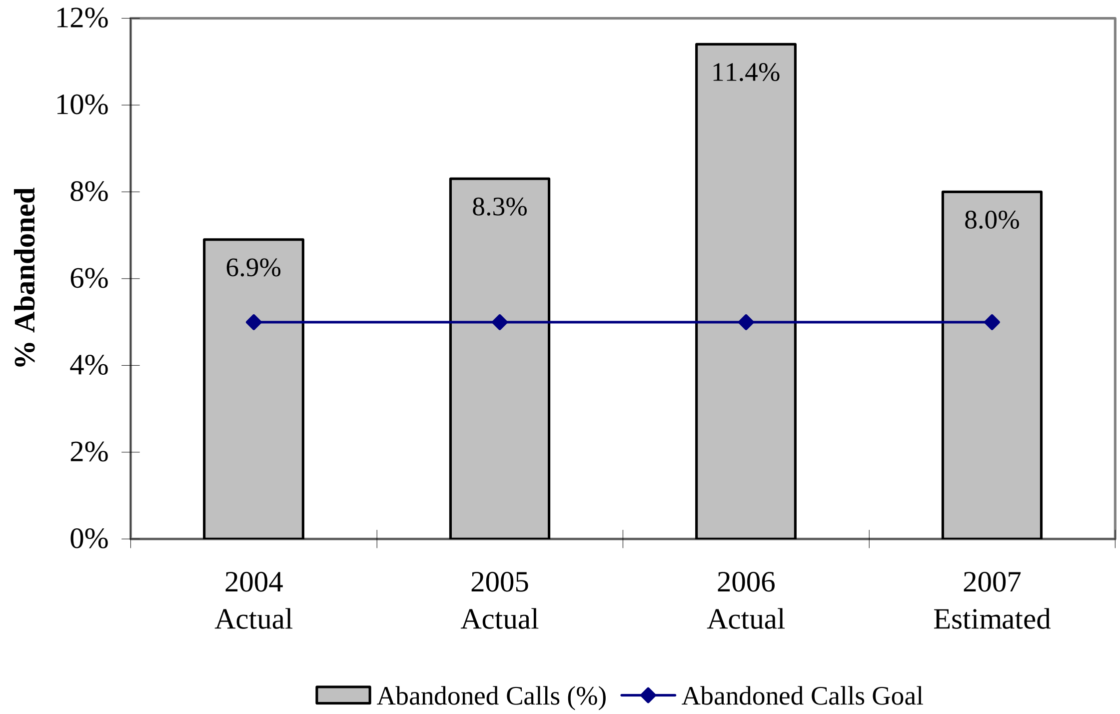
In spite of these improvements, the call center's performance continued to decline for the fourth straight year. **Exhibits 3** and **4** demonstrate this trend for the past three years. The average wait time to connect to a benefits counselor jumped 61% from its fiscal 2005 level to 2:46 minutes in fiscal 2006, well above the agency's goal of 1:45 minutes. In a related development, the percentage of abandoned calls also jumped from 8.3% in fiscal 2005 to 11.4% in fiscal 2006, also above the agency's goal of 5%. The agency attributes its deteriorating performance to recurring vacancies in the Member Relations division due to poor compensation. During fiscal 2006, the Member Relations division had 10 vacancies among its staff of 23 benefit counselors. Currently, the agency reports that 9 newly hired counselors are undergoing training. **The Department of Legislative Services (DLS) recommends that the agency comment on its plans to improve retention among benefit counselors and meet its goals for call center performance.**

Exhibit 3
Telephone Call Wait Time
Fiscal 2004-2007



Source: State Retirement Agency

Exhibit 4
Percent of Abandoned Calls
Fiscal 2004-2007



Source: State Retirement Agency

Benefits Processing Remains an Agency Strength

In fiscal 2006, 99.9% of retirement applications were processed in a timely fashion, and 99.9% of benefit payments were computed accurately. These figures remain unchanged from recent years, reflecting the agency's proficiency in these areas.

Fiscal 2007 Actions

Proposed Deficiency

SRA has requested a fiscal 2007 deficiency appropriation of $5,912,456 for the remaining costs of fully designing and implementing Phase I of the Maryland Pension Administration System (MPAS-1). Maryland Pension Administration System (MPAS) represents the agency's effort to replace its 30-year-old legacy computer system with more modern and agile technology. In

April 2006, the agency awarded a two-year, $11.2 million contract to Saber, Inc. (including $1 million in contingencies) to design and implement MPAS-1. A fiscal 2006 budget amendment for $7,783,000 was approved to fund most of the contract cost, subject to the agency's statutory spending limit. The fiscal 2007 deficiency appropriation would be divided as follows:

- $3,447,201 for the balance of the contract with Saber, Inc.
- $1,364,000 for quality assurance services
- $572,000 for project management
- $379,255 for security certification and accreditation
- $150,000 for independent verification and validation (IV&V)
- **$5,912,456 Total**

The agency's previous attempt to replace its legacy system resulted in a failed procurement and a $30 million loss for the pension trust fund. Unfortunately, the MPAS-1 contract award and early project implementation have been fraught with irregularities. First, only one vendor, Covansys, submitted a proposal in response to the MPAS procurement. While conducting its due diligence on Covansys, the agency learned that the firm was subject to a buyout by Saber. The agency delayed contract award until the sale was complete and it could verify that the MPAS team was still intact. However, within six months of contract award, the agency's executive director, MPAS project manager, and chief information officer (CIO) all resigned. In addition, three key members of Saber's MPAS team, including its project manager, all left Saber.

These developments prompted the co-chairs of the Joint Committee on Pensions to write a letter to the agency's interim executive director requesting that it immediately halt further work on MPAS until the joint committee could review its progress. In its written response, the agency indicated that it planned to continue work on the first two milestones of the MPAS-1 project, scheduled for completion in January 2007, while simultaneously conducting searches for a new project manager, CIO, and executive director. In its letter, the agency indicated that if it had not hired a regular project manager by December, it would pause the project. During its testimony before the joint committee in November 2006, the agency indicated that Saber was progressing according to schedule on the first two project milestones, so the agency had decided to proceed with MPAS-1 implementation even though it did not expect to have a regular project director in place until January at the earliest. In early January 2007, Saber delivered the final set of deliverables under the first two milestones. The agency is testing the delivered products to determine whether they conform to contract specifications.

While Saber has replaced most of the key staff, including the project manager, who left the firm in the wake of the merger with Covansys, SRA reports that it has not yet filled its vacant project manager and CIO positions. Despite these persistent vacancies, SRA has elected not to pause the

MPAS project. Moreover, it has not yet conducted an independent verification and validation review (IV&V) to determine whether MPAS's design and architecture are appropriate and technically sound. **DLS recommends making all but $150,000 of the deficiency appropriation contingent on the agency filling the vacant CIO and project manager positions and completing an IV&V, which would be subject to review and acceptance by the budget committees. The $150,000 would allow the agency to pay for the IV&V. The contingent appropriation would give the General Assembly the opportunity to recommend halting the project if the IV&V concludes that the MPAS design and architecture are not adequate. DLS further recommends that the agency report on the status of its recruitment for a new MPAS project manager and CIO.**

Governor's Proposed Budget

Exhibit 5 shows that personnel costs for fiscal 2008 actually decline by $48,000 (0.03%) in the Governor's allowance despite the additions of 2.0 FTE regular positions and funding for 2.0 FTE contractual positions. This is due in large part to one-time savings on fringe benefits, as well as increased turnover. New contracts for actuarial services, audits of participating governmental units, and an actuarial audit represent some of the largest increases in agency spending. Postage costs drop by 43% ($328,000) as the agency transitions to distributing newsletters and other member information in electronic formats. Funding for investment research also drops by $241,000 with the addition of two new investment staff members.

Exhibit 5
Governor's Proposed Budget
State Retirement Agency
($ in Thousands)

How Much It Grows:	Special Fund	Total
2007 Working Appropriation	$22,016	$22,016
2008 Governor's Allowance	22,280	22,280
Amount Change	$264	$264
Percent Change	1.2%	1.2%

Where It Goes:	
Personnel Expenses	
Retirement	$228
Increments and other compensation	214
2.0 FTE new contractual positions in Information Technology	126
Employee health insurance	91
2.0 FTE new regular positions in Human Resources	74
Other fringe benefit adjustments	26
Turnover	-174
Health insurance costs decline due to one-time savings	-633
Other Changes	
New contract for actuarial services, including experience study	317
Annual and participating governmental units audits	240
Expanded travel for conventions, training, and due diligence	196
Actuarial audit and cost effectiveness study	155
Other contractual services (programming, proxy services, software, etc.)	136
New contract for investment consultants	135
Rent	83
Materials, supplies, and equipment	35
Subscriptions and dues	31
Communication and motor vehicles	25
Board of Trustees election service – no trustee elections scheduled for fiscal 2008	-225
Investment research	-241
Administrative hearings not budgeted by the Office of Administrative Hearings	-247
Postage	-328
Total	**$264**

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

New Personnel

Regular Positions

The Governor's allowance includes 2.0 full-time equivalent new regular positions in the Retirement Agency's Human Resource division, as described in **Exhibit 6**.

Exhibit 6
New Regular Personnel
Fiscal 2008

Classification	Salary andFringes	Function	Rationale
Human Resources Unit			
1.0 FTE Admin. Officer II 1.0 FTE Admin. Specialist III	$73,949	Assist in employee recruitment and other human resource functions.	Current staffing level of 2.0 FTE positions is insufficient to develop staff training programs, update policies and procedures, and recruit for vacant positions.
Total Allowance	**$73,949**		

Source: State Retirement Agency

Issues

1. Board Governance and Administrative Structures Hamper the System's Investment Performance

As shown in **Exhibit 7**, the 2006 valuation by the system's actuary, Segal Co., concluded that the 2006 benefit enhancement increased employer contribution rates by 1.6 percentage points for the teachers' plan and by 1.18 percentage points for the employees' plan, for a total cost of $115 million. **Appendix 5** also shows that the system's funded status dropped from 87.8% in fiscal 2007 to 83.3% in fiscal 2008. Segal projects that the funded status will continue to drop before reversing course, putting more upward pressure on State contribution rates in the coming years. DLS believes that the most promising strategy for blunting the upward pressure on contribution rates is to improve the system's investment performance.

As noted earlier, even with the improved one- and five-year standings in the TUCS rankings reported earlier, SRPS still remains near the bottom in long-term returns. Moreover, it has been consistently outperformed, often by large margins, by the three pension systems in neighboring states. The investment returns achieved in Virginia, Delaware, and Pennsylvania confirm that higher investment returns are possible. To illustrate the possible effect that higher returns could have on the system, if Maryland had achieved the same 12.4% investment return experienced by Delaware and Virginia in fiscal 2006, the system would have generated an additional $640.0 million in revenues, which would have gone a long way toward easing the growth in State contribution rates.

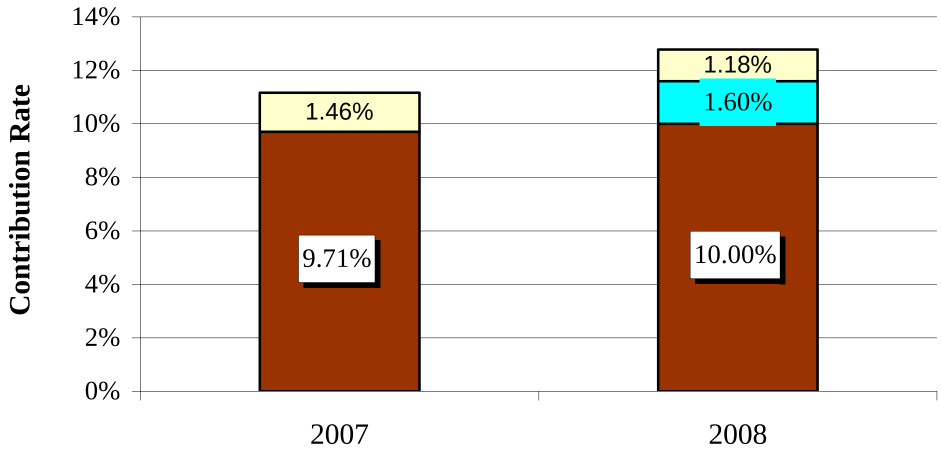
Certainly a key factor in the system's performance has been SRA's difficulty in attracting and retaining qualified investment staff. Having stable, sufficient, and skilled staff is critical to any effort to increase investment returns because staff must have the time and resources to select and monitor external managers, track market trends to take advantage of the flexibility offered by the Tactical Asset Allocation program, and explore alternative asset classes that may yield higher returns. Staffing of the investment division has been an ongoing issue at SRA. Of great concern is that even as the agency reports that it has now filled all 15 investment positions except for one, that remaining vacancy is the most critical one: the position of CIO has remained vacant for a year. In 2006, the board concluded its recruitment for the position without finding a suitable candidate. Without stable leadership of the investment division, prospects for generating improved performance remain dim.

Other personnel challenges that could affect the operations of SRA and the system include the departure of Executive Director Thomas K. Lee, who managed SRA during the time period in which many of the changes were made that led to the system's improved performance over the past three years.

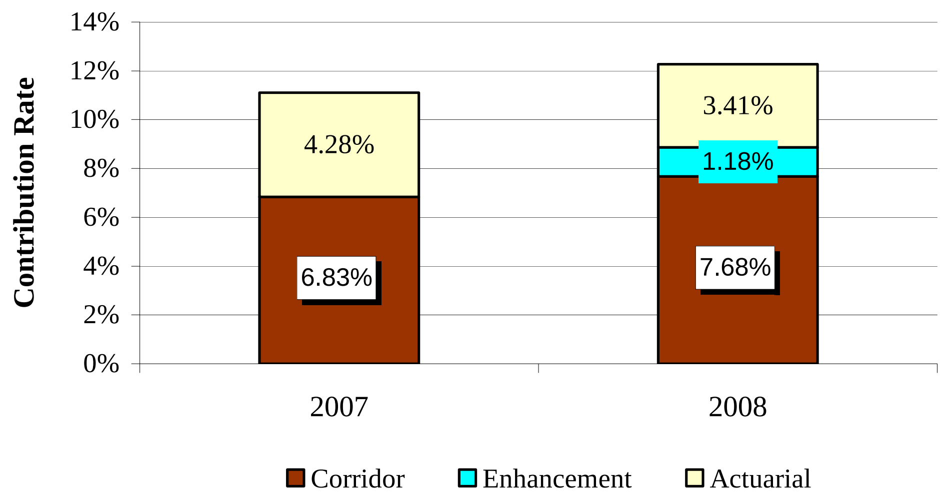
A compensation study commissioned by the agency and finished in 2006 by McLagan Partners highlights the challenge confronting the agency in its efforts to find and retain investment staff. According to the study, the CIO's salary is 12% below the median for comparable pension plans, and total compensation (including bonuses, which the agency does not offer) is 19% below the median. Salaries for two managing directors were 42 and 17% below the median, respectively.

Exhibit 7
Employer Contribution Rates and Actuarial Funding Levels
Fiscal 2007 and 2008

Actuarial Rates — Teachers' Combined Systems



Actuarial Rates — Employees' Combined Systems



Source: Segal Company

In an effort to explore solutions for the investment division's persistent underperformance, DLS interviewed CIOs from the Delaware Public Employee Retirement System (PERS) and Pennsylvania Public School Employee Retirement System (PSERS) and a trustee for the Virginia Retirement System (VRS) who, as a former chairman of the Board of Trustees, was instrumental in restructuring the system's investment management structure. The purpose of the interviews was to understand the reasons behind these systems' impressive investment performance. From these interviews, the following three themes emerged:

- ***Autonomy:*** Two of the three systems exempt their investment divisions from civil service restrictions and salary schedules, allowing the systems to hire the number of staff they believe to be appropriate and to pay them competitive salaries and bonuses. As a result, VRS has a 34-member investment staff and PSERS has a 21-member investment staff, compared with a 17-member investment staff in SRPS. Moreover, salaries and bonuses for staff far exceed SRPS salaries. For instance, the VRS CIO earns a base salary of $375,000 and bonuses in excess of $200,000, compared with the $133,000 salary and no bonuses for Maryland's CIO. Both VRS and PSERS include other retirement agency staff in their civil service systems and salary schedules. Unlike VRS and PSERS, the investment division for Delaware PERS is subject to the state salary schedule but consists of only four positions. These staff handle most of the audit functions for the system; asset management and manager oversight responsibilities are handled jointly by the system's investment consultant and an independent investment committee.

- ***Accountability:*** VRS and PSERS have both instituted performance-based compensation systems that reward staff for meeting objective benchmarks based on market indices. Bonuses tend to be linked to seniority and can be as high as 50% of base salary. As an illustration, PSERS establishes systemwide targets; if overall investment performance meets those targets, all investment staff receive a bonus. In addition, PSERS establishes asset class targets; if returns in those classes meet the targets, staff responsible receive additional bonuses. To encourage staff to maintain a long-term view, half of the performance bonuses are linked to five-year investment return targets rather than short-term returns.

- ***Governance:*** All three systems ensure that all investment decisions are made by qualified investment professionals, either on staff or on independent investment oversight committees. For both VRS and PSERS, where a majority of board members do not have investment experience, the Board of Trustees has no direct role in selecting or monitoring the performance of external managers, other than establishing asset allocation targets. In both cases, investment division staff screen, select, and monitor all external managers, and are solely responsible for their dismissal in the event that they under perform. While staff report their decisions to the investment committees of the board, the board cannot override their decisions. Delaware PERS takes a slightly different approach, but the concept is the same. The board's investment committee includes only two members of the board, including the chairman. The rest of the members are all investment professionals appointed by the chairman to select and oversee external asset managers, with the assistance of the system's investment consultant.

By comparison in Maryland, even though only 5 of the 14 members of the Board of Trustees have investment experience, statute requires the Investment Division to invest the assets of the system "as the Board of Trustees specifies." Moreover, the Investment Committee of the board consists of 13 members, which appears to be unusually large. Ten of the 13 members are also members of the Board of Trustees, which raises the issue of the necessity for a separate committee. Additionally, less than half of the members of the Investment Committee have investment expertise (6 of the 13 members). Recent experience has shown that the full board has generally followed the recommendations of the Investment Committee. The unique model could be another reason that recruiting and retaining qualified investment division staff has been problematic.

In recent years, the board has considered requesting independent salary authority and exemption from the State's position cap for SRA's investment division (among other positions). In a November 2006 letter to the Joint Committee on Pensions, former Comptroller, William Donald Schaeffer, then the chairman of the Board of Trustees, again made the case for independent salary authority and exemption from the hiring cap. Given the findings of the McLagan report and our review of neighboring retirement systems, DLS finds these proposals to be reasonable, but not sufficient. **DLS recommends that independent salary and hiring authority for the investment division be considered as part of a package of reforms that includes performance-based compensation policies for investment staff and an enhanced role for investment professionals in managing and overseeing the system's assets, in line with structures used in neighboring states. The board is asked to comment on the need for governance and staffing reforms.**

2. Board Again Recommends Ending the Corridor Funding Method

In response to the deteriorating funded status of both the teachers' and employees' combined retirement and pension systems, the Board of Trustees voted for the second consecutive year to express its "grave concern" about the continued use of the corridor funding method, and to urge the General Assembly to discontinue its use. Chapter 440 of 2002 established the corridor funding method to mitigate the effects of fluctuations in market returns on employer contribution rates by spreading those effects over five years. The corridor method froze employer contribution rates for the employees' and teachers' systems at their fiscal 2002 levels as long as the two systems remained actuarially funded between 90 and 110%. Once the plans fall out of their corridors, employer contributions increase by one-fifth of the difference between the prior year's rate and the "true" actuarial rate required to fully fund the systems. Fiscal 2008 will be the third straight year that both systems remain outside their respective corridors.

Appendix 5 shows that the combined systems funded status dropped substantially, due in large part to the pension benefit enhancement enacted in 2006. In the absence of the corridor method, the exhibit shows that the employer contribution rates for fiscal 2008 would be 12.78% for the teachers' combined systems and 12.27% for the employees' combined systems. The difference between these rates and the corridor rates of 11.60 and 8.86%, respectively, would require additional State contributions of $165 million in fiscal 2008, according to the system's actuary.

Prior to the 2006 enhancement, an actuarial analysis conducted by Milliman, the system's previous actuary, projected that the State pension system would achieve full actuarial funding by 2033 under both the corridor method and with full actuarial funding. The main difference between these two approaches is that the employer contribution rate under the corridor would be less than the full actuarial rate for about 10 years, after which the corridor rate would exceed the full actuarial rate. There has been no comparable actuarial analysis performed since the 2006 benefit enhancement to project the effects of the enhancement on the system's funded status and contribution rates under both funding methods. **DLS recommends that the agency conduct a similar actuarial analysis to gauge the effects of the enhancement on the system's funded status and contribution rates, with and without the corridor method. It should report its findings to the budget committees and the Joint Committee on Pensions.**

Recommended Actions

		Amount Reduction	
1.	Delete two contractual positions from the Information Technology Division. These positions were approved by the Department of Budget and Management to address a short-term programming backlog in the agency, due in part to the extra work generated by the 2006 benefit enhancement. They should not be needed in fiscal 2008.	$ 125,539	SF
2.	Reduce funds for travel. The fiscal 2008 travel allowance grows by $196,078 (148%) over the fiscal 2007 working appropriation to expand the number of conferences and training opportunities that staff and board members may attend, and to allow investment staff to meet more frequently with asset managers. This level of growth seems excessive, even given the expanding number of private equity asset managers. The reduction still allows the travel allowance to grow by $76,000 (52%) over fiscal 2007 levels.	128,000	SF

3. Add the following language:

,<u>provided that this appropriation may be increased by no more than $1,100,000 by approved budget amendment. Agency requirements in addition to this amount should be addressed by requesting a deficiency appropriation at the 2008 session.</u>

Explanation: The State Retirement Agency submitted budget amendments in 2005 and 2006 that represented more than 20% of its legislative appropriation. Expenditures funded through these amendments, especially those related to the Maryland Pension Administration System project, were mostly for expenses that could have been foreseen during the legislative session when the General Assembly had the opportunity to debate the merits of the agency's total budget. This language caps fiscal 2008 amendments at 5% of the agency's allowance.

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

,<u>provided that $5,762,456 of this deficiency appropriation may not be expended until the State Retirement Agency hires a regular project manager for the Maryland Pension</u>

Administration System (MPAS) and a regular chief information officer, completes an independent verification and validation (IV&V) review of the MPAS design and architecture, and provides a copy of the written IV&V report to the budget committees. The budget committees shall have 45 days from the date of receipt of the IV&V report to review it. It is the intent of the General Assembly that the agency procure an IV&V contractor through the Department of Budget and Management's Consulting and Technical Services contract.

Explanation: The Maryland Pension Administration System project has been proceeding despite vacancies in key agency positions, most notably executive director, chief information officer, and MPAS project manager. Moreover, the project's design has not been reviewed by external experts to determine whether it presents the best alternative for addressing the agency's needs and is technically sound. The language leaves in place $150,000 to pay for IV&V but makes the rest of the deficiency appropriation contingent on filling two of the vacant positions and completing an IV&V on the MPAS design and architecture.

Information Request	**Author**	**Due Date**
MPAS IV&V report	IV&V contractor to the State Retirement Agency	Open

Total Special Fund Reductions **$ 253,539**

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets

State Retirement Agency
($ in Thousands)

	General Fund	Special Fund	Federal Fund	Reimb. Fund	Total
Fiscal 2006					
Legislative Appropriation	$0	$20,097	$0	$0	$20,097
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	8,146	0	0	8,146
Reversions and Cancellations	0	-648	0	0	-648
Actual Expenditures	**$0**	**$27,595**	**$0**	**$0**	**$27,595**
Fiscal 2007					
Legislative Appropriation	$0	$21,826	$0	$0	$21,826
Budget Amendments	0	190	0	0	190
Working Appropriation	**$0**	**$22,016**	**$0**	**$0**	**$22,016**

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

Fiscal 2006

- A special fund budget amendment totaling $7,783,000 was approved in fiscal 2006 to pay for the bulk the agency's two-year, $11.2 million contract with Saber, Inc. to develop and implement Phase 1 of the Maryland Pension Administration System, subject to the agency's statutory spending limit.

- Additional special fund budget amendments approved in fiscal 2006 totaled $363,202. These paid for an outside vendor to conduct an agency audit of local governments that are participating governmental units within the State Retirement and Pension System ($200,000), and the 1.5% COLA adjustment approved by the legislature during the 2005 session ($163,202).

Fiscal 2007

- A special fund budget amendment approved in fiscal 2007 provided $190,349 for the COLA adjustment approved by the legislature during the 2006 session.

Appendix 2

Audit Findings

Audit Period for Last Audit:	July 1, 2002 – November 30, 2005
Issue Date:	April 2006
Number of Findings:	1
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

Finding 1: Security review processes and related security reporting for the system's information technology system were found to be inadequate. The Office of Legislative Audits recommended that procedures be established to provide adequate controls over the information technology security reviews and reports, and provided detailed recommendations toward that end.

Object/Fund Difference Report
State Retirement Agency

Object/Fund	FY06 Actual	FY07 Working Appropriation	FY08 Allowance	FY07 - FY08 Amount Change	Percent Change
Positions					
01 Regular	172.00	187.00	189.00	2.00	1.1%
02 Contractual	19.74	16.00	16.00	0	0%
Total Positions	**191.74**	**203.00**	**205.00**	**2.00**	**1.0%**
Objects					
01 Salaries and Wages	$ 11,533,867	$ 12,664,025	$ 12,491,395	-$ 172,630	-1.4%
02 Technical and Spec Fees	1,246,031	1,640,924	1,766,397	125,473	7.6%
03 Communication	849,423	1,001,671	682,376	-319,295	-31.9%
04 Travel	142,637	132,416	328,494	196,078	148.1%
07 Motor Vehicles	125,181	130,318	146,587	16,269	12.5%
08 Contractual Services	11,651,449	4,447,965	4,718,373	270,408	6.1%
09 Supplies and Materials	175,500	181,323	203,800	22,477	12.4%
10 Equip – Replacement	129,671	80,894	89,227	8,333	10.3%
11 Equip – Additional	80,717	51,245	55,500	4,255	8.3%
13 Fixed Charges	1,660,996	1,685,340	1,798,126	112,786	6.7%
Total Objects	**$ 27,595,472**	**$ 22,016,121**	**$ 22,280,275**	**$ 264,154**	**1.2%**
Funds					
03 Special Fund	$ 27,595,472	$ 22,016,121	$ 22,280,275	$ 264,154	1.2%
Total Funds	**$ 27,595,472**	**$ 22,016,121**	**$ 22,280,275**	**$ 264,154**	**1.2%**

Note: The fiscal 2007 appropriation does not include deficiencies, and the fiscal 2008 allowance does not reflect contingent reductions.

Appendix 3

Fiscal Summary
State Retirement Agency

Program/Unit	FY06 Actual	FY07 Wrk Approp	FY08 Allowance	Change	FY07 - FY08 % Change
01 State Retirement Agency	$ 19,812,472	$ 22,016,121	$ 22,280,275	$ 264,154	1.2%
02 Major Information Technology Development Projects	7,783,000	0	0	0	0%
Total Expenditures	**$ 27,595,472**	**$ 22,016,121**	**$ 22,280,275**	**$ 264,154**	**1.2%**
Special Fund	$ 27,595,472	$ 22,016,121	$ 22,280,275	$ 264,154	1.2%
Total Appropriations	**$ 27,595,472**	**$ 22,016,121**	**$ 22,280,275**	**$ 264,154**	**1.2%**

Note: The fiscal 2007 appropriation does not include deficiencies, and the fiscal 2008 allowance does not reflect contingent reductions.

Fiscal 2006 and 2007 Employer Contribution Rates and Actuarial Funding Levels

Plan	Fiscal 2008 Corridor Rate Enhanced	Fiscal 2008 Corridor Rate Pre-enhancement	Fiscal 2008 Actuarial Rate Enhanced	Fiscal 2008 Actuarial Rate Pre-enhancement	Fiscal 2008 Funding Level Enhanced	Fiscal 2008 Funding Level Pre-enhancement	Fiscal 2007 Corridor Rate	Fiscal 2007 Actuarial Rate	Fiscal 2007 Funding Level
Teachers	11.60%	10.00%	12.78%	11.18%	84.2%	89.7%	9.71%	11.17%	89.3%
Employees	8.86%	7.68%	12.27%	11.09%	80.6%	85.6%	6.83%	11.11%	84.9%
State Police			15.44%		98.2%			13.83%	100.3%
Judges			44.12%		77.6%			42.43%	79.3%
LEOPS			41.74%		62.8%			40.60%	57.7%
Combined System	**11.1%**		**13.0%**		**83.3%**	**88.3%**	**9.18%**	**11.58%**	**87.8%**

Source: Segal Company

Appendix 5

Summary of State Membership Data by Plan

Fiscal 2002-2006

	Total	Teachers' Retirement	Teachers' Pension	Employees' Retirement	Employees' Pension	Judges' Retirement	State Police Retirement	LEOPs
From 7/1/01 to 6/30/02								
Active Members	190,123	9,270	87,086	11,722	78,584	28	1,589	1,410
Average Annual Salary	$41,383	$65,175	$42,704	$40,135	$36,728	$113,253	$52,323	$46,749
Retired Members	87,367	29,989	11,931	4,904	18,205	311	1,598	403
Average Annual Retirement Allowance	$15,945	$23,510	$12,788	$13,285	$6,894	$55,377	$32,334	$24,028
Vested Former Members	44,355	1,643	16,397	1,331	24,845	10	27	66
From 7/1/02 to 6/30/03								
Active Members	190,021	8,199	89,099	11,347	77,939	287	1,542	1,481
Average Annual Salary	$42,808	$67,755	$44,520	$40,723	$38,004	$115,571	$52,424	$46,907
Retired Members	90,803	30,305	13,370	24,662	19,929	306	1,695	503
Average Annual Retirement Allowance	$16,278	$24,156	$13,128	$13,728	$7,284	$56,112	$33,444	$24,804
Vested Former Members	45,573	1,577	17,284	1,349	25,212	13	41	62
From 7/1/03 to 6/30/04								
Active Members	185,861	7,197	88,765	10,489	75,955	283	1,445	1,675
Average Annual Salary	$44,169	$69,819	$46,337	$41,801	$39,024	$117,137	$53,655	$46,942
Retired Members	94,880	30,598	15,093	24,559	21,913	309	1,790	581
Average Annual Retirement Allowance	$16,785	$25,064	$13,704	$14,343	$7,795	$56,761	$34,822	$26,085
Vested Former Members	46,911	1,478	18,327	1,311	25,626	14	44	81
From 7/1/04 to 6/30/05								
Active Members	188,050	6,255	91,535	9,869	76,787	282	1,439	1,826
Average Annual Salary	$47,163	$74,291	$50,152	$42,934	$41,509	$120,206	$53,934	$48,700
Retired Members	100,196	30,921	17,170	24,633	24,525	316	1,909	708
Average Annual Retirement Allowance	$17,269	$26,066	$14,171	$15,025	$8,321	$58,454	$36,005	$27,534
Vested Former Members	47,664	1,351	18,792	1,291	26,058	15	47	104
From 7/1/05 to 6/30/06								
Active Members	191,273	5,449	94,869	10,121	76,979	296	1,441	2,063
Average Annual Salary	$48,557	$75,950	$51,179	$46,222	$43,198	$121,416	$55,967	$51,706
Retired Members	103,831	31,138	19,141	24,271	26,216	330	1,937	782
Average Annual Retirement Allowance	$17,916	$27,253	$14,892	$15,732	$8,904	$61,020	$38,844	$17,412
Vested Former Members	49,310	1,229	19,824	1,258	26,805	14	58	115