

Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 999

(Senator Kramer) (Chair, Joint Committee on Pensions)

Budget and Taxation

Appropriations

State Retirement and Pension System - Investment Oversight

This bill gives the Board of Trustees of the State Retirement and Pension System (SRPS) independent authority to determine the compensation for the system's chief investment officer (CIO) based on specific criteria. It also gives the CIO sole authority to hire and fire external managers to manage the system's assets.

The bill takes effect July 1, 2007.

Fiscal Summary

State Effect: Special fund expenditures by the State Retirement Agency (SRA) would increase depending on the salary and any financial incentives provided to the CIO.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: Based on recommendations from its investment committee and the SRA executive director, the board of trustees determines the qualifications, compensation, and leave for the CIO. In making its determinations, the board must consider the qualifications, compensation, and leave provided to CIOs in comparable public pension systems. At the recommendation of its investment committee, the board may also provide performance-based bonuses to the CIO. The criteria used to determine the bonuses must be incorporated into the SRPS investment policy manual and be based on:

- objective benchmarks of investment performance; and
- criteria used by comparable public systems to award financial incentives to CIOs.

Either the Executive Director of the State Retirement Agency or the investment committee may recommend that the board of trustees fire the CIO. An affirmative vote by a majority of the board of trustees is necessary before the executive director may terminate the CIO's employment.

Compensation for the CIO is subject to the agency's statutory spending limit.

Before awarding any performance bonuses to the CIO, the board must submit its criteria for awarding those bonuses to specified committees of the General Assembly for their review and comment. The committees have 45 days to submit written comments to the board.

Current Law: The CIO participates in the Executive Pay Plan and is not entitled to any performance-based bonuses.

The SRPS board is responsible for the selection and termination of external investment managers, subject to the recommendations of its investment committee.

SRPS is subject to a statutory spending limit of 0.22% of members' payroll for administrative and operating expenses for the State Retirement Agency. In fiscal 2008, that is projected to be approximately \$31.0 million. The agency's fiscal 2007 working appropriation is \$22.0 million.

Background: During its 2006 review of SRPS' investment performance for the Joint Committee on Pensions, the Department of Legislative Services (DLS) noted that while investment returns had surpassed the system's target of 7.75% for three straight years, they consistently lagged behind investment returns for public pension plans in three neighboring states (Pennsylvania, Virginia, and Delaware). DLS attributed this poor performance to three factors: poor compensation for investment division staff, including the CIO, the absence of performance-based incentives for investment staff, and the structure of the board's investment committee. DLS recommended enhancing compensation for investment division staff, allowing for performance-based bonuses based on meeting investment targets, and restructuring the investment committee, including transferring authority for the selection of external managers from the board to the CIO.

The CIO position has been vacant for over a year. The SRPS board conducted a search for a new CIO, but after interviewing three candidates, the board determined that none of them were qualified for the position. Moreover, it concluded that it could not find a

qualified candidate at the compensation level it was offering. A compensation study commissioned by the board and completed by McLagan Associates in 2006 concluded that the CIO's salary was 13% below the median for comparable public pension plans, and total compensation (including bonuses) was 18% below the median. The previous CIO earned \$133,000 prior to his departure.

The McLagan study notwithstanding, CIO compensation has been rising rapidly in an effort to attract and retain talented investment professionals drawn by high salaries in the private sector. For instance, the CIO for the Virginia Retirement System earns a base salary of \$375,000 and potential bonuses up to \$200,000. A recent news report in *Pensions & Investments*, a trade publication, noted that the CIO for the South Dakota pension fund earned bonuses totaling almost \$500,000.

State Fiscal Effect: SRA's administrative budget is funded solely through special funds drawn from the pension trust fund based on statutory authority. According to the McLagan study, the median compensation, including bonuses, for CIOs in comparable public pension plans was \$162,500, and the average compensation in the top quartile was \$183,200.

If the board of trustees sets the CIO's compensation (including performance bonuses) at the median for comparable pension funds, special fund expenditures by SRA could increase by approximately \$29,500, which are assumed to grow by 4.5% annually. However, if SRPS sets compensation levels for the CIO comparable to those in some of the most generous public pension funds, special fund expenditures could increase by as much as \$500,000 for the CIO's salary and incentive payments.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Mercer Human Resources Consulting, Maryland State Retirement Agency, Department of Legislative Services

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