G50L00
Maryland Supplemental Retirement Plans

Operating Budget Data

($ in Thousands)

	FY 10 Actual	FY 11 Working	FY 12 Allowance	FY 11-12 Change	% Change Prior Year
Special Fund	$1,476	$1,496	$1,562	$66	4.4%
Contingent & Back of Bill Reductions	0	0	-12	-12	
Adjusted Special Fund	**$1,476**	**$1,496**	**$1,550**	**$54**	**3.6%**
Adjusted Grand Total	**$1,476**	**$1,496**	**$1,550**	**$54**	**3.6%**

- A deficiency of $41,000 is included for the fiscal 2011 appropriation to fund the replacement of the office's network system, firewall, and related computer equipment.

- The fiscal 2012 allowance grows by $54,000 over the fiscal 2011 working appropriation as personnel expenditures increase by $64,000 and other operational spending falls by $10,000.

Personnel Data

	FY 10 Actual	FY 11 Working	FY 12 Allowance	FY 11-12 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	0.14	1.00%
Positions and Percentage Vacant as of 12/31/10	0.00	0.00%

- There are no regular or contractual position changes in the allowance, but 1 senior accounting position will be abolished as part of the Voluntary Separation Program.

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

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Analysis in Brief

Major Trends

Employee Use Patterns Stabilize at Lower Level after Financial Crisis: The volatility of membership activity experienced during the economic downturn appears to have passed and a new, slightly lower level of member activity in the plans has emerged. **The agency should comment on its strategy to induce account holders that do not make deferrals to begin contributing again in light of the absence of the State match program for the foreseeable future.**

Plan Investment Returns Exceed Benchmarks: The rebounding economy helped yield an average rate of return across all plan investment options of 16.3%, once again exceeding the board's benchmark indices.

Recommended Actions

1. Concur with Governor's allowance.

Updates

Balance and Revenues Approaching Board Policy Targets: The adoption of a blended charge that combines a percentage of assets levy with a $0.50 per month flat fee has stabilized the plans' fiscal posture and will shortly yield a balance that reflects board policy.

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 supports 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 along with a newly instituted flat-rate monthly charge. For fiscal 2011, the board fee is composed of two parts, a 0.05% of assets charge and an additional monthly per account charge of $0.50. 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.

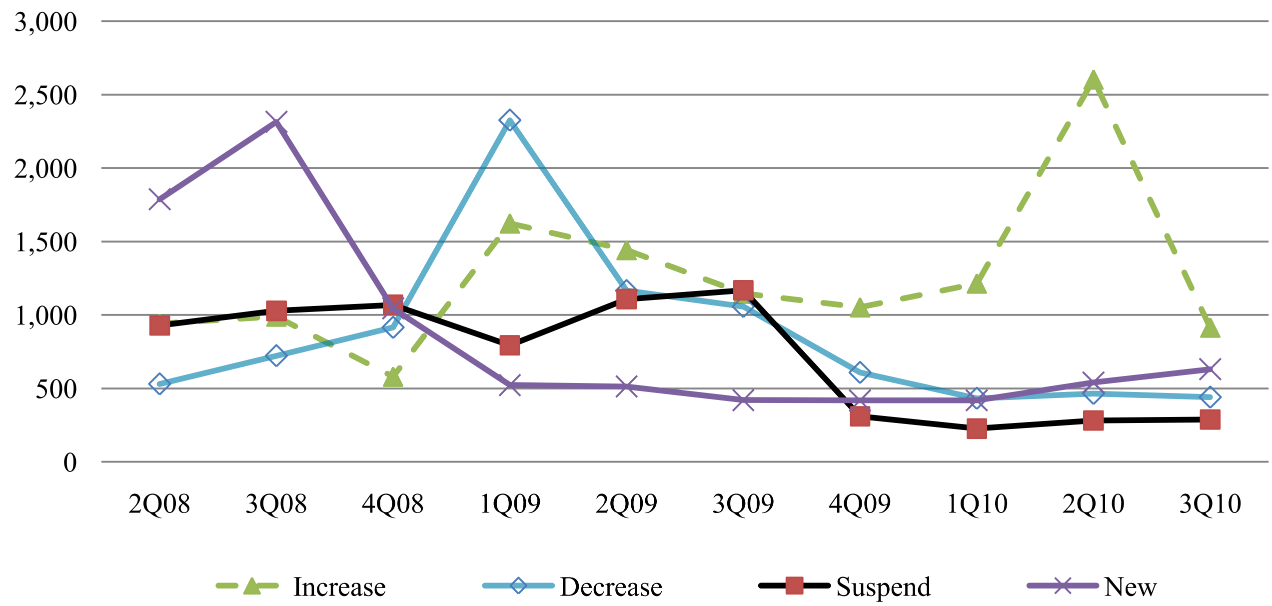
Performance Analysis: Managing for Results

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, in the aftermath of the recent turmoil in the financial markets, member behavior detail not contained in the MFR statistics provides greater insight into the usage of the plans by State employees.

Employee Use Patterns Stabilize at Lower Level after Financial Crisis

Exhibit 1 tracks the usage of MSRP account holders from July 2008 to October 2010 on a quarterly, calendar year basis. The 2008 to 2009 financial crisis interrupted the stability of member usage patterns in the plans. New membership fell dramatically as the State severely restricted hiring, while the uncertain economic climate caused many members to decrease their contributions into the various investment offerings provided by MSRP. Also, Chapter 487 of 2009 (the Budget Reconciliation and Financing Act of 2009) began the indefinite suspension of the State's match program, further depressing the incentives to employees of contributing into their supplemental retirement accounts.

Exhibit 1
MSRP Account Activity
Calendar Year Quarters 2008-2010



MSRP: Maryland Supplemental Retirement Plans

Source: Maryland Supplemental Retirement Plans; Nationwide

Yet, the most recent data points indicate a stabilization of member activities in the plan, while providing a positive outlook for MSRP's financial posture. The number of employees suspending deferrals altogether has been at 310 members or below for an entire year and those decreasing their contributions have been below 500 members for three straight quarters. Because the quarterly figures are not cumulative, those employees who have stopped payroll deductions into their accounts at some point will not be counted again in the statistics, except if their behavior changes toward enhanced participation in the plans. To that point, the number of increased deferrals spiked at the end of fiscal 2010 (the second quarter of the calendar year) before falling to levels more consistent with historical patterns.

Given that total membership has only dropped by 3,312 from fiscal 2007 through 2011, and much of that can be attributed to the shrinkage of the State workforce and less frequent turnover, the volatility experienced during the economic downturn appears to have passed, and a new, slightly lower level of member activity in the plan has emerged. The main challenge facing the agency is how to convince the participants who are no longer deferring, a cohort whose ranks have grown by 4,109 since fiscal 2007, to renew their contributions into the plans. **The agency should comment on its strategy to induce account holders that do not make deferrals to begin contributing again in light of the absence of the State match program for the foreseeable future.**

Plan Investment Returns Exceed Benchmarks

Exhibit 2 provides a snapshot of the composite returns generated by MSRP's investment options as of June 30, 2010, and compares the returns to the benchmark indices against which the mutual funds are measured. Comparable figures are provided from fiscal 2008 and 2009. In fiscal 2010, the plan posted a single year return of 16.3%, due to resurgent asset values after the large declines in the financial markets during fiscal 2008 and 2009. The MSRP offerings, however, beat the benchmarks across the board, as they have since fiscal 2007. **Appendix 2** 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 2010.

Exhibit 2
MSRP Average Rates of Return
Fiscal 2008-2010

Annual Average Rates of Return as of June 30, 2010

	1 Year	3 Years	5 Years	10 Years
MSRP Options	16.3%	-5.9%	2.2%	3.7%
Benchmark Indices	15.2%	-6.6%	1.3%	2.0%

Annual Average Rates of Return as of June 30, 2009

	1 Year	3 Years	5 Years	10 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

	1 Year	3 Years	5 Years	10 Years
MSRP Options	-8.9%	6.2%	10.0%	6.0%
Benchmark Indices	-9.2%	5.9%	9.6%	5.3%

MSRP: Maryland Supplemental Retirement Plans

Source: Maryland Supplemental Retirement Plans

Fiscal 2011 Actions

Proposed Deficiency

A deficiency of $41,000 is included for the fiscal 2011 appropriation to fund the replacement of the office's network system, firewall, and related computer equipment.

Proposed Budget

As shown in **Exhibit 3**, the majority of expenditure increases in the allowance are for personnel-related items. The restoration of furlough-reduced salaries increases costs by $25,465, and the turnover offset for MSRP has been decreased by $19,434, further freeing up funds to restore salaries and reflecting the absence of vacant positions in the agency. Also, higher employee and retiree health insurance costs add $4,025 and growing required contributions to employee retirement add $13,551 to the budget. These fringe benefit adjustments are net of the Administration's proposed reductions.

Among operational expenditures, greater expenditures for contractual services ($3,851) and rent paid to the Department of General Services ($2,691) are more than offset by reduced expenditures for equipment replacement ($6,100), travel ($5,900), and supplies ($5,300).

Impact of Cost Containment

The fiscal 2012 budget reflects several across-the-board actions. In fiscal 2012, this agency's share of the reduction is $4,653 in special funds for changes in employee health insurance. Reductions contingent upon statutory changes include $7,703 in special funds for retiree prescription drug benefits. A senior accounting specialist position will be abolished as part of the Voluntary Separation Program, with a combined salary and fringe benefit value of $71,385.

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

How Much It Grows:	Special Fund	Total
2011 Working Appropriation	$1,496	$1,496
2012 Allowance	1,562	1,562
Amount Change	$66	$66
Percent Change	4.4%	4.4%
Contingent Reductions	-$12	-$12
Adjusted Change	$54	$54
Adjusted Percent Change	3.6%	3.6%

Where It Goes:

Personnel Expenses	
Restoration of furlough and other salary adjustments	$25
Turnover adjustments	19
Retirement contributions net of proposed changes	14
Employee and retiree health insurance net of plan alterations	4
Other fringe benefit adjustments	2
Other Changes	
Legal, fiscal, and technology contractual services	4
Rent	3
Supplies and materials	-5
Travel expenditures	-6
Equipment replacement	-6
Total	**$54**

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

Recommended Actions

1. Concur with Governor's allowance.

Updates

1. Balance and Revenues Approaching Board Policy Targets

The board has traditionally received 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 prompted the board to recur to *ad hoc* supplemental account charges to bring revenues in line with expenditures in each of the past two fiscal years. In order to end frequent changes to fees that unpredictable market conditions require, the board instituted a recurring $0.50 cent per month, per account, charge to all 457, 401(k), and 403(b) plan accounts in May 2010. The blending of revenue methods has indeed increased stability in the plans' fiscal posture, as discussed during the 2010 session.

Exhibit 4
Assets and Participants' Fees and Agency Operating Budgets
Fiscal 2008-2012

	2008	2009	2010	2011 (Est.)	2012 (Est.)
Invested Assets ($ in Billions)	$2.33	$2.02	$2.24	$2.58	$2.68
Nationwide Fees	$4,649,862	$3,014,920	$3,319,031	$3,454,000	$3,592,000
as Percent of Assets	*0.23%/0.14%*[1]	*0.14%*	*0.14%*	*0.14%*	*0.14%*
Board Fees, Interest, Adjustments	$1,253,098	$1,153,949	$1,097,962	$1,204,000	$1,253,000
Fiscal 2009 $3 Charge	-	$204,006	-	-	-
$0.50 Monthly Charge May 2010 Onward	-	-	$63,537	$377,800	$377,800
as Percent of Assets	*0.05%*	*0.05%*	*0.05%*	*0.05%*	*0.05%*
Operating Expenses	$1,383,759	$1,436,942	$1,472,736	$1,501,446	$1,523,000
Carryover Balance	$546,152	$467,165	$155,928	$236,282	$344,082
Carryover Balance as Percent of Operating Expenses	*39.5%*	*32.5%*	*10.6%*	*15.7%*	*22.6%*

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

Source: Maryland Supplemental Retirement Plans; Department of Legislative Services

The board considers cash reserves of 25.0% of MSRP's annual operating expense to be the optimal level necessary to safeguard operational continuity. As the exhibit shows, the balance reached a low point during fiscal 2010 when its holdings represented just 10.6% of expenditures. The balance total would have been even lower had the new monthly charge not provided $63,537 in the final two months of the year to ensure that the plans had the required resources to operate. Going forward, when asset values grow as they have in fiscal 2010 and thus far in fiscal 2011, the agency's receipts from the percentage of assets charge will rise. In this case, after the balance has reached its target 25.0% level, the board has prepared a process by which it would provide a fee holiday to account holders on its percentage charge at the end of any given fiscal year where projected revenues will exceed the total funding required to operate the plans.

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 2010					
Legislative Appropriation	$0	$1,506	$0	$0	$1,506
Deficiency Appropriation	0	0	0	0	0
Budget Amendments	0	0	0	0	0
Cost Containment	0	-27	0	0	-27
Reversions and Cancellations	0	-3	0	0	-3
Actual Expenditures	**$0**	**$1,476**	**$0**	**$0**	**$1,476**
Fiscal 2011					
Legislative Appropriation	$0	$1,496	$0	$0	$1,496
Budget Amendments	0	0	0	0	0
Working Appropriation	**$0**	**$1,496**	**$0**	**$0**	**$1,496**

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

Fiscal 2010

- The cost containment action of August 2009 reduced the fiscal 2010 MSRP appropriation by $27,354 to represent savings from employee furloughs.

Appendix 2

MSRP Investment Performance Compared with Benchmark Indices
As of September 2010

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

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

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Note: Vanguard Small Cap Value Index Fund, Vanguard Value Index Fund, Dreyfus MidCap Index Fund, Vanguard Small Cap Growth Index Fund, and Vanguard Institutional Index Fund are all designed to track indexes, so 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	FY 10 Actual	FY 11 Working Appropriation	FY 12 Allowance	FY 11 - FY 12 Amount Change	Percent Change
Positions					
01 Regular	14.00	14.00	14.00	0.00	0%
Total Positions	**14.00**	**14.00**	**14.00**	**0.00**	**0%**
Objects					
01 Salaries and Wages	$ 1,079,950	$ 1,074,704	$ 1,151,473	$ 76,769	7.1%
02 Technical and Spec. Fees	4,368	1,500	1,500	0	0%
03 Communication	14,012	22,391	22,876	485	2.2%
04 Travel	13,415	19,900	14,000	-5,900	-29.6%
07 Motor Vehicles	9,685	11,760	11,760	0	0%
08 Contractual Services	231,864	233,270	236,851	3,581	1.5%
09 Supplies and Materials	4,193	11,300	6,000	-5,300	-46.9%
10 Equipment – Replacement	3,316	700	0	-700	-100.0%
11 Equipment – Additional	0	5,400	0	-5,400	-100.0%
13 Fixed Charges	115,027	115,021	117,502	2,481	2.2%
Total Objects	**$ 1,475,830**	**$ 1,495,946**	**$ 1,561,962**	**$ 66,016**	**4.4%**
Funds					
03 Special Fund	$ 1,475,830	$ 1,495,946	$ 1,561,962	$ 66,016	4.4%
Total Funds	**$ 1,475,830**	**$ 1,495,946**	**$ 1,561,962**	**$ 66,016**	**4.4%**

Note: The fiscal 2011 appropriation does not include deficiencies. The fiscal 2012 allowance does not include contingent reductions.