

G50L00
Maryland Supplemental Retirement Plans

Operating Budget Data

(\$ in Thousands)

	<u>FY 11</u> <u>Actual</u>	<u>FY 12</u> <u>Working</u>	<u>FY 13</u> <u>Allowance</u>	<u>FY 12-13</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Special Fund	\$1,525	\$1,510	\$1,499	-\$11	-0.7%
Adjusted Special Fund	\$1,525	\$1,510	\$1,499	-\$11	-0.7%
Adjusted Grand Total	\$1,525	\$1,510	\$1,499	-\$11	-0.7%

- The fiscal 2013 allowance declines by \$10,718 from the fiscal 2012 working appropriation due to lower expenditures on employee compensation and computer equipment. These decreases are partially offset by increased expenses attributable to statewide administrative cost allocation, management studies and rent.

Personnel Data

	<u>FY 11</u> <u>Actual</u>	<u>FY 12</u> <u>Working</u>	<u>FY 13</u> <u>Allowance</u>	<u>FY 12-13</u> <u>Change</u>
Regular Positions	14.00	13.00	13.00	0.00
Contractual FTEs	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
Total Personnel	14.00	13.00	13.00	0.00

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	0.13	1.00%
Positions and Percentage Vacant as of 12/31/11	0.00	0.00%

- There is no change to the agency's personnel complement. No positions are vacant.

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

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Analysis in Brief

Major Trends

Plans Continue Recuperation of Member Fidelity but Overall Membership Contribution Levels Still Weak: The number of participants decreasing their deferrals or suspending them altogether has leveled off, while the cohort increasing deferrals or starting new accounts has risen in the past year, yet the percentage of participants deferring into their accounts continues to drop. **The Department of Legislative Services asks the agency to comment on its strategy to increase the contributions of members not deferring into their accounts.**

Plan Investment Returns Exceed Benchmarks: The average rates of return on the Maryland Supplemental Retirement Plans investment options exceeded their benchmark indices for the 1-, 3-, 5-, and 10-year periods.

Recommended Actions

1. Concur with Governor's allowance.

Updates

Balance and Revenues Set to Reach Board Policy Target: The recently adopted blended revenue structure for the board's fees should allow agency collections to fund its target reserve levels by the end of fiscal 2012, despite continued market uncertainty.

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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 and a flat-rate monthly charge. For fiscal 2013, the board fee is composed of two parts, a 0.05% of assets charge and a 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, but both the administrator and the fee may change during fiscal 2013 as Nationwide's contract is set to expire on December 31, 2012.

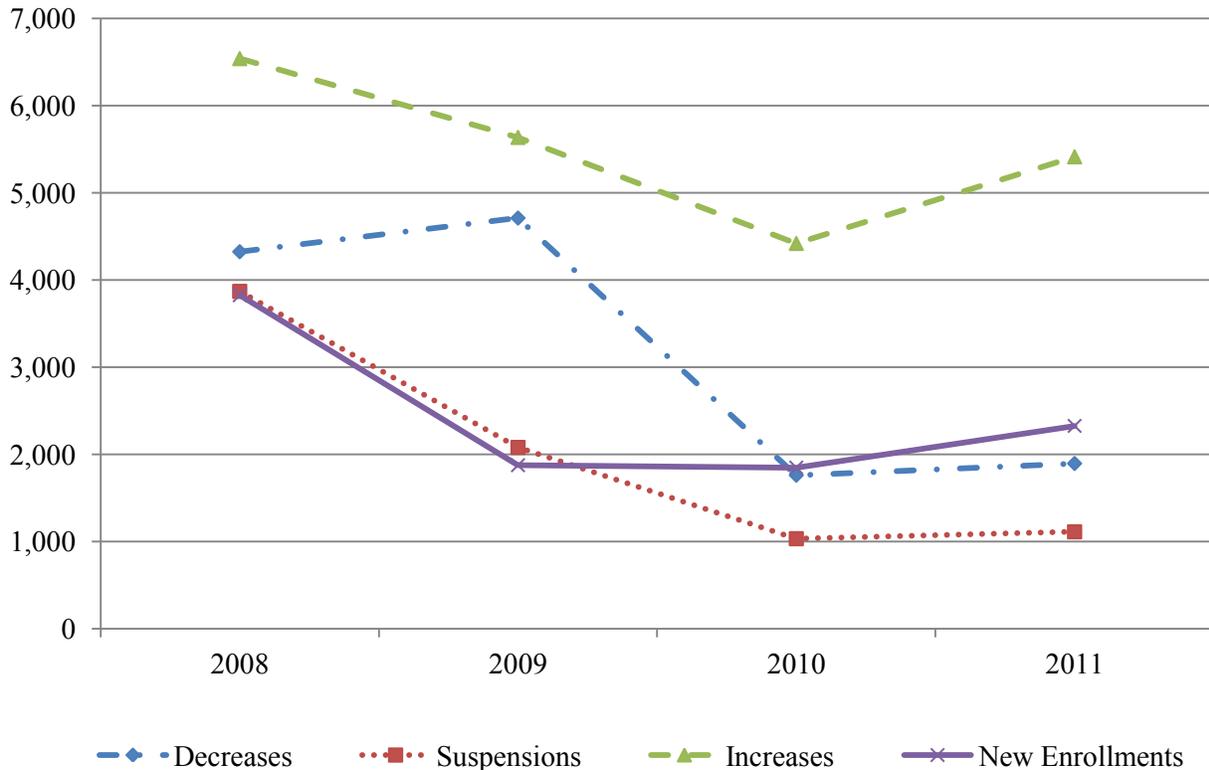
Performance Analysis: Managing for Results

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.

Plans Continue Recuperation of Member Fidelity but Overall Membership Contribution Levels Still Weak

Exhibit 1 tracks the usage patterns of MSRP account holders from calendar 2008 through 2011. This period is significant because it represents member activity before and after the indefinite suspension of the State’s match program, a move that further depressed the incentives to employees of contributing into their supplemental retirement accounts after the high volatility and large losses suffered in the 2008-2009 financial crisis. Continuing the trends reported last session, the number of participants decreasing their deferrals or suspending them altogether has leveled off, while the cohort increasing deferrals or starting new accounts has risen, albeit slightly.

Exhibit 1
MSRP Account Activity
Calendar 2008-2011



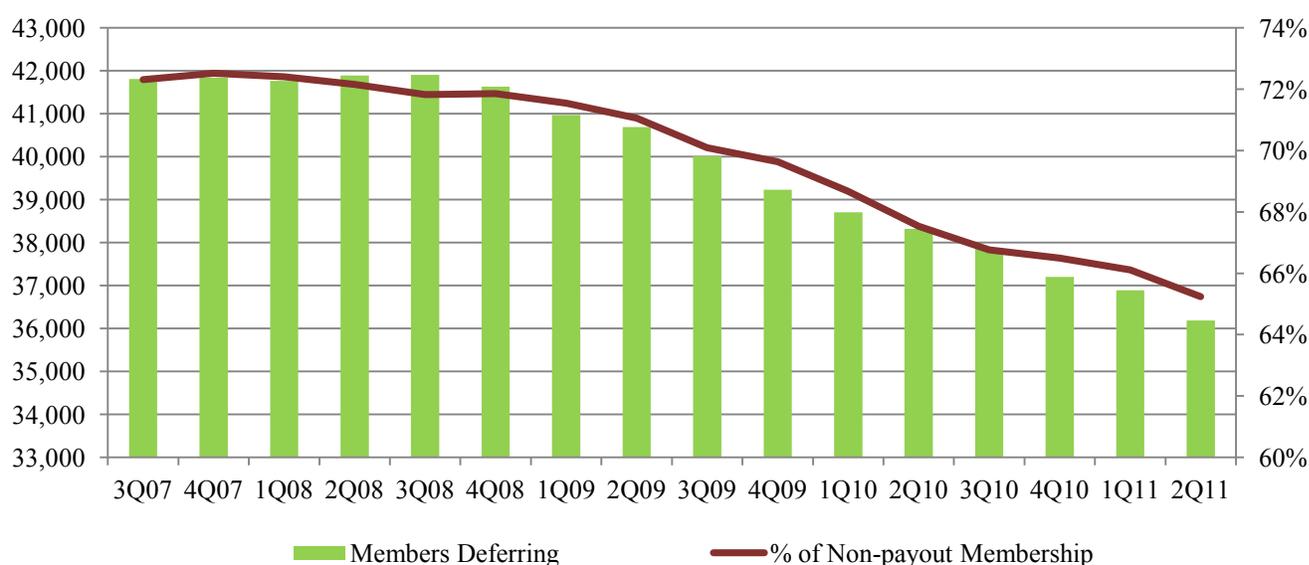
MSRP: Maryland Supplemental Retirement Plans

Source: Maryland Supplemental Retirement Plans, Nationwide

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Illuminating these figures is the composite picture of the accumulated change in behavior for participants who have ceased deferring and leave their accounts untouched. This group would only appear once in Exhibit 1's chart at the time of their suspension of contributions, but the stance of these members holds significant sway over the Plans' holdings as they represent unrealized potential inflows into the MSRP asset base. As **Exhibit 2** shows, the percentage of members deferring into accounts, *i.e.*, those not of retirement age with accounts in payout, has fallen from 72.4% of members in the third quarter of 2007 to 64.3% of the total as of the second quarter of 2011.

Exhibit 2
MSRP Percentage of Members Deferring into Accounts
Calendar Quarters 2007-2011



MSRP: Maryland Supplemental Retirement Plans

Source: Maryland Supplemental Retirement Plans, Nationwide

Combined with this decrease, overall membership has fallen, chiefly due to the slow growth of new members related to the limited hiring of new State employees. Yet, the drop in the percentage of participants deferring into their accounts is of greater magnitude in this measure than that of total membership. Over the timeframe examined, the third quarter of 2007 to the second quarter of 2011, total membership fell by 2.6%, down from 57,738 to 56,243, whereas the number of members deferring dropped from 41,805 to 36,184, a decline of 13.4%. The inactivity of existing members has the potential to be directly expanded by the agency's marketing outreach, whereas overall membership, while capable of being influenced, depends to a much greater degree on the hiring patterns of eligible State agencies. **So, the Department of Legislative Services asks the agency to comment on its strategy to increase the contributions of members not deferring into their accounts.**

Plan Investment Returns Exceed Benchmarks

Exhibit 3 provides a snapshot of the composite returns generated by MSRP’s investment options as of June 30, 2011, and compares the returns to the benchmark indices against which the funds are measured. Comparable figures are provided from fiscal 2009 and 2010. In fiscal 2011, the plan posted a single year return of 26.9%, due to continued recovery of asset values after the large declines in the financial markets during fiscal 2009. The MSRP offerings beat their benchmarks across the board, as they have since fiscal 2007. Such a performance suggests the board’s fund selection and vigilance with respect to removing underperforming fund managers has been effective, especially given the fact that over 75.0% of the portfolio is held in non-indexed funds with significant potential to stray from a standardized benchmark. **Appendix 2** offers a fund-by-fund perspective, comparing the performance of each fund available to participants against its own benchmark index, as of December 2011.

Exhibit 3 MSRP Average Rates of Return Fiscal 2009-2011

Annual Average Rates of Return as of June 30, 2011				
	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
MSRP Options	26.9%	5.3%	5.0%	6.5%
Benchmark Indices	26.3%	4.3%	4.0%	5.0%

Annual Average Rates of Return as of June 30, 2010				
	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
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				
	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>	<u>10 Years</u>
MSRP Options	-21.0%	-4.9%	1.2%	3.2%
Benchmark Indices	-21.8%	-5.8%	0.2%	1.3%

MSRP: Maryland Supplemental Retirement Plans

Source: Maryland Supplemental Retirement Plans

Proposed Budget

MSRP’s fiscal 2013 allowance declines by \$10,718 from the fiscal 2012 working appropriation. Expenditures on employee compensation decline due to the removal of one-time employee bonus funds worth \$10,492 and lower outlays for employee and retiree health insurance of \$7,098, with retirement contributions offsetting the decline through a planned increase of \$6,996. On the operating side of the ledger, computer equipment expenditures fall by \$13,250 to routine levels after fiscal 2012’s replacement cycle, while increased expenses attributable to statewide cost allocations, management studies, and rent temper the decline in agency outlays.

**Exhibit 4
Proposed Budget
Maryland Supplemental Retirement Plans
(\$ in Thousands)**

How Much It Grows:	<u>Special Fund</u>	<u>Total</u>
2012 Working Appropriation	\$1,510	\$1,510
2013 Allowance	<u>1,499</u>	<u>1,499</u>
Amount Change	-\$11	-\$11
Percent Change	-0.7%	-0.7%
 Contingent Reductions	 \$0	 \$0
Adjusted Change	-\$11	-\$11
Adjusted Percent Change	-0.7%	-0.7%
 Where It Goes:		
Personnel Expenses		
Retirement contributions.....		\$7
Salary adjustments		-3
Employee and retiree health insurance		-7
Bonus funds		-10
Other fringe benefit adjustments.....		-2
Other Changes		
Statewide Personnel System allocation.....		6
Management studies and consultants.....		5
Equipment rental costs.....		3
Rental expense		3
Computer equipment.....		-13
Total		-\$11

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

Recommended Actions

1. Concur with Governor's allowance.

Updates

1. Balance and Revenues Set to Reach Board Policy Target

The MSRP account management fees charged to users are divided between those levied by the agency and those attributable to the plan administrator. Beginning in May 2010, the MSRP board blended their revenue stream to include both a recurring \$0.50 cent per month, per account, charge to all 457, 401(k), and 403(b) plan accounts and a percentage-based management fee, which has been 0.05% of assets for the past six fiscal years. This combination of fees has increased the stability of the plans' fiscal posture as it provides some revenues that are not subject to market fluctuations while allowing the flexibility for growth as the investment base expands.

As seen in **Exhibit 5**, the turbulence of recent markets has led the agency to forecast a decline in the total value of invested assets for fiscal 2012 and 2013, in spite of member deferrals into their accounts. While the invested asset total at the end of fiscal 2011 was \$2.62 billion, the fiscal 2012 and 2013 amounts are both projected to be below this amount, causing the percentage-based charge to collect less. Yet, because of the per account charge, the agency does not forecast a destabilizing decline in inflows. In fact, the agency's carryover balance is projected to exceed 25% by the end of fiscal 2012. The board considers cash reserves of 25% of MSRP's annual operating expense to be the optimal level necessary to safeguard operational continuity. Given board policy, if the reserve levels indeed exceed the 25% target, account holders would be entitled to a holiday from the monthly account charge. It bears noting that attaining the desired reserve level is also a function of near flat-funded budgets between fiscal 2010 and 2013.

Exhibit 5
Assets and Participants’ Fees and Agency Operating Budgets
Fiscal 2010-2013

	<u>2010</u>	<u>2011</u>	<u>Est.</u> <u>2012</u>	<u>Est.</u> <u>2013</u>
Invested Assets (\$ in Billions)	\$2.24	\$2.62	\$2.52	\$2.58
Plan Administrator Fees*	\$3,319,031	\$3,556,692	\$3,530,380	\$3,614,520
<i>as Percent of Assets</i>	<i>0.14%</i>	<i>0.14%</i>	<i>0.14%</i>	<i>0.14%</i>
Board Fees, Interest, Adjustments	\$1,225,036	\$1,229,892	\$1,183,000	\$1,211,000
\$0.50 Monthly Charge May 2010 Onward	\$63,537	\$376,106	\$373,000	\$373,000
<i>as Percent of Assets</i>	<i>0.05%</i>	<i>0.05%</i>	<i>0.05%</i>	<i>0.05%</i>
Operating Expenses	\$1,472,736	\$1,525,132	\$1,510,175	\$1,499,457
Carryover Balance	\$283,002	\$363,868	\$409,693	\$494,236
<i>Carryover Balance as Percent of Operating Expenses</i>	<i>19.2%</i>	<i>23.9%</i>	<i>27.1%</i>	<i>33.0%</i>

* The current Nationwide contract ends December 31, 2012. Future rates are to be determined. The exhibit assumes no change, but the impending procurement will determine the new rate.

Source: Maryland Supplemental Retirement Plans; Department of Legislative Services

Meanwhile, the plan administrator, Nationwide, charges 0.14% of assets managed. Nationwide’s current five-year administrator contract ends December 31, 2012. Future asset-based administrator charges will be determined by the outcome of the upcoming procurement process. Current market conditions are favorable to MSRP as competition and continued weakness in the financial sector could prompt a reduction of the rates paid by account holders to the selected vendor.

Current and Prior Year Budgets

Current and Prior Year Budgets Maryland Supplemental Retirement Plans (\$ in Thousands)

	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Reimb. Fund</u>	<u>Total</u>
Fiscal 2011					
Legislative Appropriation	\$0	\$1,496	\$0	\$0	\$1,496
Deficiency Appropriation	0	41	0	0	41
Budget Amendments	0	0	0	0	0
Reversions and Cancellations	0	-12	0	0	-12
Actual Expenditures	\$0	\$1,525	\$0	\$0	\$1,525
Fiscal 2012					
Legislative Appropriation	\$0	\$1,480	\$0	\$0	\$1,480
Budget Amendments	0	30	0	0	30
Working Appropriation	\$0	\$1,510	\$0	\$0	\$1,510

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

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Fiscal 2011

- A deficiency appropriation of \$41,000 was added to the agency's fiscal 2011 appropriation to replace its network system, firewall, and other information technology needs.

Fiscal 2012

- The distribution of centrally budgeted funds for a one-time employee bonus of \$750 increased salaries by \$10,492.
- A special fund amendment added \$20,000 to the agency's fiscal 2012 appropriation to complete the information technology upgrades begun in fiscal 2011.

**MSRP Investment Performance Compared with Benchmark Indices
As of December 2011**

<u>Funds</u>	<u>One Year</u>		<u>Three Year</u>		<u>Five Year</u>	
	<u>vs. Index</u>	<u>vs. Median</u>	<u>vs. Index</u>	<u>vs. Median</u>	<u>vs. Index</u>	<u>vs. Median</u>
T. Rowe Price Small Cap Stock	✓	✓	✓	✓	✓	✓
Vanguard Prime Money Market	✓	✓	✓	✓	✓	✓
Parnassus Equity Income	✓	✓	✗	✓	✓	✓
Fidelity Puritan Fund	✗	✓	✓	✓	✗	✓
Morgan Stanley Institutional Trust	✗	✗	✓	✓	✓	✓
T. Rowe Price Retirement Income	✗	✗	✓	✓	✓	✓
T. Rowe Price Mid-Cap Value	✗	✗	✗	✓	✓	✓
PIMCO Total Return Fund	✗	✗	✓	✗	✓	✓
Neuberger Berman Partners Fund	✗	✗	✓	✓	✗	✗
Goldman Sachs Large Cap Value	✗	✗	✗	✗	✗	✗

✓ Fund Equaled or Beat Benchmark Index

✗ Fund Underperformed Benchmark Index

MSRP: Maryland Supplemental Retirement Plans

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.

Source: Segal Advisors

**Object/Fund Difference Report
Maryland Supplemental Retirement Plans**

<u>Object/Fund</u>	<u>FY 11 Actual</u>	<u>FY 12 Working Appropriation</u>	<u>FY 13 Allowance</u>	<u>FY 12 - FY 13 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	14.00	13.00	13.00	0.00	0%
Total Positions	14.00	13.00	13.00	0.00	0%
Objects					
01 Salaries and Wages	\$ 1,072,164	\$ 1,079,686	\$ 1,063,701	-\$ 15,985	-1.5%
02 Technical and Spec. Fees	976	1,500	1,500	0	0%
03 Communication	21,774	22,876	22,087	-789	-3.4%
04 Travel	14,198	14,000	14,000	0	0%
07 Motor Vehicles	10,675	11,760	11,760	0	0%
08 Contractual Services	236,966	236,851	252,904	16,053	6.8%
09 Supplies and Materials	4,447	6,000	6,000	0	0%
10 Equipment – Replacement	947	20,000	4,500	-15,500	-77.5%
11 Equipment – Additional	46,125	0	2,250	2,250	N/A
13 Fixed Charges	116,860	117,502	120,755	3,253	2.8%
Total Objects	\$ 1,525,132	\$ 1,510,175	\$ 1,499,457	-\$ 10,718	-0.7%
Funds					
03 Special Fund	\$ 1,525,132	\$ 1,510,175	\$ 1,499,457	-\$ 10,718	-0.7%
Total Funds	\$ 1,525,132	\$ 1,510,175	\$ 1,499,457	-\$ 10,718	-0.7%

Note: The fiscal 2012 appropriation does not include deficiencies.