

G50L00
Maryland Supplemental Retirement Plans

Operating Budget Data

(\$ in Thousands)

	<u>FY 14</u> <u>Actual</u>	<u>FY 15</u> <u>Working</u>	<u>FY 16</u> <u>Allowance</u>	<u>FY 15-16</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Special Fund	\$1,522	\$1,667	\$1,693	\$26	1.6%
Contingent & Back of Bill Reductions	0	0	-31	-31	
Adjusted Special Fund	\$1,522	\$1,667	\$1,662	-\$4	-0.3%
Adjusted Grand Total	\$1,522	\$1,667	\$1,662	-\$4	-0.3%

Note: The fiscal 2015 working appropriation reflects deficiencies and the Board of Public Works reductions to the extent that they can be identified by program. The fiscal 2016 allowance reflects back of the bill and contingent reductions to the extent that they can be identified by program.

- After factoring in contingent and back of the bill reductions, the Maryland Supplemental Retirement Plans' fiscal 2016 allowance contracts by 0.3% compared with fiscal 2015 levels. Absent those reductions, the agency's budget would grow by 1.6%.
- The fiscal 2016 allowance has no new activities, expenses, or personnel changes.

Personnel Data

	<u>FY 14</u> <u>Actual</u>	<u>FY 15</u> <u>Working</u>	<u>FY 16</u> <u>Allowance</u>	<u>FY 15-16</u> <u>Change</u>
Regular Positions	13.00	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	13.00	13.00	13.00	0.00

Vacancy Data: Regular Positions

Turnover and Necessary Vacancies, Excluding New Positions	0.29	2.22%
Positions and Percentage Vacant as of 12/31/14	n/a	n/a

- The agency's staffing configuration for fiscal 2016 remains unchanged.

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

For further information contact: Michael C. Rubenstein

Phone: (410) 946-5510

Analysis in Brief

Major Trends

Total Participation Stabilizes, Reflects Underlying Eligibility: Although the number of plan participants has declined, so has the number of eligible employees.

Investment Returns Generally Exceed Benchmarks: Strong aggregate performance across investment options belies a small number of weak options.

Issues

Absence of Employer Match Is Hurting Employees' Retirement Savings: Restoration of the employer match in the past resulted in a noticeable increase in the number of employees making deferrals. **The agency should discuss the role that a match might play in encouraging members to save for retirement.**

Recommended Actions

1. Concur with Governor's allowance.

Updates

With Another Fee Holiday, Agency Is on Pace to Reach Appropriate Fund Balance: A fee holiday is scheduled for early calendar 2015 to further reduce the agency's excessive fund balance.

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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 2016, the board fee is composed of two parts: a fee of 0.05% of assets and a monthly per account charge of \$0.50 on every account with at least \$500. In addition, the board contracts with Nationwide Retirement Solutions, Inc., (Nationwide) for administration of all four plans. The Nationwide contract, renewed for five years as of January 1, 2013, provides for a management fee of 0.09% of assets, for a total participant fee of 0.14% of assets.

Performance Analysis: Managing for Results

1. Total Participation Stabilizes, Reflects Underlying Eligibility

As **Exhibit 1** shows, total participation in the retirement savings plans offered by MSRP declined gradually for the last five fiscal years, but stabilized in fiscal 2014, even growing by a handful of participants. Rather than reflecting a decrease in interest in saving for retirement, the decline more likely reflected a decrease in the number of eligible employees due to the contraction in the size of the State workforce. This is demonstrated by the fact that the percentage of eligible participants remained fairly constant throughout that period, even growing slightly in two of the five years. Nevertheless, MSRP's goal of reaching 85% participation has been elusive for many years.

Exhibit 1
Maryland Supplemental Retirement Plans Participation
Fiscal 2007-2014

<u>Year</u>	<u>Total Participants</u>	<u>% Change</u>	<u>% of Eligible</u>
2007	60,477		75%
2008	61,362	1.5%	73%
2009	61,202	-0.3%	75%
2010	60,188	-1.7%	75%
2011	58,993	-2.0%	75%
2012	58,121	-1.5%	76%
2013	57,477	-1.1%	74%
2014	57,486	0.0%	74%

Source: Maryland Supplemental Retirement Plans

As the Governor’s allowance includes an effective salary reduction beginning July 1, 2015, and does not include any step or cost-of-living increases for fiscal 2016, it is possible that the number of participants may once again decline. **The Department of Legislative Services (DLS) recommends that MSRP discuss the strategies that are in place to recruit more employees into the plan.**

2. Investment Returns Generally Exceed Benchmarks

As shown in **Exhibit 2**, except for the three-year return, MSRP options outperformed the benchmark options in fiscal 2014. For the year, MSRP funds gained 20.6%, compared with benchmark performance gaining 19.8%. Compared to plan benchmarks, the 1-, 5-, and 10-year annualized returns for MSRP options continue to outperform plan benchmarks, as they have consistently in recent prior years.

Exhibit 2
MSRP Average Rates of Return
Fiscal 2009-2014

	<u>1-year</u>	<u>3-years</u>	<u>5-years</u>	<u>10-years</u>
Annual Average Rates of Return as of June 30, 2014				
MSRP Options	20.6%	11.8%	15.3%	8.2%
Benchmark Indices	19.8%	11.9%	15.2%	7.6%
Annual Average Rates of Return as of June 30, 2013				
MSRP Options	16.5%	13.8%	6.5%	8.3%
Benchmark Indices	16.3%	14.0%	6.1%	7.7%
Annual Average Rates of Return as of June 30, 2012				
MSRP Options	-0.7%	13.4%	1.5%	7.1%
Benchmark Indices	0.6%	13.2%	0.9%	6.0%
Annual Average Rates of Return as of June 30, 2011				
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				
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				
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

MSRP made no changes in fiscal 2014 to the lineup of investment options available to its members but did approve several changes in the early months of fiscal 2015. Two funds were removed from the performance watch list (Growth Fund of America in September 2013 and Morgan Stanley Institutional Trust in March 2014), leaving no investment funds on the watch list. In addition, Galliard Capital Management took over administration of the stable value fund from Deutsche Asset and Wealth Management in February 2014 following a competitive procurement. Despite not being on the watch list, the board approved the closure of three investment options in September 2014, which will take effect February 2015; one new fund is being added. The three closed funds and the one new fund are all Vanguard funds: Large Cap Value, Small Cap Growth, and Small Cap Value are being closed, and the Small Cap Core Index fund is being added.

Despite being removed from the watch list, **Exhibit 3** shows that both the Morgan Stanley Institutional Trust Fund and the Growth Fund of America, among several others, continue to underperform their benchmarks over multiple time periods. **DLS recommends that the agency discuss the reasons for the underperformance of the funds shown and whether any changes are planned to the menu of investment options. The agency should also discuss the reasons for closing three funds that were not on the watch list.**

Exhibit 3
MSRP Investment Performance Compared with Benchmark Indices
As of September 2014

	<u>One Year</u>	<u>Three Year</u>	<u>Five Year</u>
Bond Funds			
PIMCO Total Return Fund	✘	✓	✓
Vanguard Total Bond Market Index	✓	✓	✓
Balanced Fund			
Fidelity Puritan Fund	✓	✓	✓
Large Cap Stock Funds			
Parnassus Core Equity	✘	✘	✘
American Century Equity Growth	✓	✓	✓
American Funds Growth	✘	✓	✘
Goldman Sachs Large Cap Value	✘	✓	✘
Mid Cap Stock Funds			
Morgan Stanley Institutional Trust	✘	✘	✘
T. Rowe Price Mid Cap Value	✘	✘	✘
Small Cap Stock Fund			
T. Rowe Price Small Cap Stock	✓	✓	✓
International Stock Fund			
American Funds Euro Pacific Growth	✓	✓	✓
Other			
T. Rowe Price Retirement Income	✓	✓	✓

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

MSRP: Maryland Supplemental Retirement Plans

Note: Vanguard Institutional Index Fund, Vanguard Total International Stock Index Fund, and Vanguard Mid Cap Index Fund are all designed to track indices, so benchmarking is inappropriate.

Source: Segal Advisors

Proposed Budget

Once again, the fiscal 2016 allowance is a maintenance budget. As **Exhibit 4** shows, expenditure growth is linked primarily to employee benefits, which is partially offset by the back of the bill reductions to employee compensation. Expenditures for legal services decrease by \$30,000 due to a one-time expenditure in fiscal 2015 for previously unbilled legal services.

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

How Much It Grows:	<u>Special Fund</u>	<u>Total</u>
Fiscal 2014 Actual	\$1,522	\$1,522
Fiscal 2015 Working Appropriation	1,667	1,667
Fiscal 2016 Allowance	<u>1,662</u>	<u>1,662</u>
Fiscal 2015-2016 Amt. Change	-\$4	-\$4
Fiscal 2015-2016 Percent Change	-0.3%	-0.3%

Where It Goes:

Personnel Expenses

Increments and other compensation (prior to cost containment).....	\$17
Section 20: Across-the-board cut to the general salary increase	-19
Section 21: Across-the-board reduction to employee increments	-12
Employee and retiree health insurance.....	37
Turnover adjustments	-23
Other fringe benefit adjustments	20

Other Changes

Legal services.....	-30
Rent	5
Other.....	1
Item.....	0

Total **-\$4**

Note: Numbers may not sum to total due to rounding. The fiscal 2015 working appropriation reflects deficiencies and the Board of Public Works reductions to the extent that they can be identified by program. The fiscal 2016 allowance reflects back of the bill and contingent reductions to the extent that they can be identified by program.

Cost Containment

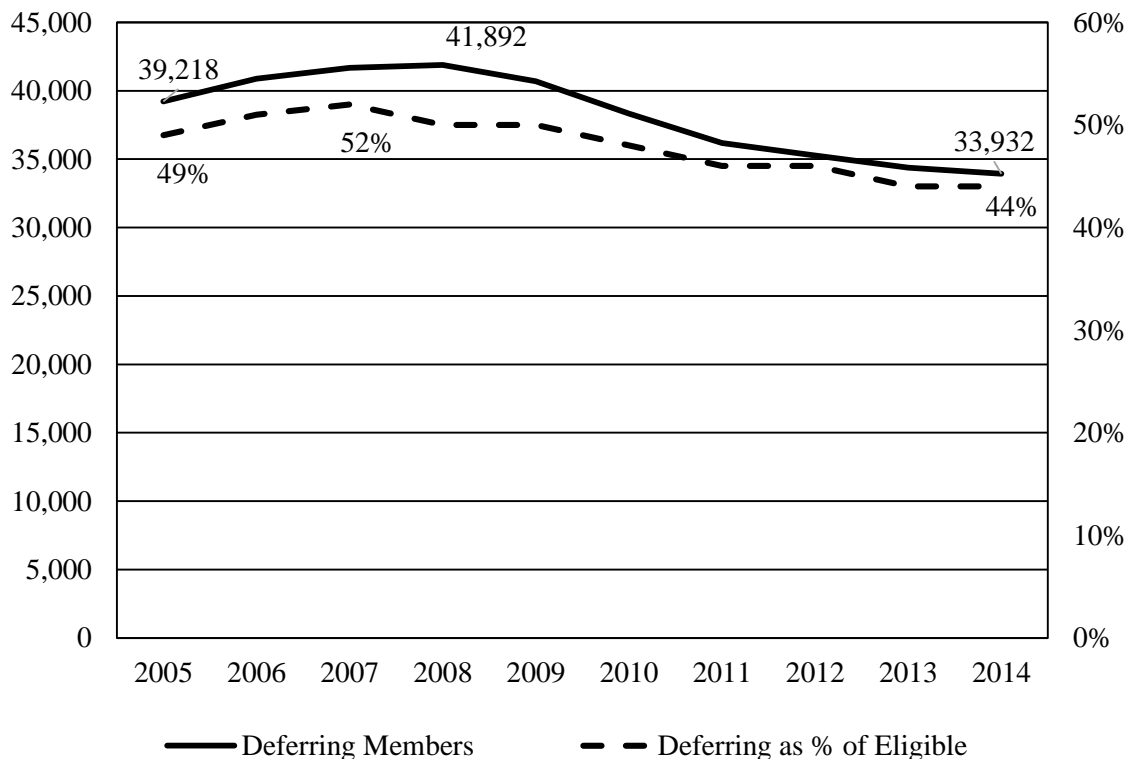
There are two across-the-board reductions in the Governor’s spending plan for the fiscal 2016 allowance, which affects funding for cost-of-living adjustments (COLA) and increments for State employees. The agency’s share of these reductions totals \$30,868 in fiscal 2016. These actions are fully explained in the analysis of the Department of Budget and Management – Personnel.

Issues

1. Absence of Employer Match Is Hurting Employees’ Retirement Savings

Although total membership in MSRP has remained fairly constant as a percentage of eligible employees, the proportion of members who actively defer compensation to their plans has consistently dropped in recent years. **Exhibit 5** shows that both the number and percentage of eligible employees deferring to their plans has dropped steadily, especially since the employer matching contribution up to \$600 was eliminated from the budget in fiscal 2010. During the 2011 session, retirement benefits were reduced for employees hired after June 30, 2011. As a result, newer employees will have to save even more of their compensation in order to receive comparable income when they retire. Exhibit 5 appears to show that fewer rather than more of them are actively saving.

Exhibit 5
Maryland Supplemental Retirement Plans
Members Making Deferrals
Fiscal 2005-2014



Source: Maryland Supplemental Retirement Plans

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Chapter 487 of 2009 (the Budget Reconciliation and Financing Act) temporarily suspended the employer match for fiscal 2010, and Chapter 484 of 2010 (the Budget Reconciliation and Financing Act) eliminated the statutory requirement for a \$600 match altogether, making it a discretionary item in the annual budget. The match has not been funded at any level since the funding mandate was eliminated. For fiscal 2009 and 2010, it was estimated that the elimination of the match saved almost \$24.0 million each year, including \$11.8 and \$14.3 million in general funds, respectively.

Exhibit 5 shows that when the match was restored in fiscal 2006 after being suspended for two years, it had a discernible positive effect on the number and percentage of members actively deferring to their supplemental plans. Due to the greater burden on new State employees to save for retirement and the overall lack of active participation in supplemental retirement plans by State employees, the return of the State match may help employees prepare for a secure retirement given reductions in State benefits. **DLS recommends that the agency discuss the role that a match might play in encouraging members to save for retirement.**

Recommended Actions

1. Concur with Governor's allowance.

Updates

1. With Another Fee Holiday, Agency Is on Pace to Reach Appropriate Fund Balance

In each of the past two fiscal years, a run up in financial markets and a windfall payment from a legal settlement agreement caused MSRP revenues to increase at a much faster pace than its expenditures. This created substantial fund balances well in excess of the board's target of 25% of its operating expenses, as shown in **Exhibit 6**. The board responded with a prolonged fee holiday that lasted for most of calendar 2013, affecting revenues in both fiscal 2013 and 2014. Even with the fee holiday, the fund balance remained slightly above 40% at the conclusion of fiscal 2014, so the board has approved a new three-month fee holiday to begin in February 2015. Based on DLS projections of revenue and expenses, shown in Exhibit 6, the agency should reach its 25% fund balance target by the conclusion of fiscal 2016.

Exhibit 6 Assets and Participants' Fees and Agency Operating Budget Fiscal 2012-2016

	<u>2012</u>	<u>2013*</u>	<u>2014</u>	<u>2015 Est.</u>	<u>2016 Est.</u>
Invested Assets (\$ in Billions)	\$2.64	\$2.94	\$2.80	\$3.31	\$3.50
Plan Administrator Fees	\$3,696,603	\$3,376,326	\$2,520,000	\$2,976,300	\$3,154,500
As Percent of Assets	0.14%	0.115%	0.09%	0.09%	0.09%
Board Asset Fee	\$1,251,220	\$1,010,687	\$922,207	\$1,240,125	\$1,314,375
As Percent of Assets**	0.05%	0.05%	0.05%	0.05%	0.05%
\$0.50 Monthly Charge per Account	\$368,354	\$362,996	\$360,105	\$360,000	\$360,000
One-time Settlement Revenue		\$599,457		\$13,639	
Total Board Revenue	\$1,619,574	\$1,973,140	\$1,282,312	\$1,613,764	\$1,674,375
Operating Expenses	\$1,444,892	\$1,504,309	\$1,521,864	\$1,693,123	\$1,777,779
Carryover Balance	\$382,656	\$851,487	\$611,935	\$532,576	\$429,172
Carryover Balance as Percent of Operating Expenses	26.5%	56.6%	40.2%	31.5%	24.1%

*Management fee of 0.115% represents 0.14% management fee for the first six months of the fiscal year under the expired contract and 0.09% for the final six months of the fiscal year under a new contract that took effect January 1, 2013. Board asset fee remains 0.05% of assets. Fiscal 2011 had a balance of \$207,974 that carried over into fiscal 2012.

**In fiscal 2013, 2014, and 2015, fee holidays have resulted in revenues being less than 0.05%.

Source: Maryland Supplemental Retirement Plans; Department of Legislative Services

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 2014					
Legislative Appropriation	\$0	\$1,527	\$0	\$0	\$1,527
Deficiency Appropriation	0	-22	0	0	-22
Budget Amendments	0	18	0	0	18
Reversions and Cancellations	0	-1	0	0	-1
Actual Expenditures	\$0	\$1,522	\$0	\$0	\$1,522
Fiscal 2015					
Legislative Appropriation	\$0	\$1,627	\$0	\$0	\$1,627
Cost Containment	0	0	0	0	0
Budget Amendments	0	40	0	0	40
Working Appropriation	\$0	\$1,667	\$0	\$0	\$1,667

Note: Numbers may not sum to total due to rounding. The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies.

Fiscal 2014

The distribution of centrally budgeted funds for a 3% employee COLA beginning January 1, 2014, and additional increments increased the agency's special fund expenditures by \$17,675 (\$13,883 for the COLA and \$3,792 for the increments).

Deficiency appropriations contained in the fiscal 2015 budget reduced fiscal 2014 special fund expenditures by a total of \$22,069 for unexpended balances (\$15,155 for employee retirement costs and \$6,914 for employee health insurance costs).

Fiscal 2015

The distribution of centrally budgeted funds for a 2% employee COLA beginning January 1, 2015, increased the agency's special fund expenditures by \$9,917. Expenditures also increased by \$30,000 for previously unbilled legal services.

Audit Findings

Audit Period for Last Audit:	September 16, 2011 – August 19, 2014
Issue Date:	December 2014
Number of Findings:	0
Number of Repeat Findings:	0
% of Repeat Findings:	0%
Rating: (if applicable)	n/a

This audit did not disclose any findings.

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

<u>Object/Fund</u>	<u>FY 14 Actual</u>	<u>FY 15 Working Appropriation</u>	<u>FY 16 Allowance</u>	<u>FY 15 - FY 16 Amount Change</u>	<u>Percent Change</u>
Positions					
01 Regular	13.00	13.00	13.00	0.00	0%
Total Positions	13.00	13.00	13.00	0.00	0%
Objects					
01 Salaries and Wages	\$ 1,082,491	\$ 1,145,354	\$ 1,195,821	\$ 50,467	4.4%
02 Technical and Spec. Fees	6,245	3,850	3,850	0	0%
03 Communication	21,786	20,422	21,514	1,092	5.3%
04 Travel	16,465	20,074	20,074	0	0%
07 Motor Vehicles	9,685	11,760	11,760	0	0%
08 Contractual Services	242,067	312,536	283,042	-29,494	-9.4%
09 Supplies and Materials	12,216	12,000	12,000	0	0%
10 Equipment – Replacement	0	3,300	3,300	0	0%
11 Equipment – Additional	6,322	3,500	3,500	0	0%
13 Fixed Charges	124,587	133,901	138,262	4,361	3.3%
Total Objects	\$ 1,521,864	\$ 1,666,697	\$ 1,693,123	\$ 26,426	1.6%
Funds					
03 Special Fund	\$ 1,521,864	\$ 1,666,697	\$ 1,693,123	\$ 26,426	1.6%
Total Funds	\$ 1,521,864	\$ 1,666,697	\$ 1,693,123	\$ 26,426	1.6%

Note: The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies. The fiscal 2016 allowance does not reflect contingent or across-the-board reductions.

Fiscal Summary
Maryland Supplemental Retirement Plans

<u>Program/Unit</u>	<u>FY 14 Actual</u>	<u>FY 15 Wrk Approp</u>	<u>FY 16 Allowance</u>	<u>Change</u>	<u>FY 15 - FY 16 % Change</u>
01 MD Supplemental Retirement Plan Board and Staff	\$ 1,521,864	\$ 1,666,697	\$ 1,693,123	\$ 26,426	1.6%
Total Expenditures	\$ 1,521,864	\$ 1,666,697	\$ 1,693,123	\$ 26,426	1.6%
Special Fund	\$ 1,521,864	\$ 1,666,697	\$ 1,693,123	\$ 26,426	1.6%
Total Appropriations	\$ 1,521,864	\$ 1,666,697	\$ 1,693,123	\$ 26,426	1.6%

Note: The fiscal 2015 working appropriation does not include January 2015 Board of Public Works reductions and deficiencies. The fiscal 2016 allowance does not reflect contingent or across-the-board reductions.