

G50L00
Maryland Supplemental Retirement Plans

Operating Budget Data

(\$ in Thousands)

	<u>FY 15</u> <u>Actual</u>	<u>FY 16</u> <u>Working</u>	<u>FY 17</u> <u>Allowance</u>	<u>FY 16-17</u> <u>Change</u>	<u>% Change</u> <u>Prior Year</u>
Special Fund	\$1,666	\$1,674	\$1,773	\$99	5.9%
Deficiencies and Reductions	0	0	-4	-4	
Adjusted Special Fund	\$1,666	\$1,674	\$1,769	\$95	5.7%
Adjusted Grand Total	\$1,666	\$1,674	\$1,769	\$95	5.7%

- The fiscal 2017 allowance increases by \$95,000 overall, or 5.7%, over the working appropriation, including a back of the bill reduction in health insurance. The primary driver of the increase is personnel, particularly health insurance and retirement costs.

Personnel Data

	<u>FY 15</u> <u>Actual</u>	<u>FY 16</u> <u>Working</u>	<u>FY 17</u> <u>Allowance</u>	<u>FY 16-17</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	0.31	2.42%
Positions and Percentage Vacant as of 12/31/15	n/a	n/a

- This agency's staffing configuration for fiscal 2017 remains unchanged.

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

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Analysis in Brief

Major Trends

Membership Participation Experiences First Growth Since Fiscal 2008: From fiscal 2009 to 2013, membership participation in the Maryland Supplemental Retirement Plans (MSRP) declined. In fiscal 2014, minor growth in membership began and continued in fiscal 2015, where membership grew by 1.4%.

Investment Returns Remain Close to Plan Benchmarks: Over the past six fiscal years, MSRP investment returns have remained very close to benchmark indices, generally equaling or outperforming in most categories each fiscal year. **The Department of Legislative Services (DLS) recommends that the agency discuss the reasons for the underperformance of the funds shown, particularly Goldman Sachs Large Cap Value and T. Rowe Price Mid-Cap Value funds, and whether any changes are planned to the menu of investment options.**

Issues

Reinstating the State Match Could Improve 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. Restoration of the employer match in the past resulted in a noticeable increase in the number of employees making deferrals. **DLS recommends that the agency discuss the role that a match might play in encouraging members to save for retirement.**

Calendar 2016 Fee Holiday Uncertain: At the November 2015 MSRP Board meeting, the board adopted a four-month Board Asset Fee Holiday that, if markets remain consistent, would begin on March 31, 2016. At the January 2016 MSRP Board meeting, preliminary indications show that plans' assets were down about 6.0% year-to-date. Further decreases in plan assets may not support the full four-month holiday, and close monitoring will continue before announcing a fee holiday. **MSRP should update the committees to the extent possible on potential fee holidays in calendar 2016. Also, MSRP should comment on whether the .05% board asset fee is appropriate given fee holidays over the past three fiscal years to use up fund balances, even with the recent downturn in invested assets.**

Recommended Actions

1. Concur with Governor's allowance.

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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 410(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 resources 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 the 401(k), 457(b), and 403(b) plans; there is no \$0.50 charge on 401(a) match plan accounts. 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. The reported total participant fee includes the \$0.50 charge on specified accounts, plus up to 0.14% of assets on an annual basis.

Performance Analysis: Managing for Results

1. Membership Participation Experiences First Growth Since Fiscal 2008

As shown in **Exhibit 1**, total participation in the retirement savings plans offered by MSRP declined gradually from fiscal 2009 to 2013. The decline likely reflected a decrease in the number of eligible employees due to the contraction in the size of the State workforce rather than a decrease in interest in saving for retirement. This is demonstrated by the fact that the percentage of eligible

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participants remained fairly constant throughout that period despite the decline in participating members. In fiscal 2014, minor growth in membership began and continued in fiscal 2015, where membership grew by 1.4%; MSRP membership has not experienced growth since fiscal 2008. MSRP believes membership growth is the result of a combination of greater efforts to increase knowledge and make enrollment easier and more available to State employees, and favorable market conditions and pay increases. The Governor’s allowance does include step increases for fiscal 2017, thus it is possible that the number of participants may continue to increase slightly.

Exhibit 1
Maryland Supplemental Retirement Plan Participation
Fiscal 2007-2015

<u>Year</u>	<u>Members</u>	<u>% Change</u>	<u>% of Eligible State Employees</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%
2015	58,311	1.4%	74%

Source: Maryland Supplemental Retirement Plans

2. Investment Returns Remain Close to Plan Benchmarks

As shown in **Exhibit 2**, except for the one-year return, MSRP options outperformed or tied benchmarks in fiscal 2015.

Exhibit 2
MSRP Average Rates of Return
Fiscal 2010-2015

	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>	<u>10 Year</u>
Annual Average Rates of Return as of June 30, 2015				
MSRP Options	3.6%	13.0%	12.6%	7.6%
Benchmark Indices	3.8%	12.7%	12.6%	7.0%
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%

MSRP: Maryland Supplemental Retirement Plans

Note: State fiscal years end on June 30. For instance, the annual average rate of return as of June 30, 2010, is associated with the end of fiscal 2010.

Source: Maryland Supplemental Retirement Plans

Compared to plan benchmarks, MSRP options generally outperformed plan benchmarks from fiscal 2010 to 2015. There were four years in which MSRP options underperformed in a single category compared to plan benchmarks; in those years, investment returns only underperformed by a range of -0.1% to -1.3%.

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Exhibit 3 compares MSRP investment performance with benchmark indices as of September 2015. The Morgan Stanley Institutional Trust was removed from the performance watch list in March 2014 but did not perform well enough to be retained. The board selected the Janus Enterprise Fund, which is a Mid Cap Growth type fund, to replace Morgan Stanley in July 2015. The Growth Fund of America was also removed from the watch list in September 2013 and recovered enough to perform like its peers and so was retained. Additionally, the board approved the closure of three investment options in February 2015: Vanguard Large Cap Value, Vanguard Small Cap Value Index Fund, and Vanguard Small Cap Growth Index Fund. The board decided to open a new fund on January 16, 2015: the Vanguard Small Cap Index Fund.

Exhibit 3
MSRP Investment Performance Compared with Benchmark Indices
As of September 2015

	<u>One Year</u>	<u>Three Year</u>	<u>Five Year</u>
Bond Funds			
PIMCO Total Return Fund	x	x	✓
Balanced Fund			
Fidelity Puritan Fund	x	✓	✓
Large Cap Stock Funds			
Parnassus Core Equity	✓	✓	✓
American Century Equity Growth	x	x	✓
American Funds Growth	x	✓	x
Goldman Sachs Large Cap Value	x	x	x
Mid Cap Stock Funds			
Janus Enterprise N	✓	✓	
T. Rowe Price Mid Cap Value	x	x	x
Small Cap Stock Fund			
T. Rowe Price Small Cap Stock	x	✓	✓
International Stock Fund			
American Funds Euro Pacific Growth	✓	✓	✓
Other			
T. Rowe Price Retirement Income	✓	✓	✓

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

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Source: Segal Advisors

The Department of Legislative Services (DLS) recommends that the agency discuss the reasons for the underperformance of the funds shown, particularly Goldman Sachs Large Cap Value and T. Rowe Price Mid Cap Value funds, and whether any changes are planned to the menu of investment options.

Proposed Budget

As shown in **Exhibit 4**, the fiscal 2017 allowance increases by \$95,000 overall, or 5.7%, over the working appropriation, including a back of the bill reduction in health insurance. The primary driver of the increase is personnel, specifically health insurance and retirement costs.

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

How Much It Grows:	<u>Special</u> <u>Fund</u>	<u>Total</u>
Fiscal 2015 Actual	\$1,666	\$1,666
Fiscal 2016 Working Appropriation	1,674	1,674
Fiscal 2017 Allowance	<u>1,769</u>	<u>1,769</u>
Fiscal 2016-2017 Amount Change	\$95	\$95
Fiscal 2016-2017 Percent Change	5.7%	5.7%

Where It Goes:

Personnel Expenses

Employee and retiree health insurance, including a back of the bill reduction	\$61
Employees' retirement system	26
Salaries and other compensation	-4
Turnover adjustments	-3
Other fringe benefit adjustments	1

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Where It Goes:

Other Changes

Shared human resources services.....	15
Shared assistant Attorney General position	8
New audit contract	6
Office equipment and rent	5
Five-year contract for investment consultant services to the MSRP Board.....	-25
Other fringe benefit adjustments.....	5
Total	\$95

MSRP: Maryland Supplemental Retirement Plans

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

Personnel Expenditures

Personnel expenses increase overall by \$81,000. Health insurance increases by \$61,000, including an across-the-board reduction of \$4,348 in special funds included in the fiscal 2017 budget bill based on a revised estimate of the amount of funding needed. Employees’ retirement systems increase by \$26,000. Regular earnings and turnover expectancy decrease by \$7,000 combined.

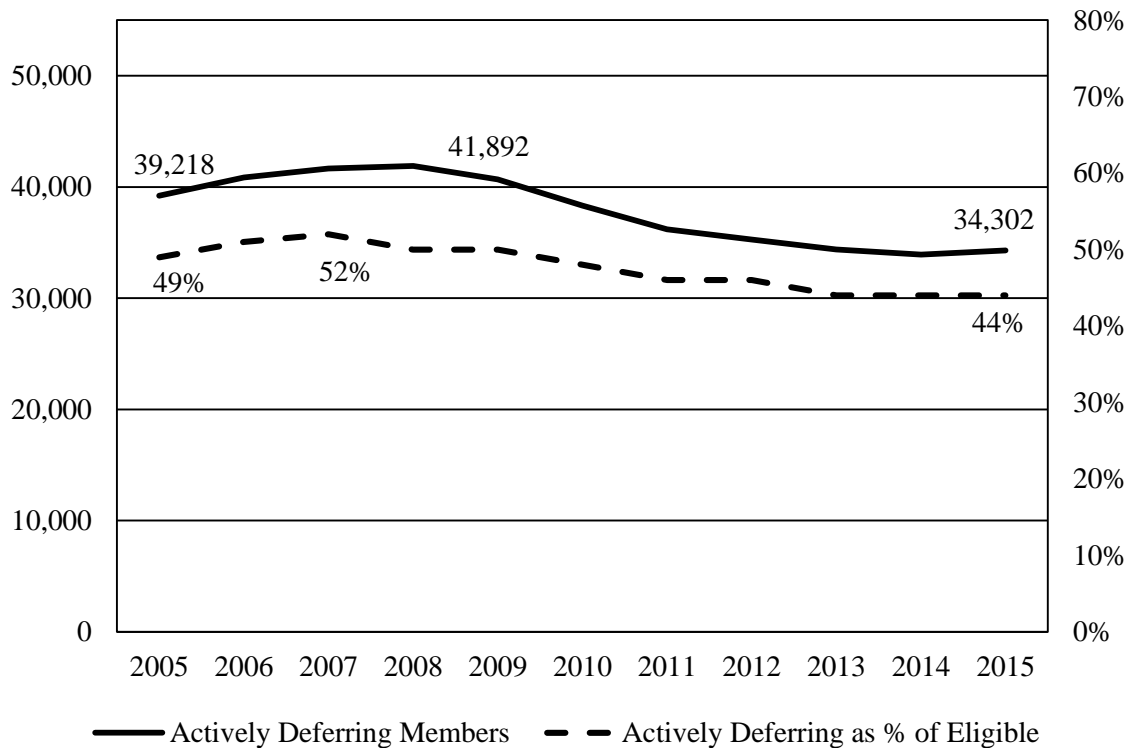
Although not reflective in the MSRP fiscal 2017 budget, \$13,974 in employee increments and associated expenses are expected to be distributed to the agency by budget amendment at the start of the fiscal year. Currently, increments for agencies are included in the Department of Budget and Management’s budget. There is also an across-the-board reduction to abolish positions statewide, but the amounts have not been allocated by agency.

Issues

1. Reinstating the State Match Could Improve 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; fiscal 2015 shows a slight increase in deferring members from a low in fiscal 2014.

Exhibit 5
Maryland Supplemental Retirement Plans
Members Actively Making Deferrals
Fiscal 2005-2015



Source: Maryland Supplemental Retirement Plans

After being suspended in fiscal 2004 and 2005, Exhibit 5 shows that when the match was restored in fiscal 2006 it had a discernible positive effect on the number and percentage of members actively deferring to their supplemental plans. Chapter 484 of 2010 (the Budget Reconciliation and Financing Act) eliminated the statutory requirement for a \$600 match, making it a discretionary item in the annual budget, and the match has not been funded at any level since the funding mandate was eliminated. 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, but fewer rather than more of them appear to be actively saving. 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.

2. Calendar 2016 Fee Holiday Uncertain

In recent 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 fee holidays that affected revenues from fiscal 2013 to 2015. Even with the fee holiday, the fund balance remained slightly above the 25% target at the conclusion of fiscal 2015.

Exhibit 6
Assets and Participants' Fees and Agency Operating Budgets
Fiscal 2013-2016 Est.

	<u>2013</u> ¹	<u>2014</u>	<u>2015</u>	<u>2016 Est.</u> ³
Invested Assets (\$ in Billions)	\$2.91	\$3.31	\$3.40	\$3.05
Plan Administrator Fees	\$3,376,326	\$3,093,325	\$3,291,519	\$2,745,000
As Percent of Assets	0.116%	0.093%	0.097%	0.090%
Board Asset Fee	1,009,786	922,149	1,107,118	1,525,000
As Percent of Assets ²	0.03%	0.03%	0.03%	0.05%
\$0.50 Monthly Charge per Account	362,996	360,230	359,090	362,656
One-time Settlement Revenue	599,457		13,660	
Total Board Revenue	\$1,972,239	\$1,282,379	\$1,479,868	\$1,887,656
Operating Expenses	\$1,501,897	\$1,521,864	\$1,666,333	\$1,673,956
Carryover Balance	\$852,998	\$613,513	\$427,048	\$640,748
Carryover Balance as Percent of Operating Expenses	56.8%	40.3%	25.6%	38.3%

¹ Management fee of 0.116% represents 0.14% management fee for first six months of the fiscal year under expired contract, and 0.09% for the final six months of the fiscal year under new contract that took effect January 1, 2013. Board asset fee remains 0.05% of assets.

² In fiscal 2013, 2014, and 2015, fee holidays have resulted in revenues being less than 0.05%.

³ Fiscal 2016 invested assets as of February 8, 2016. The Board Asset Fee could be lower than .05% if a fee holiday is implemented to reduce the carryover balance.

Source: Maryland Supplemental Retirement Plans; Department of Legislative Services

At the November 2015 MSRP Board meeting, the board adopted a four-month Board Asset Fee Holiday that, if markets remain consistent, would begin on March 31, 2016. However, at the January 2016 MSRP Board meeting, preliminary indications show that the plans' assets were down about 6% year-to-date. On December 31, 2015, invested assets were \$3.32 billion but as of February 8, 2016, assets dipped to \$3.05 billion, a \$270 million drop, which is reflected in Exhibit 6 for fiscal 2016. Further decreases in plan assets may not support the full four-month holiday and close monitoring will continue before announcing a fee holiday. Currently, Exhibit 6 does not reflect fee holidays in fiscal 2016 and the estimated carryover balance is 38.3% of operating expenses. MSRP feels a fee holiday to bring down that balance is likely, but it is uncertain how long the holiday will be. **MSRP should update the committees to the extent possible on potential fee holidays in calendar 2016. Also, MSRP should comment on whether the .05% board asset fee is appropriate given fee holidays over the past three fiscal years to use up fund balances, even with the recent downturn in invested assets.**

Recommended Actions

1. Concur with Governor's allowance.

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 2015					
Legislative Appropriation	\$0	\$1,627	\$0	\$0	\$1,627
Deficiency Appropriation	0	0	0	0	0
Cost Containment	0	0	0	0	0
Budget Amendments	0	40	0	0	40
Reversions and Cancellations	0	0	0	0	0
Actual Expenditures	\$0	\$1,667	\$0	\$0	\$1,667
Fiscal 2016					
Legislative Appropriation	\$0	\$1,655	\$0	\$0	\$1,655
Budget Amendments	0	19	0	0	19
Working Appropriation	\$0	\$1,674	\$0	\$0	\$1,674

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. Numbers may not sum to total due to rounding.

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Fiscal 2015

The fiscal 2015 appropriation increased by approximately \$40,000 due to increased costs to replace an assistant Attorney General position (\$30,000) and a 2% cost-of-living adjustment beginning January 1, 2015 (\$10,000).

Fiscal 2016

The special fund appropriation in fiscal 2016 increases by about \$19,000 based on the distribution of funds to restore employee salaries, per Section 48 of the fiscal 2016 budget.

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

<u>Object/Fund</u>	<u>FY 15 Actual</u>	<u>FY 16 Working Appropriation</u>	<u>FY 17 Allowance</u>	<u>FY 16 - FY 17 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	\$ 1,185,030	\$ 1,176,654	\$ 1,261,593	\$ 84,939	7.2%
02 Technical and Spec. Fees	0	3,850	3,850	0	0%
03 Communication	25,141	21,514	24,344	2,830	13.2%
04 Travel	21,587	20,074	21,074	1,000	5.0%
07 Motor Vehicles	10,500	11,760	11,760	0	0%
08 Contractual Services	273,187	283,042	288,071	5,029	1.8%
09 Supplies and Materials	11,836	12,000	12,408	408	3.4%
10 Equipment – Replacement	0	3,300	3,500	200	6.1%
11 Equipment – Additional	3,641	3,500	5,976	2,476	70.7%
13 Fixed Charges	135,411	138,262	140,870	2,608	1.9%
Total Objects	\$ 1,666,333	\$ 1,673,956	\$ 1,773,446	\$ 99,490	5.9%
Funds					
03 Special Fund	\$ 1,666,333	\$ 1,673,956	\$ 1,773,446	\$ 99,490	5.9%
Total Funds	\$ 1,666,333	\$ 1,673,956	\$ 1,773,446	\$ 99,490	5.9%

Note: The fiscal 2016 working appropriation does not include deficiencies or reversions. The fiscal 2017 allowance does not include contingent reductions.