G50L00
Maryland Supplemental Retirement Plans

Operating Budget Data

($ in Thousands)

	FY 09 Actual	FY 10 Working	FY 11 Allowance	FY 10-11 Change	% Change Prior Year
Special Fund	$1,437	$1,479	$1,528	$49	3.3%
Contingent & Back of Bill Reductions	0	0	-32	-32	
Adjusted Special Fund	**$1,437**	**$1,479**	**$1,496**	**$17**	**1.2%**
Adjusted Grand Total	**$1,437**	**$1,479**	**$1,496**	**$17**	**1.2%**

Note: For purposes of illustration, the Department of Legislative Services has estimated the distribution of selected across-the-board reductions. The actual allocations are to be developed by the Administration.

- The fiscal 2011 allowance increases by $17,200 over the fiscal 2010 working appropriation, with personnel expenditure increases for higher retirement contributions and rising health insurance costs comprising nearly all of the change.

Personnel Data

	FY 09 Actual	FY 10 Working	FY 11 Allowance	FY 10-11 Change
Regular Positions	14.00	14.00	14.00	0.00
Contractual FTEs	0.00	0.00	0.00	0.00
Total Personnel	**14.00**	**14.00**	**14.00**	**0.00**
Vacancy Data: Regular Positions				
Turnover and Necessary Vacancies, Excluding New Positions		0.43	3.07%	
Positions and Percentage Vacant as of 12/31/09		0.0	0.0%	

- There are no regular or contractual position changes in the allowance, and the agency currently has no vacant positions.

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

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Analysis in Brief

Major Trends

Financial Crisis Alters Employee Use Patterns of the Plans: Current Managing for Results (MFR) measures do not provide enough information to reflect the volatility of membership activity like that seen during the financial crisis. **The agency should comment on recent membership trends and the potential enhancement of the MFR submission to include more detailed membership activity figures.**

Plan Investment Returns Exceed Benchmarks: For the third consecutive fiscal year, the plan's investment options have bested the returns of the respective benchmarks.

Issues

Market Downturn, Plan Charges, and Reserve Levels: Market fluctuations have often caused variations in the Board's percent of assets fee structure. The board recently adopted the use of a monthly flat fee supplement that may help stabilize fee intake. **The board should discuss its plan for implementing fee reductions once reserve level targets are met.**

Recommended Actions

1. Concur with Governor's allowance.

Updates

Special Legislative Audit of Investments: The Office of Legislative Audits performed a special review of the Maryland Supplemental Retirement Plans' oversight of the Investment Contract Pool. The agency has enhanced its monitoring and reporting of this investment option in response to concerns over clarity of financial disclosures.

Operating Budget Analysis

Program Description

Title 35 of the State Personnel and Pensions Article established the Teachers' and State Employees' Supplemental Retirement Plans and a board of trustees to administer them. The board of trustees has the responsibility of administering the State's:

- Deferred Compensation Program pursuant to Internal Revenue Code (IRC) Section 457;

- Tax-deferred Annuity Program for Educational Employees under IRC Section 403(b);

- Savings and Investment Program under IRC Section 401(k); and

- Employer Matching Plan under IRC Section 401(a).

The Maryland Supplemental Retirement Plans (MSRP) staff provides education programs and support information to State employees and human resource personnel in State agencies. These efforts are designed to create awareness among State employees of the need and mechanisms available to save for their own retirement. Staff also support the board's work in selecting investment options and overseeing the operation.

MSRP finances operations through a fee imposed on members' accounts, based on a percentage of assets in the plans. For fiscal 2010, the board fee is 0.05% of assets, but an additional monthly per account charge of $0.50 will be instituted in May 2010. In addition, the board contracts with Nationwide Retirement Solutions, Inc., (Nationwide) for administration of all four plans. The fee charged by Nationwide is 0.14% of assets. Therefore, the combined asset fee paid by participants is 0.19% plus the supplementary charge. The charges are detailed in the Issues section.

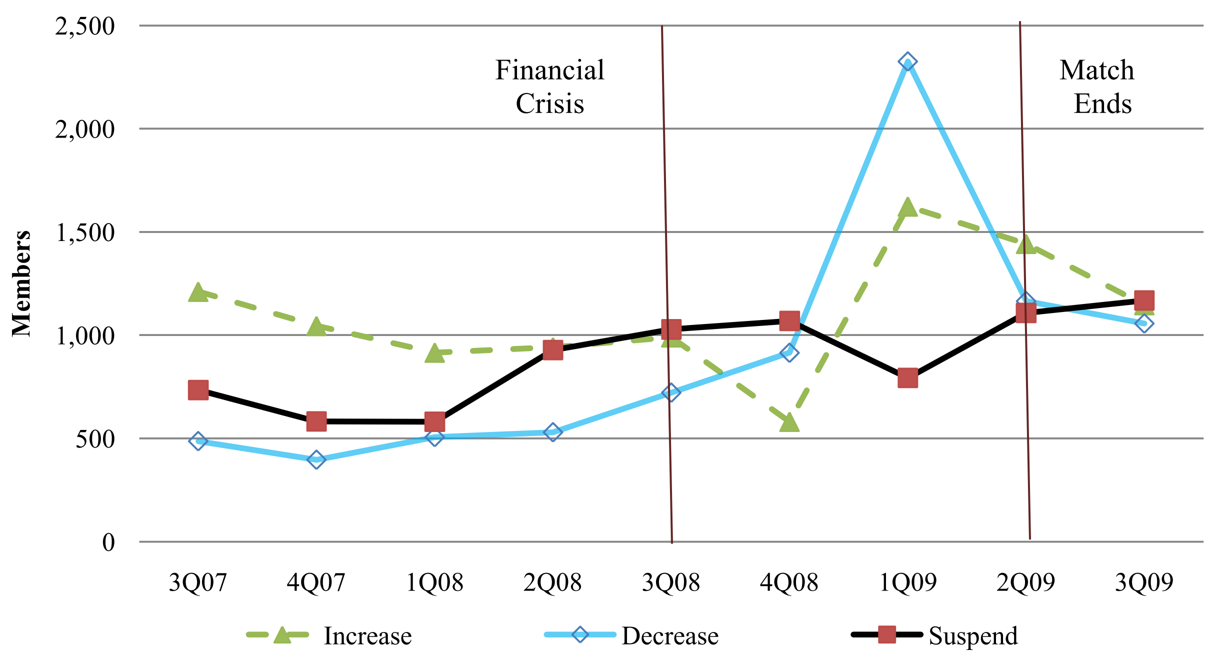
Performance Analysis: Managing for Results

With day-to-day administration and management of the plans handled by Nationwide, the agency's two primary goals are to (1) provide clear and complete information about the plans to employees to help cultivate informed decisions about participation; and (2) provide effective long-term investment opportunities for participants. With respect to the first goal, the agency has established a goal of 85% participation in the plans by eligible State employees. The current Managing for Results (MFR) measures show steady membership totals and a modest decline in participation levels, which remain below MSRP's stated goals. However, given the turmoil in the financial markets, further detail not contained in the MFR statistics is needed to shed light onto the recent state of this agency.

Financial Crisis Alters Employee Use Patterns of the Plans

Exhibit 1 tracks the usage of MSRP account holders from June 2007 to October 2009 on a quarterly, calendar year basis. Prior to fall 2008, fairly static numbers of MSRP clients increased, decreased, or completely suspended contributions each quarter. In the wake of the financial crisis, this stability was interrupted. For example, the number of employees decreasing the amount they contributed to their supplemental retirement accounts spiked, from 530 members in the second quarter of 2008 to 2,326 in the first quarter of 2009, with over 1,000 additional participants lowering their deferrals in the subsequent quarters for which data is available. These decreases occurred at a time when U.S equities lost over 50% of their value, between the third quarter of 2008 and the second quarter of 2009.

Exhibit 1
Maryland Supplemental Retirement Plans Account Activity
Calendar Year Quarters 2007-2009



Source: Maryland Supplemental Retirement Plans; Nationwide

After the end of the second quarter of 2009, Chapter 487 of 2009 (the Budget Reconciliation and Financing Act (BRFA)of 2009) came into effect, suspending the State's match program for fiscal 2010. This initiative matches all eligible employee deferrals with State contributions of up to $600 into a 401 (a) account. The match is also proposed to be suspended for fiscal 2011 through the BRFA of 2010. During the first quarter without the match in fiscal 2010, the number of MSRP participants decreasing or suspending deferrals remained relatively stable. This signals the paramount importance of investment returns to those that choose to supplement their retirement savings through the plans vis-à-vis the availability of the match. However, the total number of members having suspended or decreased referrals in the most recent quarter may indicate the impact of the match's absence, as they are nearly twice those seen in 2007 and early 2008, when the matching funds were available. **Given these two substantial shifts in the supplemental retirement investment environment, the agency should comment on recent membership trends and the potential enhancement of its MFR submission to include more detailed membership activity figures.**

These membership and deferral changes directly impact the agency's budget because the decline in assets associated with decreased or suspended deferrals lowers the revenue that the agency receives for operations. Lags in revenue from the percent of assets charged required additional charges to be levied to members in fiscal 2009 and again in fiscal 2010, as will be described in the Issues section.

Plan Investment Returns Exceed Benchmarks

Exhibit 2 provides a snapshot of the composite returns generated by MSRP's investment options as of June 30, 2009, and compares the returns to the benchmark indices against which the mutual funds are measured. Comparable figures are provided from fiscal 2007 and 2008. In fiscal 2009, the plan posted a single year negative return of -21%, due to declines in the financial markets. The MSRP offerings, however, beat the benchmarks across the board, as they have since fiscal 2007. **Appendix 3** offers a fund-by-fund perspective of these options, comparing the performance of each fund available to participants against its own benchmark index, as of September 2009.

Exhibit 2
MSRP Average Rates of Return
Fiscal 2007-2009

Annual Average Rates of Return as of June 30, 2009	**One Year**	**Three Years**	**Five Years**	**Ten Years**
MSRP Options	-21.0%	-4.9%	1.2%	3.2%
Benchmark Indices	-21.8%	-5.8%	0.2%	1.3%
Annual Average Rates of Return as of June 30, 2008	**One Year**	**Three Years**	**Five Years**	**Ten Years**
MSRP Options	-8.9%	6.2%	10.0%	6.0%
Benchmark Indices	-9.2%	5.9%	9.6%	5.3%
Annual Average Rates of Return as of June 30, 2007	**One Year**	**Three Years**	**Five Years**	**Ten Years**
MSRP Options	18.2%	12.9%	12.2%	10.1%
Benchmark Indices	17.4%	12.4%	12.1%	8.1%

MSRP: Maryland Supplemental Retirement Plans

Source: Maryland Supplemental Retirement Plans

Fiscal 2010 Actions

Impact of Cost Containment

The August 2009 cost containment action reduced the MSRP appropriation by $27,350, the entirety of which represented salary savings from furloughs.

Proposed Budget

As shown in **Exhibit 3**, the primary increases in the allowance are for personnel expenses, the largest of which was retirement contribution growth of $15,100.

In other operating expense categories, the department reduced expenditures by a net of $9,600. Growth in rent paid to the Department of General Service, cell phone usage, and postage was offset by decreased expenditures for management consultant fees, telecommunication hardware, and computer software.

Impact of Cost Containment

The fiscal 2011 budget reflects several across-the-board actions to be allocated by the Administration. This includes a combination of employee furloughs and government shut-down days similar to the plan adopted in fiscal 2010; a reduction in overtime based on accident leave management; streamlining of State operations; hiring freeze and attrition savings; a change in the injured workers' settlement policy and administrative costs; and a savings in health insurance to reflect a balance in that account. For purposes of illustration, the Department of Legislative Services has estimated the distribution of selected actions relating to employee furloughs and health insurance.

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

How Much It Grows:	Special Fund	Total
2010 Working Appropriation	$1,479	$1,479
2011 Allowance	1,528	1,528
Amount Change	$49	$49
Percent Change	3.3%	3.3%
Contingent Reductions	-$32	-$32
Adjusted Change	$17	$17
Adjusted Percent Change	1.2%	1.2%

Where It Goes:	
Personnel Expenses	
Retirement contributions	$15
Salary-related adjustments	11
Employee and retiree health insurance	3
Turnover adjustments	-6
Other fringe benefit adjustments	4
Other Changes	
Contracts	-8
Training and Employee Awards	-5
Other	3
Total	**$17**

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

Issues

1. Market Downturn, Plan Charges, and Reserve Levels

The board receives funds for operating expenditures through a percentage charge on user accounts. These fees are based on a percentage of the asset base, so the revenue generated is subject to market fluctuations. As seen in **Exhibit 4,** the board's fee as a percentage of assets has remained at 0.05% of assets throughout the market turmoil of the past two years. However, steep declines in asset values and steady agency expenditures have prompted the board to instead recur to *ad hoc* supplemental account charges to bring revenues in line with expenditures over the past two fiscal years.

For fiscal 2009, the board approved a $3 charge in May 2009 in response to depleted reserves. The board considers cash reserves of 25.0% of annual operating expense to be the level necessary to safeguard operational continuity. This was not the first time that the board's fee structure has resulted in a series of charges to fees. In fiscal 2002 and 2003, in response to overall poor market returns, the board imposed a flat per account fee of $8 and $6, respectively, to meet revenue shortfalls. Subsequently, it increased its asset-based charge from 0.06% in fiscal 2002 to 0.11% in fiscal 2003.

Exhibit 4
Assets and Participants' Fees and Agency Operating Budgets
Fiscal 2007-2011

	2007	2008	2009	2010 (Est.)	2011 (Est.)
Invested Assets ($ in Billions)	$2.50	$2.33	$2.02	$2.24	$2.37
Nationwide Fees	$5,125,018	$4,649,862	$3,014,920	$3,118,103	$3,324,000
as Percent of Assets	*0.23%*	*0.23%/0.14%*[1]	*0.14%*	*0.14%*	*0.14%*
Board Fees, Interest, Adjustments	$1,158,166	$1,253,098	$1,153,949	$1,070,571	$1,187,200
Fiscal 2009 $3 Charge	-	-	$204,006	-	-
$0.50 Monthly Charge May 2010 Onward	-	-	-	$65,000	$390,000
as Percent of Assets	*0.05%*	*0.05%*	*0.05%*	*0.05%*	*0.05%*
Operating Expenses	$1,311,258	$1,383,759	$1,436,942	$1,479,028	$1,496,165
Carryover Balance	$670,772	$546,152	$467,165	$123,708	$204,743
Carryover Balance as Percent of Operating Expenses	*51.2%*	*39.5%*	*32.5%*	*8.4%*	*13.7%*

[1] New administrator's contract ratified January 30, 2008, reduced Nationwide fee to 0.14%.

Source: Maryland Supplemental Retirement Plans; Department of Legislative Services

Attempt to Stabilize Revenue Model

A new approach is now being taken that seeks to temper the frequent changes to fees that unpredictable market conditions can have on the board's charge mechanism. The board approved a recurring $0.50 cent per month, per account, charge to all 457, 401(k), and 403(b) plan accounts at its February 2010 meeting. The charge begins in May 2010 and will remain in place for the nearly 65,000 affected accounts until the board is confident that assets have grown enough to warrant its elimination.

The one-time fiscal 2009 charge yielded $204,006. MSRP calculations estimate that the new charge will provide the agency with approximately $32,500 per month, or $390,000 per year if account totals remain constant. As Exhibit 4 shows, under this model, the reserves on hand are projected to fall to 8.4% of operating expenditures at the end of fiscal 2010. However, because the flat charge provides a reliable source of income, the reserve should rise to over $204,000 by the end of fiscal 2011, even with modest projections for asset base growth from assumed investment returns. In fact, MSRP staff states that it may be more prudent to leave the monthly $0.50 cent charge intact and drop the larger 0.05% fee as asset values grow in time as a means of stabilizing the board's revenue.

The blending of revenue methods should increase stability, but the motivation of building the reserve should be articulated by the board in policy. A requirement that the board, at the meeting following the event of its reserve levels having reached 25% of operating expenses, must decide upon a plan to adjust its charges downward would help protect users from fee creep. **The board should discuss its plan for implementing fee reductions once reserve level targets are met.**

Recommended Actions

1. Concur with Governor's allowance.

Updates

1. Special Legislative Audit of Investments

In October 2009, the Office of Legislative Audits (OLA) released a review of MSRP's oversight of the investment offerings it makes available to employees that utilize its various deferred compensation plans. The principal concern of this special audit, which was initiated because of a call to OLA's fraud hotline, was that MSRP did not adequately disclose unrealized losses of the Maryland Investment Contract Pool (ICP) investments in its reports. OLA stated that the agency should disclose the actual dollar amount and fair value of ICP unrealized gains or losses in its plan participant material and financial statements.

MSRP's reply indicated that its disclosure procedures were within industry standards, but that it had taken steps to enhance the plan's transparency to further comply with OLA concerns. The first step undertaken by the board of the plan was to hire an independent consultant in July 2009 to review ICP disclosure material. The consultant's report concluded that the wrapper disclosure information for MSRP users was appropriate and, in fact, contained more information than similar material of other similar plans, thus ratifying the results of a comparable March 2009 report on the issue by the board's regular investment consultant.

In terms of disclosing dollar values rather than percentage values of losses, MSRP is developing plain language descriptions of wrapper exposure to clarify the potential losses involved in ICP wrapper agreements. An agency concern that prevented such disclosure, such as posting ICP dollar loss values, was that these might be interpreted as an attempt to influence participant investment behavior, which could be alleged to violate certain contract provisions. The independent consultant's final recommendation was that the disclosure should remain unchanged. MSRP states that publishing the percentage values of wrapper exposure is the appropriate industry standard for this information because percentages can be applied to a participant's individual account balance to calculate the risk associated with one's investments. Dollar changes across the entire plan would not provide this indication.

Finally, the board has enacted a 22-point compliance matrix to provide the augmented oversight stressed by the audit. The compliance monitoring includes issue reviews and periodic reporting on ICP activity by MSRP staff, its investment managers, and pertinent outside consultants to address topics discussed by OLA. Critical oversight such as custodian bank validation reports, credit ranking calculation verification, and benchmark investment performance comparisons are now on a defined schedule for review by staff, the board, and its committees, although much of this activity was undertaken previous to the audit in a less coordinated fashion.

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 2009					
Legislative Appropriation	$0	$1,492	$0	$0	$1,492
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	17	0	0	17
Cost Containment	0	-21	0	0	-21
Reversions and Cancellations	0	-52	0	0	-52
Actual Expenditures	**$0**	**$1,437**	**$0**	**$0**	**$1,437**
Fiscal 2010					
Legislative Appropriation	$0	$1,506	$0	$0	$1,506
Cost Containment	0	-27	0	0	-27
Budget Amendments	0	0	0	0	0
Working Appropriation	**$0**	**$1,479**	**$0**	**$0**	**$1,479**

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

Fiscal 2009

- A special fund amendment transferred $17,234 to MSRP for the 2% cost-of-living adjustment that was centrally budgeted in the Department of Budget and Management.

- As part of the June 2008 and March 2009 cost containment actions, $21,382 of the commission's special fund appropriation was reduced from salaries.

- A cancelation of $51,192 was processed at closeout, primarily representing the special fund cost savings from employee salaries reduced via furloughs.

Fiscal 2010

- The cost containment action of August 2009 reduced the MSRP appropriation by $27,354 to represent savings from employee furloughs.

Appendix 2

Audit Findings

Audit Period for Last Audit:	October 19, 2006 – January 7, 2009
Issue Date:	November 2009
Number of Findings:	2
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	

Finding 1: MSRP had not published the award of two contracts valued at approximately $19.8 million on *eMaryland Marketplace*, as required. During fiscal 2007 and 2008, MSRP awarded two contracts for retirement plan administration and audit services valued at approximately $19.5 million and $260,000, respectively, that were not published on *eMaryland Marketplace*.

Finding 2: MSRP did not adequately document efforts to monitor certain aspects of the ICP. This item is discussed in detail in the Updates section.

*Bold denotes item repeated in full or part from preceding audit report.

Appendix 3

MSRP Investment Performance Compared with Benchmark Indices
As of September 2009

	One-year		Three-year		Five-year	
Mutual Funds	vs. Index	vs. Median	vs. Index	vs. Median	vs. Index	vs. Median
Vanguard Prime Money Market	✓	×	✓	✓	✓	✓
PIMCO Total Return Fund	✓	✓	✓	✓	✓	✓
Fidelity Puritan Fund	✓	×	×	×	✓	✓
Neuberger Berman Equity Fund	✓	✓	✓	✓	✓	✓
Goldman Sachs Large Cap Value	✓	✓	✓	✓	✓	✓
Growth Fund of America	×	✓	×	✓	✓	✓
T. Rowe Price Mid-Cap Value	✓	✓	✓	✓	✓	✓
Van Kampen Midcap Growth Fund	✓	✓	✓	✓	✓	✓
T. Rowe Price Small Cap Stock	✓	✓	✓	✓	✓	✓
EuroPacific Growth Fund	✓	✓	✓	✓	✓	✓
Other Funds						
Maryland Investment Contract Pool	✓	×	✓	×	✓	×
Nationwide Fixed Annuity	✓	×	×	✓	✓	✓
T. Rowe Price Retirement Income	✓	✓	✓	✓	✓	✓

✓ Fund Equaled or Beat Benchmark Index × Fund Underperformed Benchmark Index

Note: Vanguard Small Cap Value Index Fund, Vanguard Value Index Fund, Dreyfus MidCap Index Fund, Vanguard Small Cap Growth Index Fund, Vanguard Institutional Index Fund are all designed to track indexes, therefore, benchmarking is inappropriate. The lone index not to track with its target was the Vanguard Total International Stock Fund in the one-year measurement period.

Source: Mercer

Object/Fund Difference Report
Maryland Supplemental Retirement Plans

Object/Fund	FY09 Actual	FY10 Working Appropriation	FY11 Allowance	FY10 - FY11 Amount Change	Percent Change
Positions					
01 Regular	14.00	14.00	14.00	0	0%
Total Positions	**14.00**	**14.00**	**14.00**	**0**	**0%**
Objects					
01 Salaries and Wages	$ 1,029,774	$ 1,048,100	$ 1,106,923	$ 58,823	5.6%
02 Technical and Spec. Fees	2,740	6,500	1,500	-5,000	-76.9%
03 Communication	21,734	22,556	22,391	-165	-0.7%
04 Travel	17,323	19,557	19,900	343	1.8%
07 Motor Vehicles	11,802	11,760	11,760	0	0%
08 Contractual Services	233,814	240,918	233,270	-7,648	-3.2%
09 Supplies and Materials	11,458	12,300	11,300	-1,000	-8.1%
10 Equipment – Replacement	3,596	700	700	0	0%
11 Equipment – Additional	284	5,400	5,400	0	0%
13 Fixed Charges	104,417	111,237	115,021	3,784	3.4%
Total Objects	**$ 1,436,942**	**$ 1,479,028**	**$ 1,528,165**	**$ 49,137**	**3.3%**
Funds					
03 Special Fund	$ 1,436,942	$ 1,479,028	$ 1,528,165	$ 49,137	3.3%
Total Funds	**$ 1,436,942**	**$ 1,479,028**	**$ 1,528,165**	**$ 49,137**	**3.3%**

Note: The fiscal 2010 appropriation does not include deficiencies.