Joint Committee on Pensions

2024 Interim Report

Annapolis, Maryland
January 2025

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Contributing Staff

Writers
Phillip S. Anthony
Joe Gutberlet

Support Staff
Callie Ingwersen

For further information concerning this document contact:

Library and Information Services
Office of Policy Analysis
Department of Legislative Services
90 State Circle
Annapolis, Maryland 21401

Baltimore Area: 410-946-5400 ● Washington Area: 301-970-5400
Other Areas: 1-800-492-7122, Extension 5400
TTY: 410-946-5401 ● 301-970-5401
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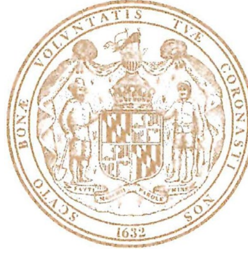

THE MARYLAND GENERAL ASSEMBLY
ANNAPOLIS, MARYLAND 21401-1991

JOINT COMMITTEE ON PENSIONS

December 19, 2024

The Honorable Bill Ferguson, Co-Chair
The Honorable Adrienne A. Jones, Co-Chair
Members of the Legislative Policy Committee

Dear President Ferguson, Speaker Jones, and Members:

During the 2024 interim, the Joint Committee on Pensions met three times. The joint committee addressed legislative proposals requested by the Board of Trustees for the State Retirement and Pension System. The joint committee made recommendations on these items at its final meeting for the 2024 interim, voting to sponsor eight legislative proposals. The joint committee also had briefings on the actuarial valuation of the system and the system's investments. In addition, the joint committee had a briefing from the Maryland Teachers and State Employees Supplemental Retirement Plans that provided an overview of the plan and information on automatic enrollment. A complete report of the joint committee's 2024 interim activities and legislative recommendations will be published in January 2025.

We thank the joint committee members for their diligence and attention to the work of the committee. Also, on behalf of the committee members, we thank Phillip S. Anthony, Joe Gutberlet, and Callie Ingwersen of the Department of Legislative Services, and the staff of the Maryland State Retirement Agency for their assistance.

Sincerely,

Michael A. Jackson
Senate Chair

Catherine M. Forbes
House Chair

MAJ:CMF/PSA:JG/csi

cc: Sally Robb
Matthew Jackson
Victoria L. Gruber
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Joint Committee on Pensions
2024 Interim
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Nino Mangione
Aletheia McCaskill
Ric Metzgar

Committee Staff

Phillip S. Anthony
Joe Gutberlet

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Joint Committee on Pensions
2024 Interim Report

Over the course of three meetings during the 2024 interim, the Joint Committee on Pensions had briefings on the Teachers' and Employees' Supplemental Retirement Plans, legislative proposals requested by the Board of Trustees for the State Retirement and Pension System (SRPS), and its annual briefings on the actuarial valuation of the system and the system's investments.

Results of the 2024 Actuarial Valuation and Fiscal 2026 Contribution Rates

Although the plan's financial status deteriorated modestly over the past year, it is still benefiting from reforms enacted by the General Assembly. SRPS's funded status (the ratio of projected actuarial assets to projected actuarial liabilities) decreased from 74.7% at the end of fiscal 2023 to 72.9% at the end of fiscal 2024 (these figures exclude funding for local governments that participate in the State plan). Also, from fiscal 2023 to 2024, the total State unfunded liability increased from $21.0 billion to $23.8 billion. This modest deterioration in the plan's financial condition is generally caused by investment performance below the actuarial assumed rate of return in recent years, actuarial assumption changes, and higher-than-expected price and wage inflation. The reformed benefit structure enacted in 2011 increased employee contributions, added additional caps to cost-of-living adjustments earned after 2011, increased the vesting period and reduced the multiplier for employees hired after 2011, and appropriated a share of savings as supplemental contributions. The State also eliminated the corridor funding method in favor of a full actuarial funding method.

Chapters 195 and 196 of 2023 altered the State's amortization policy for recognition of gains and losses to the system. The system had been operating under a closed 25-year amortization policy enacted under Chapters 475 and 476 of 2013, in which all unfunded liabilities were being amortized to reach full system funding by fiscal 2039. Under the closed amortization policy, as new liabilities (or surpluses) were added to the existing unfunded liabilities each year, they were amortized over an increasingly smaller number of years. This model increased the risk that a fiscal shock to the system (such as a severe downturn in financial markets) in the latter years of the closed amortization period would significantly increase unfunded liabilities that would have to be amortized over just a small number of years, resulting in significant increases in State pension contributions.

SRPS and the Department of Legislative Services (DLS) had been monitoring the progression through the single, closed 25-year amortization, and in the 2022 interim, the SRPS actuary and the General Assembly's actuary made recommendations to alter the amortization policy in accordance with current recommended actuarial practices for the amortization of system gains and losses. These recommendations were presented to the joint committee, which voted to sponsor legislation to alter the amortization policy to utilize rolling,

closed amortization periods for the recognition of system losses and gains. Chapters 195 and 196 established new "tiers" of unfunded liabilities or surpluses each year to ensure that any shocks to the system are spread out over 5 to 25 years, with clear guidelines on determining the appropriate amortization period based on the reason for a gain or loss. The tiered amortization methodology starts with liabilities accruing beginning July 1, 2023. This methodology enhances transparency regarding the sources of the system's unfunded liabilities and also allows the SRPS board on the advice of its actuary as established by law to make adjustments to those tiers to minimize the potential for future volatility in contribution rates. Such adjustments are consistent with the model amortization policy developed by the national Conference of Consulting Actuaries.

Fiscal 2026 Contribution Rates

Exhibit 1 shows that the fiscal 2026 actuarially determined contribution (ADC) rates for employers have increased when compared with the fiscal 2025 rates. The aggregate contribution rate for all systems increases from 19.15% in fiscal 2025 to 20.23% in fiscal 2026. Based on projected payroll growth and other factors, the SRPS actuary estimates that total employer pension contributions will increase from $2.54 billion in fiscal 2025 to $2.93 billion in fiscal 2026. The fiscal 2026 ADC rates and contributions reflect an investment return assumption of 6.8%, adopted by the SRPS board for the current fiscal year. The funding levels and contribution amounts shown in Exhibit 1 do not reflect any supplemental or sweeper contributions.

Exhibit 1
State Pension Contributions
Fiscal 2025-2026
($ in Millions)

	2025		2026	
Plan	**Rate**	**Estimated Contribution**	**Rate**	**Estimated Contribution**
Teachers' Combined	16.25%	$1,414	17.56%	$1,646
Employees' Combined	21.54%	906	21.87%	1,027
State Police	85.51%	124	94.81%	144
Judges	47.22%	29	51.63%	33
Law Enforcement Officers	46.00%	70	47.03%	78
Aggregate	**19.15%**	**$2,544**	**20.23%**	**$2,928**

Note: Except for the Teachers' Combined System (TCS), contribution rates and dollar amounts reflect State funds only, excluding local contributions. For TCS, they reflect the combined total of State and local contributions. Fiscal 2025 does not include a $25 million supplemental contribution, as required by the fiscal 2025 Budget Bill. Fiscal 2026 does not include a $50 million supplemental contribution, as required by Chapter 717 of 2024.

Source: Gabriel, Roeder, Smith, & Co., Results of the June 30, 2024 Actuarial Valuation for Fiscal Year 2026

Employer contribution rates were subject to multiple influences this year, with some exerting upward pressure and others exerting downward pressure. As noted previously, higher than expected inflation, among other factors, exerted upward pressure on the rates. The phased-in recognition of record fiscal 2021 investment returns mitigated and largely offset the investment losses sustained in fiscal 2022. Increased membership under the reformed benefit structure will continue to exert downward pressure on the rates; however, the system has nearly $3 billion in unrecognized investment losses, which will place upward pressure on contribution rates in future years.

In addition to the ADC rate, the State also provides supplemental contributions. Chapter 489 of 2015 required a supplemental contribution of $75 million each year until the system is 85% funded. This amount was reduced to $35.3 million for fiscal 2024 during the passage of the fiscal 2024 budget in the 2023 legislative session. Chapter 717 of 2024 reduced the yearly supplemental contribution from $75 million to $50 million, beginning in fiscal 2025. Additionally, Chapter 557 of 2017 altered a sweeper provision to direct a portion of unspent general funds to the system as an additional supplemental payment to the system. This sweeper provision requires the Governor to include up to $25 million of unspent funds from the second preceding fiscal year as an additional appropriation for State pension contributions; however, this payment has been suspended in all but two years since its enactment and was not included in the fiscal 2025 budget.

Fiscal 2024 Investment Performance

SRPS's investment return for the fiscal year that ended on June 30, 2024, was 6.93%, exceeding the assumed rate of return of 6.8%. System assets increased by $3 billion to a market value of $68.2 billion as of June 30, 2024. Investment returns have exceeded the assumed rate of return in only 2 of the last 5 years. The system as a whole outperformed its Investment Policy Benchmark by 0.59% (59 basis points). This benchmark is calculated by the board and allows a comparison between actual performance and a passively managed portfolio. The 5-year weighted average annual return as of June 30, 2024, is 7.02%, which is 0.89% (89 basis points) above the plan return benchmark for that period. The weighted average annual return for the past 10 years is 6.32%, which is 0.58% (58 basis points) above its benchmark for that period. The system's investment approach is cautious, with a goal of minimizing volatility. Therefore, when compared to other public pension funds, returns tend to underperform in years with strong asset growth (especially among public equities) and overperform in years in which asset values decline. All returns are calculated net of management fees.

Maryland Teachers and State Employees Supplemental Retirement Plans

The Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) provided a briefing to the joint committee on the plans. MSRP offers optional defined contribution plans for State employees. The supplemental plans are intended to augment the retirement savings that an employee will earn with SRPS. MSRP was created in 1985 to merge the responsibility for deferred compensation plans, then administered by three different agencies. MSRP currently offers four types of retirement plans.

Fund Performance

MSRP's returns rebounded in fiscal 2024 amid soaring global markets. The annual rate of returns for all of MSRP's investment options as of June 30, 2024, for 1 year was 16.22%. The rates of return for the 3-, 5-, and 10-year periods were 5.22%, 10.87%, and 9.68%, respectively. Similarly, the annual rate of return for all of MSRP's investment indices for 1 year was 15.32%, reflecting significant market growth. The rate of return for the indices for the 3-, 5-, and 10-year periods was 5.05%, 10.23%, and 9.04%, respectively.

Member Services

MSRP offers members services to support and educate State employees about the benefits of retirement savings. The effort is led by 4 certified retirement counselors and 2 administrative professionals. In 2024, MSRP provided member services via in person and virtual events, including seminars, workshops, new employee orientations, an awareness week, and a symposium. In 2023, across 344 members services events, the agency connected with 28,000 employees.

Automatic Enrollment

State employees are not required to enroll with MSRP, though 38% of eligible employees have voluntarily enrolled. During the 2024 session, SB 322 was introduced to establish automatic enrollment for new State employees. The bill did not pass, but MSRP presented findings from a 2024 study — along with a 2024 Congressional Budget Office projection that the Social Security Administration will be forced to provide benefit payouts at lower percentages after federal fiscal 2034 — to the joint committee in October 2024. The agency plans to pursue automatic enrollment legislation in the 2025 session.

401(a) Match Plan

Following the enactment of Chapter 100 of 2023, MSRP reactivated the 401(a) match plan after it had been deactivated due to a lack of funding. Under the match plan, the State provides up to $600 towards an employee's retirement savings each year if the employee meets certain criteria. Whether an employee qualifies with retirement contributions or student loan payments, the State will apply up to $600 to the employee's State supplemental retirement plan. An employee can only receive the State match from one of the two eligibility criteria in a year. MSRP reported that as of late October 2024, 39,489 employees had enrolled in the match plan, and 3,107 retirees were receiving benefit payments.

Board Requested Legislation

Pre-2011 Deferred Vested Members Returning to Service

Provisions of the Employees' Pension System (EPS) and Teachers' Pension System (TPS) provide that a deferred vested member of the Alternate Contributory Pension Selection (ACPS) tier of EPS or TPS who returns to State employment and resumes membership in EPS or TPS shall resume participation in the ACPS tier of EPS or TPS. Regardless of the break in service that has occurred, a returning vested member will not be enrolled in the Reformed Contributory Pension Benefit (RCPB) tier of EPS or TPS (which is applicable to new members on or after July 1, 2011) when returning to service. This allows the ACPS-deferred vested member to continue to receive the benefits provided for under the ACPS tier and not start anew in the RCPB tier.

While the Correctional Officers' Retirement System (CORS), the State Police Retirement System (SPRS), and the Law Enforcement Officers' Pension System (LEOPS) do not have benefit tiers similar to EPS and TPS, the 2011 session pension reforms did change vesting and average final compensation for any individual who began membership in the public safety systems on or after July 1, 2011. These systems do not have a comparable provision that allows for deferred vested members of the CORS, SPRS, or LEOPS to resume membership subject to the pre-July 1, 2011 provisions if they began membership before July 1, 2011, and later return to membership in their former system after incurring a break in service of more than 4 years (the length of time an individual remains in membership status after leaving employment with a participating employer). An individual who vested in one of these systems after accruing 5 years of service, left employment, and returned to membership after incurring a break in service of more than 4 years would now be subject to 10-year vesting and a 5-year average final compensation, with respect to all service on or after July 1, 2011. The State Retirement Agency (SRA) is required to maintain two separate accounts for an employee in CORS, because different rules apply to the pre- and post-July 1, 2011 service. Again, this is because the public safety plans do not have a corresponding provision similar to that in EPS and TPS that allows deferred vested members who return to membership, regardless of the length of their break in service, to be subject to the same requirements that were in effect for those plans on June 30, 2011.

The legislative history indicates that the provisions to preserve an EPS or TPS member's pre-July 1, 2011 membership status beyond a break in service of more than 4 years were enacted in response to a deferred vested member of the ACPS tier of EPS returning to membership after more than a 10-year break in service. Staff for the agency can find no indication that the public safety plans were deliberately excluded; rather, it appears that the focus of the legislation was limited to EPS and TPS because of the individual who brought this issue to the attention of the legislature.

For consistency and ease of administration across the several systems, the Board of Trustees for SRPS recommended legislation that would provide that returning deferred vested members of CORS, SPRS, or LEOPS who began membership in these plans prior to July 1, 2011,

shall be subject to the same requirements that were in effect in their former plan on June 30, 2011, regardless of the length of their break in service.

The joint committee will sponsor the requested legislation.

SPRS Deferred Retirement Option Program Participation Clarification

An SPRS member may enter the Deferred Retirement Option Program (DROP) if the member has at least 25 years of service, less than 32 years of service, and is less than 60 years old. An eligible member may elect to participate in DROP for a period not to exceed the lesser of:

- seven years;
- the difference between 32 years and the member's service credit as of the date of the member's election to participate in DROP and retire from SPRS; and
- the difference between age 60 and the member's age as of the date of the member's election to participate in DROP and retire from SPRS.

Provisions in the State Personnel and Pensions Article provide that a member is entitled to receive one month of service credit for employment for one month or part of a month if member contributions are received for that month. Chapters 265 and 266 of 2020 provide that after 28 years of service as a member of the SPRS, a member does not make any further member contributions, effectively capping the service credit a member may earn at 28 years.

SRA studied how each of these pieces regarding service credit and participation in SPRS DROP intersect with each other and discovered an inconsistency that the board believes requires clarification from the General Assembly. Prior to the 2020 session, SPRS members would continue to make contributions after accruing 28 years of service and thus would continue to earn service credit. A member who continued active membership for 32 years would accrue 32 years of service credit; a member with 32 years of service credit would not be eligible to participate in SPRS DROP.

With the passage of the 2020 legislation that ended member contributions after 28 years of service, a member who continues active membership after 28 years will not accrue any additional service credit, capping their service at 28 years regardless of how long they remain an active SPRS member after that point. In addition, the 2020 legislative change to discontinue member contributions and service credit accrual after 28 years of service has had a corresponding impact on the provisions governing the DROP participation period for SPRS. For example, an SPRS member who chooses to work 32 years will still only have 28 years of service credit. Because DROP participation is calculated based on the difference between 32 years and the member's service credit when entering DROP, the 2020 law change could potentially allow a member of SPRS to work indefinitely after accruing 28 years of service (provided that they have not reached

the mandatory retirement age of 60) and still be guaranteed 4 additional years of DROP participation, since their service credit will always be capped at 28 years.

The board is uncertain if this outcome is an unintended consequence of the 2020 legislation and is seeking clarification from the General Assembly regarding these provisions of the State Personnel and Pensions Article that govern the system.

The joint committee will sponsor legislation to clarify that the DROP limitation should be calculated based on a member's employment in an SRPS-eligible position instead of a member's service credit.

Reemployment Earnings Limitations

Current provisions of the State Personnel and Pensions Article exempt EPS and TPS service retirees and all ordinary disability retirees from a reemployment earnings limitation if the retirees had an average final compensation (AFC) at the time of retirement that was less than $25,000. This AFC reemployment exemption was increased for EPS and TPS service retirees from $10,000 in 2010 and was added for the first time for ordinary disability retirees in 2016. An accidental or special disability retiree does not have the benefit of this AFC reemployment exemption. Although retirees who are receiving accidental or special disability benefits are not subject to an earnings limit, a reemployed accidental or special disability retiree whose reemployed annual gross salary exceeds their AFC at the time of retirement will have their disability retirement benefit temporarily suspended while they continue to earn a gross salary that is greater than their AFC.

The board recommended legislation that would add a similar AFC reemployment exemption for the temporary suspension of a retirement allowance (State Personnel and Pensions Article § 29-115) applicable to all disability retirees. Additionally, the board recommended increasing the AFC reemployment exemption for both service and disability retirees from $25,000 to $35,000 – the current minimum annual salary on the standard State pay scale – for all retirees of the system. SRA believes that this increase is consistent with the 2010 legislation that increased the then AFC reemployment exemption from $10,000 to $25,000. At that time, the minimum annual salary on the standard State pay scale was $21,200.

DLS notes that while raising the AFC reemployment exemption salary threshold would be consistent with prior legislative action, a fixed amount would at some point in the future result in the same issue that is currently being experienced. DLS recommended that the joint committee consider including an automatic inflationary adjustment to the AFC reemployment exemption, such as tying the exemption to the minimum annual salary on the standard State pay scale or providing for annual increases based on an inflation metric, such as the consumer price index, the annual payroll inflation assumption used for the system's annual actuarial valuation, or the average compensation increase (cost-of-living and merit) for State employees over the prior fiscal year.

The joint committee will sponsor the requested legislation and include an automatic inflationary adjustment to the AFC exemption amount to match the minimum annual salary on the standard State pay scale.

CORS Security Attendant Supervisors or Managers

Chapters 135 and 136 of 2024 moved members from EPS to CORS who were employed by the Maryland Department of Health in security attendant positions at State forensic facilities. Individuals hired into these positions on or after July 1, 2024, at the facilities included in the legislation will be enrolled in CORS as a condition of employment. As Chapters 135 and 136 were drafted, many supervisor and manager positions for these security attendants were inadvertently omitted from the legislation. As a result, under current law, an individual serving in a security attendant position who is promoted to a supervisor or manager position that was omitted from the legislation will be moved back to EPS at the time of promotion. To avoid disruption to these members' benefits, the board recommended clarifying that the supervisors and managers of security attendants will also be members of CORS as a condition of employment. SRA noted that this recommendation would be consistent with the prior legislation that allowed employees to remain in CORS when promoted to positions that had not been eligible for CORS membership. SRA indicated that it is aware of 45 individuals serving as supervisors or managers of security attendants who would be moved into these positions.

The joint committee will sponsor the requested legislation.

Title 37 Study Group

Title 37 of the State Personnel and Pensions Article governs the transfer of service from any State or local retirement or pension system to another State or local retirement or pension system. Provisions within Title 37 include those that address the types of service credit that may be transferred from one system to another, the member contributions and interest that must accompany these transfers, and the time frame under which these transfers must be made. Title 37 is the only pension-related title in this Article that applies to the State and local jurisdictions.

Over the years, SRA has noticed that there are many inconsistencies, duplicative provisions, and ambiguities throughout this Title. The board is interested in addressing these issues, though many will require legislative changes. Given that the groups that are impacted by Title 37 include the State and local jurisdictions, the board believes that addressing issues related to Title 37 is an undertaking that should include input from all stakeholders. To accomplish this, the board recommended legislation that would establish a workgroup consisting of representatives from SRA, each of the counties (including Baltimore City) that operate their own retirement or pension system, and DLS. The proposal is for the workgroup to meet throughout the 2025 interim to address issues that SRA found in Title 37 as well as any issues that the counties may be trying to resolve. SRA indicates that it would provide staff for this workgroup and submit recommended changes to Title 37 to the joint committee during fall 2025.

The joint committee will sponsor the requested legislation.

General Assembly Reports – Due Dates

Two reports that SRA is required to submit to the General Assembly each year have statutory due dates that are very difficult for SRA to meet. SRA has reached out to the DLS Library and was told that SRA may request changes to the due dates of their reports. The board recommended legislation that would change the due dates for the annual report regarding the Investment Committee's business relationships with minority business enterprise brokerage and investment management services firms as well as the annual report addressing the system's private equity and venture capital investments in Maryland technology with the Maryland Technology Development Corporation from September 1 and December 1, respectively, to November 1 and December 31, respectively.

The joint committee will sponsor the requested legislation.

Repeal of Administrative Fees

Prior to July 1, 2011, the administrative budget for SRA, based on statutory authority, was funded solely through special funds drawn down from the pension trust fund. Chapter 397 of 2011 changed this process and requires SRA to apply a per employee charge on all employers participating in the system in order to fund its operating expenses.

The current process of determining the amount of administrative fees that each participating employer owes the system in any given year is based on a formula that involves determining the number of employees who are also members of the several systems as of June 30 of the second prior fiscal year for each employer, and dividing this number by the total number of current members in the system. This percentage is applied to the actual amount that SRA spent during the second previous fiscal year. Each participating employer is then notified in October of each year what they will owe the system in administrative fees for the upcoming fiscal year.

When calculating the administrative fees for SRA operations, the Finance Division for SRA and the budget analysts for the Department of Budget and Management (DBM) and DLS continue to use differing methodologies when determining the final closeout number for SRA for the previous fiscal year. The three agencies met throughout summer 2024 to discuss the entire process for determining administrative fees for SRA and agreed that the current method of funding SRA's operating expenses continues to be overly cumbersome.

Throughout these discussions, the agencies reviewed the changes that were made to the process during the 2024 legislative session, as well as recent information received by the system's actuary. The Budget Reconciliation and Financing Act of 2024 (Chapter 717) eliminated a long-standing reduction that the State was required to make to the TPS employer contribution. This reduction was a component of the process for determining the amount of administrative fees due to the system. To mitigate the loss of this reduction, the annual $75 million that the system receives in supplemental payments has been reduced to $50 million. Additionally, the system's actuary reported that the General Accounting Standards Board would prefer that actuaries for

public pension plans, when calculating the annual employer contribution rate for a public plan, include a certain percentage above the employer contribution rate that serves to cover a plan's operating expenses. The system's actuary also noted that it is unaware of any other public plans that fund their operating expenses through administrative fees similar to SRPS.

In light of the 2024 legislative changes coupled with the information provided by the system's actuary, the three agencies reached the consensus that there is no meaningful benefit to the system, the State, or other participating employers of the system to maintain the current process of funding SRA operating expenses through administrative fees. Therefore, on behalf of SRA, DBM, and DLS, the board recommended returning to the past practice of funding SRA operating expenses through funds drawn down from the SRA trust. These funds would be collected through the additional operating expense percentage added to the employer contribution rate determined by the system's actuary each fiscal year. In addition to significantly reducing the complexity of this process for the three agencies, this proposal would also simplify the payment process for SRPS participating employers. The proposal would provide that, going forward, participating employers would only receive one annual bill from the system.

SRA indicates that the proposal would not have a fiscal impact on the system, because the operating expense percentage determined by the system's actuary should be comparable to the amount that would otherwise be certified as its administrative fees.

The joint committee will sponsor the requested legislation.

Board of Trustees' Compensation Committee

Chapters 727 and 728 of 2018 gave the board the authority to determine and create positions necessary to carry out the professional investment functions of the Investment Division and to set qualifications and compensation for the positions, including incentive compensation, subject to certain limitations. To assist the board in adopting objective criteria for setting compensation and awarding financial incentives for the Chief Investment Officer (CIO) and specified Investment Division staff, the 2018 legislation also created the Objective Criteria Committee (OCC).

Under provisions of the State Personnel and Pensions Article, OCC is required to meet at least once every five years. OCC includes one Senator and Delegate who are serving on the joint committee, the Treasurer (or the Treasurer's designee), the Secretary of DBM (or the Secretary's designee), two trustees appointed from the board, and a member of the public with financial industry experience. OCC is charged with recommending objective criteria for the board to use when it is determining the compensation and financial incentives for the CIO and certain staff of the Investment Division. The board is also required to hire a compensation consultant to assist OCC regarding objective criteria. This consultant may not be actively providing consulting services to the board or the staff of the Investment Division.

OCC met throughout summer 2018, shortly after Chapters 727 and 728 became effective. At the conclusion of its work, OCC submitted to the board a recommended compensation and

incentive compensation program for the Investment Division. These recommendations served as the foundation for the expansion of the Investment Division from calendar 2018 to 2023. However, as the Investment Division grew and created new positions, including an internal training desk in the intervening five years, the board has noted that it would have benefited from having an ongoing committee that could review criteria for compensation and incentive compensation and assist with creating new positions within the Investment Division.

Section 21-108(b) of the State Personnel and Pensions Article provides in part that the board may establish committees of the Board of Trustees. Section 21-108 therefore would allow the board to establish a compensation committee of the board that would address Investment Division compensation issues that arise in real time, rather than wait for OCC every five years. While OCC's role is limited to recommending objective criteria, the board's responsibilities are far broader, including determining the type and number of positions to carry out the functions of the Investment Division and their qualifications and compensation (including financial incentives). In addition to adopting objective criteria, the board needs to determine a position classification system and pay scale and review and regularly update these items as the needs of the system change. A compensation committee of the board could better assist with the broad array of responsibilities that have been assigned. Additionally, the board also recommended enabling the board to hire a compensation consultant to assist both the compensation committee and the board with reviewing and updating its objective criteria, as well as creating and maintain a position classification structure, pay scale, and financial incentive program for the CIO and Investment Division.

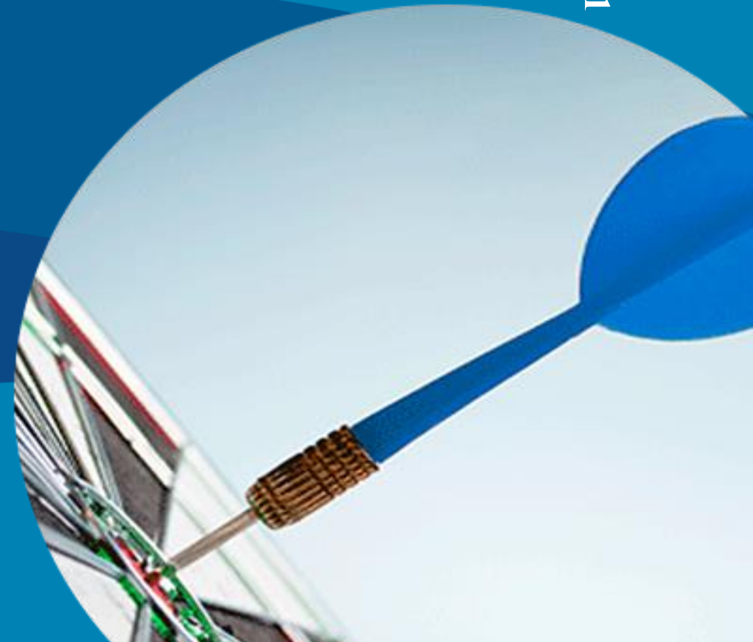
To accomplish this, the board recommended legislation that would repeal provisions establishing OCC. In its place, the board would establish a compensation commission of the Board of Trustees. This proposal would also enable the board to hire one compensation consultant to assist both the new committee and the board. DLS noted that one of the functions of OCC was to provide a public and transparent process for reviewing and determining compensation for Investment Division staff. While § 21-208 provides the board with authority to establish a compensation committee, DLS advised that the joint committee may want to consider a statutory requirement for the board to do so, particularly if the joint committee would like to ensure that certain information is considered by the board or that existing restrictions on who may be retained as a compensation consultant are maintained. DLS noted that a statutorily-required board compensation committee pertaining to Investment Division staff would be consistent with the statutory creation of the board's investment committee under §§ 21-114 through 21-116 of the State Personnel and Pensions Article.

The joint committee will sponsor legislation repealing the OCC provisions and codifying the board proposed compensation committee with retention of the existing requirements and limitations on the use of compensation consultants.

Maryland State Retirement and Pension System

Results of the June 30, 2024
Actuarial Valuation for Fiscal Year 2026

November 20, 2024 Meeting of the Joint Committee on Pensions



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VALUTION INFORMATION

GRS

Valuation Information

Purpose of the Actuarial Valuation

- Measure the financial position of MSRPS
- Provide the Board with State and PGU contribution rates for certification
- Provide disclosure information for financial reporting
  - Provided by separate GASB Statement Nos. 67 and 68 valuations
- Analyze aggregate experience over the last year

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Valuation Information

Funding Objectives

Benefit security

- Plan sponsor commitment, strong governance, effective administration, and accommodated by sources of revenue.

Stable pattern of contribution rates

- Weighted average State Contribution rate increased by 1.08% of payroll this year.

Intergenerational equity with respect to plan costs

- This is a long term goal. We will only know in hindsight if it is achieved. The break with corridor funding was a step in the right direction.

Stable or increasing ratio of assets to liabilities

- Funded ratio decreased this year on an actuarial value of assets basis and on a market value basis.

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Valuation Information

Primary Assumptions

- Economic assumptions
  - 6.80% investment return; 3.00% payroll growth; 2.50% CPI
  - 2.13% COLA, 2.48% COLA, 2.50% COLA for service where COLA is capped at 3%, 5% or not capped, respectively
  - 1.40% COLA for service earned after July 1, 2011 where COLA is capped at 2.5% in years when the System earns at least the investment assumption or capped at 1% in years when the System earns less than the investment assumption
- Demographic actuarial assumptions based on the 2018-2023 experience study (first used in 2024 Valuation)
  - Demographic Assumptions
    - Public Sector mortality tables with generational mortality projection using scale MP-2021
      - Calibrated to MSRPS experience
    - Retirement, termination, disability and seniority and merit salary increase rates based on plan experience

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Valuation Information

Variables Affecting Valuation Results

- Benefits (Retirement, Disability, Survivor)
- Actual past experience
- Recent Legislative Changes
  - 2024 General Assembly passed HB 768
    - Special Death Benefit for active Judges
  - 2023 General Assembly passed SB 139
    - Increase maximum DROP participation time from 5 to 7 years (or up to 32 years of service) for State Police and LEOPS
  - 2023 General Assembly passed SB 466
    - Implements "layered" amortization of unfunded liability by source for State Systems effective July 1, 2023 (will first affect the 2024 valuation)
  - 2020 General Assembly passed HB 588
    - Member contributions cease upon reaching maximum benefit for State Police (28 yrs.) and LEOPS (32.5 yrs.)
  - 2018 General Assembly passed HB 1042 and 1049
    - Increased LEOPs maximum benefit and extended State Police DROP participation

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Valuation Information

Funding Policy

- Entry Age Actuarial Cost Method
- 5-year asset smoothing/20% market value collar
- 40% of FY 2021 gains recognized, with 15% recognized in each following year
- Amortization policy
  - State Systems
    - Single period closed amortization of unfunded liabilities occurring before July 1, 2023
      - Ending in FY 2039 (14 years remaining in 2024 valuation)
    - Layered amortization begins with the 2024 valuation (for unfunded liabilities occurring after July 1, 2023)
      - 15 years for experience gains and losses
      - 25 years for changes in actuarial assumptions and methods
      - 10-15 years for benefit changes
      - 5 years for early retirement incentives
  - Municipal Systems
    - ECS: Single period closed amortization period ending in FY 2043. 18 years remaining in 2024 valuation (FY 2026).
    - LEOPS: Single period closed amortization period ending in FY 2040
    - CORS: Single period closed amortization period ending in FY 2047
  - Level % of payroll
  - Single period amortization needs to be reconsidered to control volatility once remaining period falls below about 10-15 years

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PARTICIPANT DATA

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Participant Data

Summary

	Statistics as of June 30				
	2024			2023	
Number Counts	**State**	**PGU**	**Total**	**Total**	**% Chg**
Active Members	177,683	27,361	205,044	198,647	3.2%
Vested Former Members	40,176	5,923	46,099	47,087	-2.1%
Retired Members	155,266	20,905	176,171	174,609	0.9%
Total Members	373,125	54,189	427,314	420,343	1.7%
Total Valuation Payroll ($ in Millions)	$13,960.4	$1,690.0	$15,650.4	$14,384.6	8.8%
Active Member Averages					
Age	46.1	48.4	46.4	46.4	0.0%
Service	12.1	10.4	11.8	12.0	-1.6%
Pay	$ 78,569	$ 61,766	$ 76,327	$ 72,413	5.4%
Total Retiree Benefits ($ in Millions)	$4,633.4	$ 393.3	$ 5,026.7	$ 4,801.8	4.7%
Average Retiree Benefit	$ 29,842	$ 18,813	$ 28,533	$ 27,501	3.8%

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ASSET DATA

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Asset Data
FY 2024 Experience

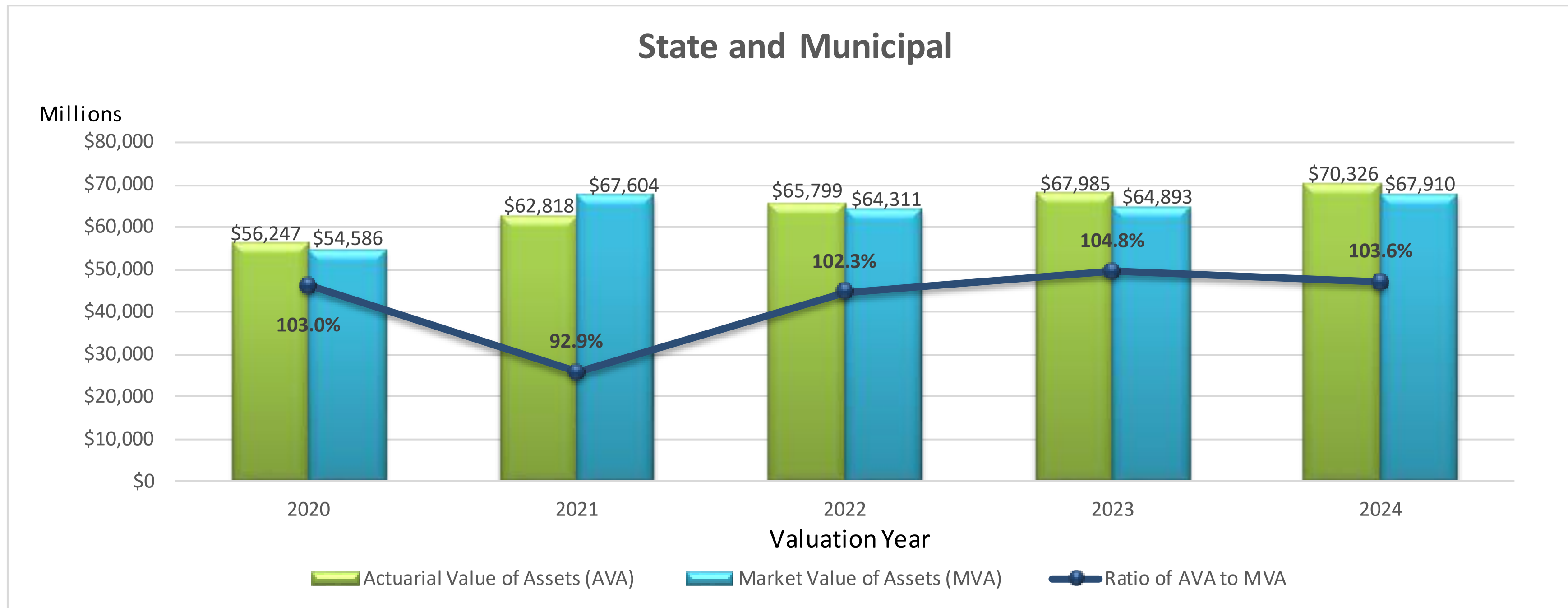
State and Municipal ($ in Billions)

	2024	2023	% Change
Market Value - Beginning of Year	$ 64.89	$ 64.31	0.91%
Employer Contributions	2.62	2.44	7.36%
Member Contributions	1.06	0.96	9.60%
Disbursements	(5.07)	(4.80)	5.70%
Net Non-Investment Cash Flow	(1.40)	(1.40)	0.12%
Investment Income	4.42	1.98	123.04%
Net Change	3.02	0.58	418.36%
Market Value - End of Year	**$ 67.91**	**$ 64.89**	4.65%
Estimated Rate of Return	6.88%	3.11%	
Actuarial Value - Beginning of Year	$ 67.99	$ 65.80	3.32%
Net Non-Investment Cash Flow	(1.40)	(1.40)	0.12%
Expected Return	4.37	4.33	0.91%
Total Recognized Gains/Losses	(0.63)	(0.74)	-15.67%
Net Change	2.34	2.19	7.04%
Actuarial Value - End of Year	**$ 70.33**	**$ 67.99**	3.44%
Estimated Rate of Return	5.56%	5.51%	

Numbers may not add due to rounding.

Asset Data

Actuarial Value of Assets - ($ Millions)



The actuarial valuation is not based directly upon market value, but rather uses a smoothed value of assets that phases in each year's gain or loss above/below the investment return assumption over 5 years.

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VALUTION OVERVIEW

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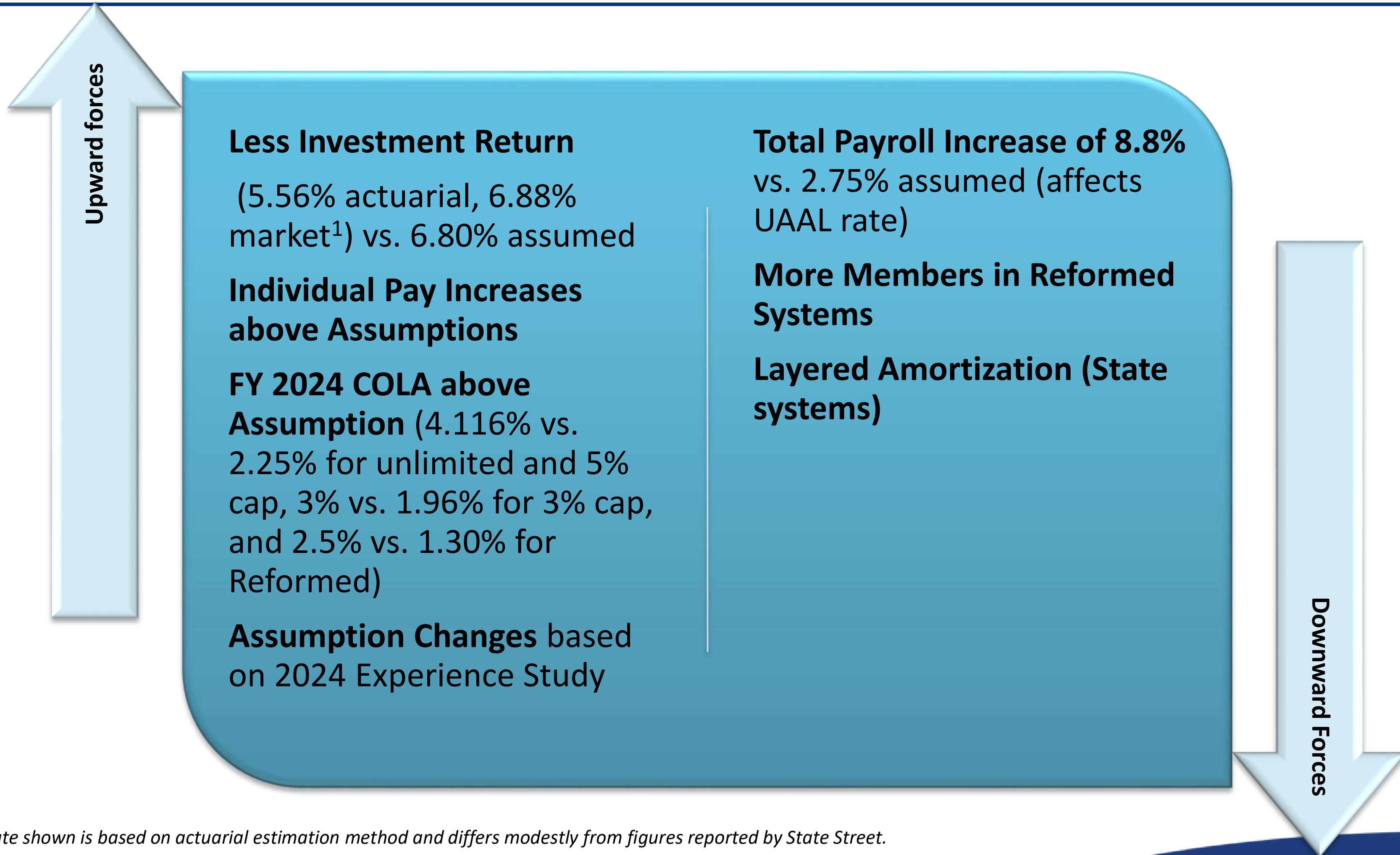
Valuation Overview

Impact of FY 2024 Experience on Contribution Rates



[1] *Rate shown is based on actuarial estimation method and differs modestly from figures reported by State Street.*

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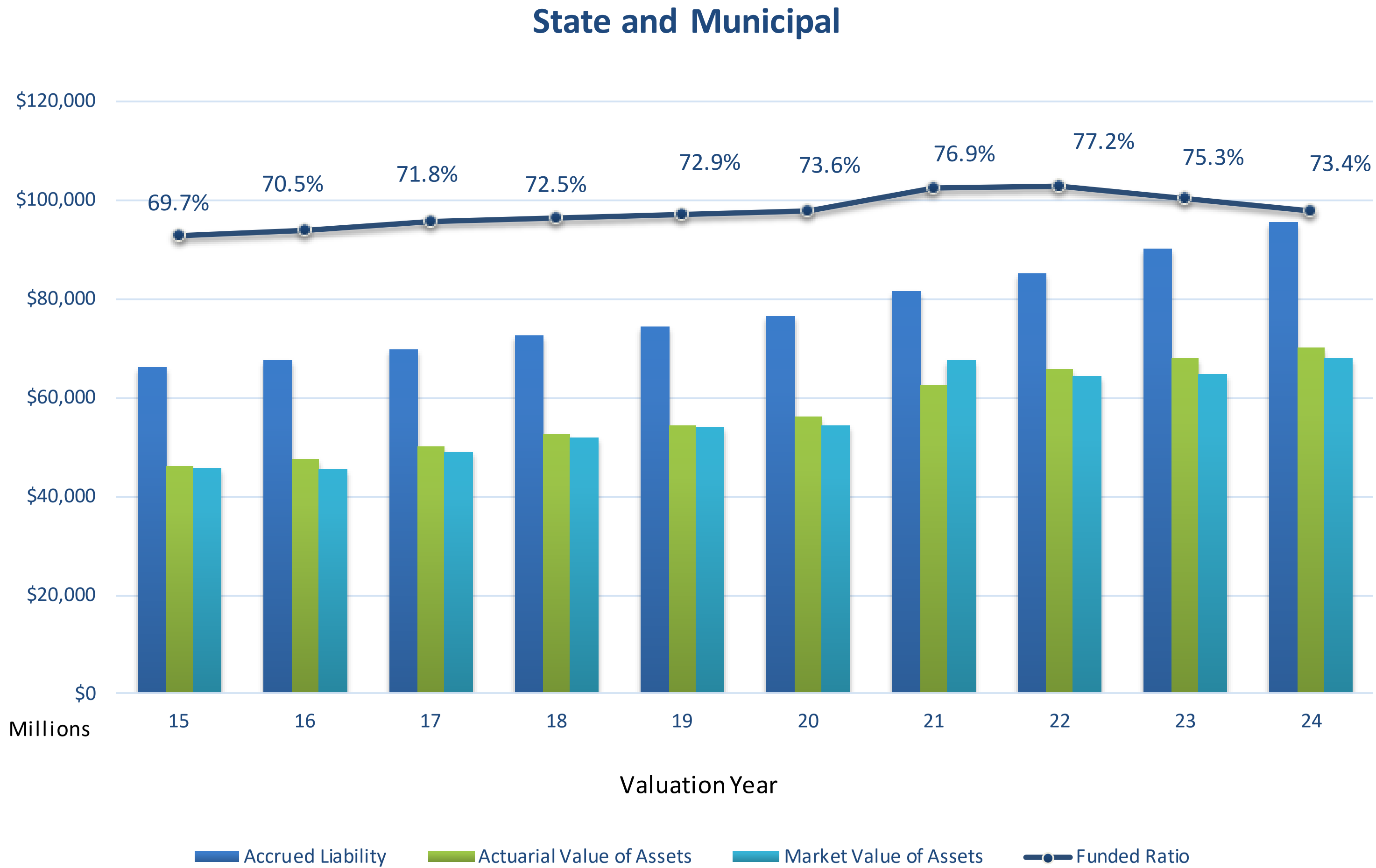
Valuation Overview

Historical Funded Status



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Valuation Overview

Summary of State Results

State Only ($ in Millions)

	Teachers' Combined System	Employees' Combined System	State Police	Judges	LEOPS	Total
June 30, 2024						
Actuarial Accrued Liability (AAL)	$ 55,684	$ 26,904	$ 3,091	$ 763	$ 1,562	$ 88,005
Actuarial Value of Assets (AVA)	42,593	17,900	2,018	631	1,048	64,189
Unfunded AAL (UAAL)	**13,091**	**9,005**	**1,073**	**133**	**514**	**23,816**
Increase/(Decrease) from Prior Year	*1,946*	*702*	*108*	*31*	*28*	*2,815*
Funded Ratio (AVA)	**76.5%**	**66.5%**	**65.3%**	**82.6%**	**67.1%**	**72.9%**
Increase/(Decrease) from Prior Year	*(2.3%)*	*(0.9%)*	*(1.5%)*	*(3.2%)*	*0.1%*	*(1.8%)*
Fiscal Year 2026						
Actuarially Determined Employer Contrbution Rate (ADEC)	**17.56%**	**21.87%**	**94.81%**	**51.63%**	**47.03%**	**20.23%**
Increase/(Decrease) from Prior Year	*1.31%*	*0.33%*	*9.30%*	*4.41%*	*1.03%*	*1.08%*

Contribution rates are percent of payroll. Totals may not add due to rounding.

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Valuation Overview

Summary of Municipal Results

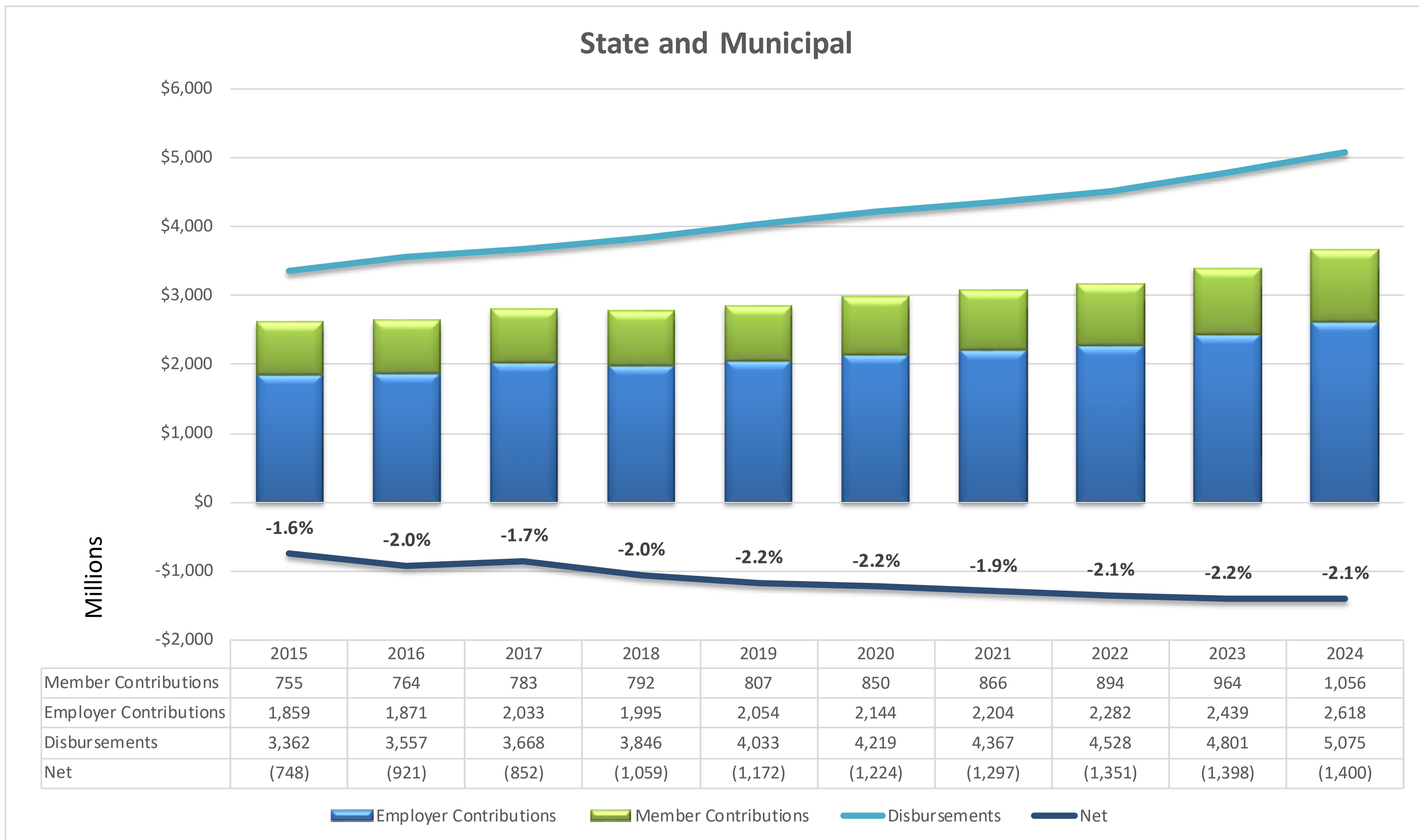
Municipal Only ($ in Millions)

	Employees' Combined System	LEOPS	CORS	Total
June 30, 2024				
Actuarial Accrued Liability (AAL)	$ 6,923	$ 787	$ 60	$ 7,770
Actuarial Value of Assets (AVA)	5,556	536	45	6,137
Unfunded AAL (UAAL)	**1,367**	**250**	**15**	**1,633**
Increase/(Decrease) from Prior Year	*261*	*35*	*4*	*300*
Funded Ratio (AVA)	**80.3%**	**68.2%**	**74.6%**	**79.0%**
Increase/(Decrease) from Prior Year	*(2.8%)*	*(1.4%)*	*(4.0%)*	*(2.7%)*
Fiscal Year 2026				
Basic/Pooled Contrbution Rate	**9.75%**	**39.64%**	**18.56%**	**11.74%**
Increase/(Decrease) from Prior Year	*1.31%*	*1.57%*	*3.14%*	*1.42%*

Contribution rates are percent of payroll. Totals may not add due to rounding.

Risk/Maturity Measures

Historical Non-Investment Cash Flow



	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Member Contributions	755	764	783	792	807	850	866	894	964	1,056
Employer Contributions	1,859	1,871	2,033	1,995	2,054	2,144	2,204	2,282	2,439	2,618
Disbursements	3,362	3,557	3,668	3,846	4,033	4,219	4,367	4,528	4,801	5,075
Net	(748)	(921)	(852)	(1,059)	(1,172)	(1,224)	(1,297)	(1,351)	(1,398)	(1,400)

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CONCLUSION

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Recommended Budgeted Contributions

Fiscal Year 2026: STATE

System	Fiscal 2026		Prior Year	
	Actuarial Rate	Illustrated Dollars (Millions)	Actuarial Rate	Illustrated Dollars (Millions)
TCS	**17.56%**	$1,646	16.25%	$1,414
ECS	**21.87%**	1,027	21.54%	906
State Police	**94.81%**	144	85.51%	124
Judges	**51.63%**	33	47.22%	29
LEOPS	**47.03%**	78	46.00%	70
Total	20.23%	$2,928	19.15%	$2,544
TCS Local Employer Portion		439		397
Total State Only Portion		$2,489		$2,147

Contribution rates are percent of payroll. Totals may not add due to rounding.

Recommended Basic Contributions

Fiscal Year 2026: MUNICIPAL

System	FY 2026	FY 2025
ECS	9.75%	8.44%
LEOPS	39.64%	38.07%
CORS	18.56%	15.42%

PGU Contributions consist of the basic pooled rate shown above, certain surcharges, deficits or credits related to pre-2001 ECS liability, and new entrant and withdrawal payments and credits, all of which are shown in the full report.

Contribution rates are percent of payroll.

Concluding Comments

- Contribution rates increased since the previous valuation, while funded ratios decreased
  - Unfavorable experience during FY 2024 contributed to approximately half of the contribution rate increase (in total)
  - Assumption changes caused the remaining increase in the contribution rate
  - New amortization policy (State systems) and total payroll growth mitigated a portion of the contribution rate increases
- Upward pressure on contribution rates expected through FY 2029 due to deferred asset losses

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Disclosures

- This presentation is intended to be used in conjunction with the June 30, 2024 actuarial valuation reports. This presentation should not be relied on for any purpose other than the purpose(s) described in the valuation reports.
- This presentation shall not be construed to provide tax advice, legal advice or investment advice.
- The actuaries submitting this presentation (Brad Armstrong and Jeff Tebeau) are Members of the American Academy of Actuaries (MAAA) and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.
- The purposes of the actuarial valuation are to measure the financial position of MSRPS, assist the Board in establishing employer contribution rates necessary to fund the benefits provided by MSRPS, and provide certain actuarial reporting and disclosure information for financial reporting. There is an additional report and documents with other actuarial reporting and disclosure information for financial reporting.

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Disclosures

- Future actuarial measurements may differ significantly from the current and projected measurements presented in this presentation due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan’s funded status); and changes in plan provisions or applicable law.

- This is one of multiple documents comprising the actuarial reports for the combined systems and the municipal corporations. Additional information regarding actuarial assumptions and methods, and important additional disclosures are provided in the Actuarial Valuations as of June 30, 2024.

- This results in this presentation were prepared using our proprietary valuation model and related software, which in our professional judgment, has the capability to provide results that are consistent with the purposes of the valuation and has no material limitations or known weaknesses. We performed tests to ensure that the model reasonably represents that which is intended to be modeled.

- If you need additional information to make an informed decision about the contents of this presentation, or if anything appears to be missing or incomplete, please contact us before relying on this presentation.

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Appendix 2

Annual State Retirement and Pension System Investment Overview

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Presented to the
Joint Committee on Pensions

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

December 2024

Annual State Retirement and Pension System's Investment Overview

At the request of the Joint Committee on Pensions, the Department of Legislative Services (DLS) annually reviews the investment performance of the State Retirement and Pension System (SRPS) for the preceding fiscal year. This report is intended to provide an overview of SRPS performance, a comparison of this performance to its peers, and an identification of issues meriting further comment by the State Retirement Agency (SRA).

State Retirement and Pension System Investment Performance

Asset Allocation

The SRPS Board of Trustees sets the allocation of assets to each investment class and continuously monitors the appropriateness of the allocation in light of its investment objectives. The SRPS *Investment Policy Manual* sets forth the investment objectives:

> The board desires to balance the goal of higher long-term returns with the goal of minimizing contribution volatility, recognizing that they are often competing goals. This requires taking both assets and liabilities into account when setting investment strategy as well as an awareness of external factors such as inflation. Therefore, the investment objectives over extended periods of time (generally 10 to 20 years) are to achieve an annualized investment return that:
>
> 1. In nominal terms, equals or exceeds the actuarial investment return assumption of the system adopted by the board. The actuarial investment return assumption is a measure of the long-term rate of growth of the system's assets. In adopting the actuarial return assumption, the board anticipates that the investment portfolio may achieve higher returns in some years and lower returns in other years.
>
> 2. In real terms, exceeds the U.S. inflation rate by at least 3%. The inflation-related objective compares the investment performance against the rate of inflation as measured by the Consumer Price Index plus 3%. The inflation measure provides a link to the system's liabilities.
>
> 3. Meets or exceeds the system's Investment Policy Benchmark. The Investment Policy Benchmark is calculated by using a weighted average of the board-established benchmarks for each asset class. The Policy Benchmark enables comparison of the system's actual performance to a passively managed proxy and measures the contribution of active investment management and policy implementation.

The assets allocation is structured into five categories:

- ***Growth Equity:*** public equity (domestic, international developed, and international emerging markets) and private equity investments;

- ***Rate Sensitive:*** investments in bonds, loans, or associated derivatives with an average portfolio credit quality of investment grade;

- ***Credit:*** investments in bonds, loans, or associated derivatives with an average portfolio credit quality of below investment grade;

- ***Real Assets:*** investments whose performance is expected to exceed the rate of inflation over an economic cycle; and

- ***Absolute Return:*** consists of investments that are expected to exceed the three-month U.S. Treasury bill by 4% to 5% over a full market cycle and exhibit low correlation to public stocks.

Included within these asset classes are sub-asset classes. The board approves adjustments to the asset allocations and sets transitional targets. The board also approves target ranges for sub-asset classes as well as constraints on hedge fund exposure, with total hedge fund investments capped across all asset classes. In fall 2021, the board adjusted the system's asset allocation, and it has made minor adjustments periodically since then, with the most recent adjustment occurring in February 2023. **Exhibit 1** shows system asset allocations in relation to the strategic targets in effect on June 30, 2024.

Exhibit 1

State Retirement and Pension System Asset Allocation

Asset Class	Actual June 30, 2024	Target July 1, 2024
Growth Equity		
U.S. Equity	14.2%	17%
International Equity	8.1%	11%
Emerging Markets Equity	4.9%	6%
Global Equity	3.6%	n/a
Private Equity	21.6%	16%
Subtotal	***52.4%***	***50%***
Rate Sensitive		
Nominal Fixed Income	13.2%	16%
Inflation-linked Bonds	3.3%	4%
Subtotal	***16.5%***	***20%***
Credit/Debt		
High Yield Bonds and Bank Loans	7.8%	8%
Emerging Market Debt	1.1%	1%
Subtotal	***8.9%***	***9%***
Real Assets		
Real Estate	9.4%	10%
Natural Resources and Infrastructure	4.5%	5%
Subtotal	***14.2%***	***15%***
Absolute Return	**5.8%**	**6%**
Multi-asset	**0.4%**	**n/a**
Cash	**1.8%**	**n/a**
Total Fund	**100%**	**100%**

Note: Columns may not add to total due to rounding. Real Assets Subtotal includes 0.3% commodities assets.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2024; State Retirement and Pension System Investment Policy Manual, March 2024

The system's asset allocation is reflective of a decision to restructure the portfolio in fiscal 2008 and 2009. The overall strategy is part of an approach by the board to decrease risk through diversification in the wake of the 2008 financial crisis and is also a prudent approach as the system becomes more mature with an increasing ratio of retirees to active members. Increased investment in private equity has resulted in positive returns for the system, with less experienced volatility than public equity. Lower allocations to public equity investments are expected to result in lower returns when public equities are in growth patterns. However, as public equity can be a highly volatile asset class, a more diverse investment allocation should reduce volatility to provide protection when equity markets perform poorly or decline. While mitigating volatility will result in not taking full advantage of highly performing public equity markets, more stable investment returns will also mitigate swings in employer contribution rates. The board of trustees and the investment committee monitor the allocation of assets and continue to discuss the appropriate allocation (in consultation with the system's investment staff and investment consultants) that will achieve the system's investment return needs. Given the certain nature of defined benefit payment obligations, prudent allocation strategy should consider both achieving positive returns as well as being positioned to avoid losses. While investment division staff have some authority to make tactical, short-term adjustments to asset allocations, the *Investment Policy Manual* states an objective of long-term investment strategy, acknowledging that the system's long-term investment horizon may lead to short-term volatility. The manual reflects actions by the board to alter the asset allocation and can be found on the SRA website.

Investment Performance

The system's investment return for fiscal 2024 was 6.93% net of management fees, above the assumed rate of return of 6.80%. The system also exceeded its policy benchmarks for the system as a whole by 0.59%. As shown in **Exhibit 2**, the total market value of the system's assets was $68.2 billion as of June 30, 2024, compared to $65.2 billion in assets at the end of fiscal 2023.

Exhibit 2

State Retirement and Pension System of Maryland

Fund Investment Performance for Periods Ending June 30, 2024
($ in Millions)

	Assets	% Total	Time-weighted Total Returns 1 Year	5 Years	10 Years
Growth Equity					
Public Equity	$20,952	30.7%	17.94%	9.79%	8.03%
Private Equity	14,761	21.6%	5.24%	15.38%	14.95%
***Subtotal*[1]**	***$35,727***	***52.4%***	***12.32%***	***11.55%***	***9.75%***
Rate Sensitive					
Nominal Fixed Income	$8,986	13.2%	-2.09%	-2.65%	0.67%
Inflation Sensitive	2,278	3.3%	2.97%	2.26%	2.31%
Subtotal	***$11,264***	***16.5%***	***-1.08%***	***-1.46%***	***1.10%***
Credit/Debt					
High Yield Bonds and Bank Loans	$1,864	2.7%	10.14%	4.66%	n/a
Private Credit	3,467	5.1%	9.70%	8.04%	7.65%
Credit Hedge Fund	25	0.0%	-24.83%	-9.39%	-4.07%
Non-U.S. Credit	736	1.1%	10.63%	0.99%	-0.03%
Subtotal	***$6,090***	***8.9%***	***9.83%***	***4.82%***	***4.40%***
Real Assets					
Real Estate	$6,443	9.4%	-7.70%	4.02%	6.51%
Natural Resources and Infrastructure	3,088	4.5%	7.21%	6.41	n/a
Commodities	192	0.3%	n/a	n/a	n/a
Subtotal	***$9,722***	***14.2%***	***-2.82%***	***5.07%***	***3.59%***
Absolute Return	**$3,960**	**5.8%**	**5.86%**	**3.59%**	**2.50%**
Multi Asset	**$260**	**0.4%**	**9.88%**	**2.27%**	**n/a**
Cash	**$1,222**	**1.8%**	**6.42%**	**2.83%**	**4.23%**
Total Fund	**$68,245**	**100.0%**	**6.93%**	**7.02%**	**6.32%**

[1] The Growth Equity Subtotal includes an additional $13.7 million in stock distribution assets.

Note: Returns beyond one year are annualized. Returns are net of fees. Columns may not add to total due to rounding.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2024

The asset allocation targets set by the board are intended to maintain an acceptable risk tolerance for the system, providing protection for the system against investment volatility. The investment returns of each asset class can result in deviation from the target allocations, requiring additional oversight to maintain the overall asset allocation within the system's established risk tolerance.

Exhibit 3 shows that the system performed 0.59% (59 basis points) above the total system return benchmark for fiscal 2024. The system did not meet its benchmarks in three of its five major asset classes. However, as previously noted, it exceeded the total fund benchmark for the year.

Exhibit 3

State Retirement and Pension System of Maryland

Performance Relative to Benchmarks for Year Ending June 30, 2024

	Return	Return Benchmark	Excess
Growth Equity	**12.32%**	**12.38%**	**-0.06%**
Public Equity	17.94%	17.25%	0.69%
Private Equity	5.24%	6.31%	-1.07%
Rate Sensitive	**-1.08%**	**-1.18%**	**0.10%**
Nominal Fixed Income	-2.09%	-2.15%	0.06%
Inflation Sensitive	2.97%	2.48%	0.48%
Credit	**9.83%**	**10.32%**	**-0.49%**
High Yield Bonds and Bank Loans	10.14%	10.59%	-0.45%
Private Credit	9.70%	n/a	n/a
Credit Hedge Fund	-24.83%	10.35%	-35.18%
Non-U.S. Credit	10.63%	8.10%	2.53%
Real Assets	**-2.82%**	**-5.43%**	**2.61%**
Real Estate	-7.70%	-9.59%	1.90%
Natural Resources and Infrastructure	7.21%	4.56%	2.65%
Absolute Return	**5.86%**	**8.43%**	**-2.58%**
Multi Asset	**9.88%**	**6.34%**	**3.54%**
Cash and Cash Equitization	**6.42%**	**5.64%**	**0.78%**
Total Fund	**6.93%**	**6.34%**	**0.59%**

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2024

DLS requests that SRA comment on the fiscal 2024 return performance in relation to the policy benchmarks. For any asset classes and asset sub-classes that underperformed the benchmark, SRA should comment on the factors that led to the underperformance, whether those factors are expected to negatively affect performance in fiscal 2025, and what actions are being taken to mitigate those factors from impacting the fiscal 2025 returns.

Performance Relative to Other Systems

In addition to comparing the system's performance to its policy benchmarks, another method of evaluating the system's investment performance is to compare it with the performance of other systems. The Wilshire Trust Universe Comparison Service (TUCS) rankings are useful for providing a big picture, snapshot assessment of the system's performance relative to other large public pension plans. In the TUCS analysis, systems are ranked on a scale of 1 to 100, with a rank of 1 being the system with the highest investment returns for the time period. According to TUCS, the system's fiscal 2024 total fund investment performance was rated in the ninety-fourth percentile among the public pension funds with at least $25 billion in assets, as shown in **Exhibit 4**. As the system has historically had a low allocation to equity investments compared to its peers – and to domestic equity in particular – the system's investment policy will have a low TUCS ranking when equity markets are experiencing strong performance, as has been the case for a number of recent years. The long-term relative performance rankings have placed SRPS' relative total fund performance in the bottom quartile. The TUCS rankings are based on returns gross of fees.

Exhibit 4
TUCS Percentile Rankings for Periods Ending June 30
Fiscal 2021-2024

	2021	2022	2023	2024
1 Year	64	37	96	94
3 Years	57	37	71	89
5 Years	75	43	59	70
10 Years	88	75	78	75

TUCS: Wilshire Trust Universe Comparison Service

Note: Rankings for systems greater than $25 billion.

Source: Wilshire Trust Universe Comparison Service

The impact of asset allocation on total system TUCS rankings can also be seen in the system's TUCS rankings on performance within individual asset classes. When the system as a whole has experienced relatively low rankings when compared to peer systems, the system has experienced better relative performance by asset class. **Exhibit 5** shows the difference in the system's relative rankings by asset class. These asset class comparisons are based on pension funds with assets of at least $1 billion in assets, unlike the total fund comparisons, which are based on pension funds with at least $25 billion in assets.

The asset allocation has impacted the relative ranking of the total system return, with the system having lower allocations to public equity and domestic public equity in particular when compared to peer plans. This effect can also be seen in the ranking for total equity. The system does not have a bias to U.S. equity, which had strong performance in recent years. A system with higher allocations to well-performing asset classes will have better relative performance. The system's 5- and 10-year returns by asset class indicate sustained above-average performance in multiple asset classes. With public equity – particularly U.S. public equity – comprising very efficient public investment markets, the system's long-term average performance indicates a measured approach to balance risk and return in those volatile asset classes. While the overall performance within each asset class generally indicates successful management, the performance in fixed income has dropped significantly over the past three years. Private equity performance dropped significantly to the seventy-fifth percentile in 2024, but long-term performance remains among the best compared with peers.

Exhibit 5

TUCS Percentile Rankings for Periods Ending June 30, 2024

Asset Class	1-year	3-year	5-year	10-year
Total Equity	75	99	84	65
U.S. Equity	32	40	31	35
International Developed	45	48	26	35
International Emerging	87	83	66	n/a
Fixed Income	89	96	75	46
Private Equity	75	29	5	5
Real Estate	64	55	50	40

TUCS: Wilshire Trust Universe Comparison Service

Note: Rankings for systems greater than $1 billion.

Source: Wilshire Trust Universe Comparison Service

DLS requests that SRA comment on the relative TUCS performance rankings by asset class and how overall asset allocation impacts the total system's TUCS rankings.

Additionally, DLS requests that SRA comment on the drop in TUCS performance rankings in the fixed income and private equity asset classes over the past three years, and the strategies being implemented to improve performance within the asset classes.

Recent historical returns have seen both exceptionally strong and exceptionally weak returns in public equity, which demonstrates how highly volatile this asset class is. Allocations that limit exposure to more volatile assets should result in more stable employer contribution rates over time. An allocation that would result in mitigating volatility of returns (whether excess gains, returns below the assumed rate of return, or investment losses) will also mitigate the impact to employer contributions from contribution rate increases. A system's asset allocation should be impacted by a number of considerations that reflect a system's risk tolerance. A system's maturity (ratio of retirees to active members), funded status, assumed rate of return, benefit structure, regularity of full contributions, and other considerations factor into a system's risk tolerance. The importance of these factors will vary from plan to plan, leading to different tolerances for risk, variation in investment allocations, and differences in annual returns.

TUCS provides data on the risk-return profile of its members that shows that the system's level of risk over the three-year period ending June 30, 2024, was below the median for other public funds with assets greater than $25 billion. This is consistent with the system's comparatively lower allocation to public equity, which historically is a highly volatile asset class. The system's asset allocation strategy is intended to protect against more extreme losses in down markets. Due to the nature of the benefits that the system's investments ultimately fund, there is prudence in setting an asset allocation that achieves the necessary investment returns with the lowest level of risk capable of achieving those returns, while also mitigating volatility. The system's allocation strategy has appeared to continue providing this intended result. Despite having a return of -2.97% in fiscal 2022 and a return of 3.14% in fiscal 2023, many other plans experienced significantly higher investment losses in fiscal 2022 that necessitated a higher level of investment risk to achieve higher subsequent returns to recover the experienced losses.

DLS requests that SRA comment on how the system's asset allocation strategy affected the system's investment return volatility over the prior five fiscal years and the impact to the system of the mitigated volatility.

Investment Management Fees

As shown in **Exhibit 6**, SRPS incurred $437 million in investment management fees during fiscal 2024, an increase from $434 million in fiscal 2023 fees, and fees paid as a percentage of assets were less in fiscal 2024 than in fiscal 2023. Management fees for the plan have grown substantially since the system adjusted its asset allocation to invest more heavily in alternative asset classes with higher fee structures. The shift of public equity assets to global and emerging market equity managers, which are almost all active managers, has also contributed to the growth in fees over the years. Fees also fluctuate as assets increase or decrease.

Exhibit 6
Asset Management Fees Paid by Asset Class
Fiscal 2023-2024
($ in Millions)

	2023				2024			
Asset Class	**Management Fee**	**Incentive Fee**	**Total**	**Fees as % of Asset**	**Management Fee**	**Incentive Fee**	**Total**	**Fees as % of Asset**
Equity	$56.5	-$22.8	$33.9	0.27%	$52.4	$1.6	$54.0	0.45%
Rate Sensitive	15.8	14.0	29.8	0.64%	17.2	15.4	32.7	0.67%
Credit	5.5	n/a	5.5	0.19%	5.2	n/a	5.2	0.18%
Private Equity	126.8	n/a	126.8	0.93%	134.7	n/a	134.7	0.93%
Real Estate	55.5	4.5	60.1	0.84%	50.4	3.1	53.5	0.81%
Real Return	18.1	0.7	18.8	0.87%	23.5	0.6	24.1	1.58%
Absolute Return	50.5	43.3	93.9	2.34%	46.7	25.9	72.7	1.87%
Multi-asset	1.1	n/a	1.1	0.49%	1.1	n/a	1.1	0.45%
Credit/Debt	18.9	0.2	19.0	0.84%	23.9	n/a	23.9	0.76%
Equity Long Short	16.4	20.4	36.8	1.97%	16.2	10.0	26.3	1.51%
Service Providers	8.2	n/a	8.2	n/a	9.1	n/a	9.1	n/a
Total Fund	**$373.3**	**$60.5**	**$433.9**	**0.68%**	**$380.6**	**$56.7**	**$437.2**	**0.66%**

Note: Columns may not sum to total due to rounding. Fees as % of Asset column indicates fees as a percentage of the average market value of the asset under management.

Source: State Retirement Agency

Review of the SRPS fees by the system's investment consultant has noted that SRPS has been effective at negotiating more favorable fee arrangements than peer systems. Transitioning assets to internal management is also expected to result in fee savings to the system. As discussed in the following sections, the system has moved $14.5 billion in assets under internal management, which is approximately 21% of system assets. SRA has stated that its goal is to increase this to as much as 50% of assets by the tenth year of this transition, which is 2028.

Active Management

While active management of assets results in higher overall fees, the system has benefited from active management. The system has found passive investment strategies to be effective where available. However, active management is able to add more diversification to system investments by investing in assets where active management can generate returns where passive investment is not available or efficient. Active management can allow for tactical adjustments to respond to short-term or rapidly developing market conditions. **Exhibit 7** shows the system's fiscal 2024 performance where active and passive management are utilized. Actively managed U.S. equity

generally outperformed passive assets in the short term and for the fiscal year and five-year periods. U.S. nominal fixed income actively managed assets also generally outperformed passively managed assets, either achieving higher returns or avoiding deeper losses. Passively managed international developed equity outperformed the actively managed assets. Unlike U.S. equity and U.S. nominal fixed income, the system has significantly more actively managed International Developed Equity assets than it does passively managed assets.

Exhibit 7

Active and Passive Management Performance

Periods Ending June 30, 2024

($ in Millions)

	Assets	1 Month	3 Months	FYTD	3-year	5-year
U.S. Equity						
Passive Management	$4,320.7	2.74%	2.89%	22.21%	7.75%	13.56%
Active Management	4,797.2	3.63%	3.33%	24.56%	7.10%	14.29%
International Developed Equity						
Passive Management	$748.7	-1.18%	0.23%	12.70%	n/a	n/a
Active Management	3,416.9	-2.41%	-0.84%	10.71%	1.74%	6.14%
U.S. Nominal Fixed Income						
Passive Management	$3,639.8	1.39%	-1.04%	-2.39%	-8.17%	-2.46%
Active Management	4,307.3	1.15%	0.09%	2.12%	-4.32%	0.18%

FYTD: fiscal year to date

Note: Returns are net of fees.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2023

DLS requests that SRA comment on the potential impact of its decision to allocate a higher portion of the system's international developed equity investments to actively managed funds.

Absolute Return Fees and Performance

Absolute return fee structures typically include base fixed management fees and incentive compensation based on performance. Fees paid for absolute return were $72.7 million in fiscal 2024, which represents approximately 17% of all management fees. Absolute return comprises 5.8% of SRPS investments. The absolute return investment return has consistently performed well below the system's assumed rate of return as well as additionally performing below its benchmark. The system's

Investment Policy Manual describes the absolute return asset class as, “investments whose performance is expected to exceed the three-month U.S. Treasury bill by 4% to 5% over a full market cycle and exhibit low correlation to public stocks.”

In fiscal 2024, managers achieved returns of 5.86% against a benchmark of 8.43%, following returns of -1.37% against a benchmark of 1.41% in fiscal 2023. Performance relative to benchmarks was mixed within the asset class, with only 10 of the 24 absolute return managers achieving returns above the asset class benchmark. Returns varied considerably between underperformance and overperformance. A significant number of investments sustained losses with 10 managers underperforming their benchmarks by more than 5%, and 6 underperforming by at least 10%. Only 4 managers had returns exceeding the Financial Times Stock Exchange three-month U.S. Treasury bill benchmark of 5.64%.

Absolute return has returns below benchmarks for the 1-, 3-, 5-, and 10-year periods ending June 30, 2024. Since inception, the returns have exceeded the benchmarks, but that return is only 3.32% against a benchmark of 2.99%. In contrast, the system’s cash assets (0.4% of total system assets) have returned 3.70% since inception (against a benchmark of 1.03%) and have outperformed the absolute return assets over the 1-, 3-, and 10-year periods ending June 30, 2024.

Given the historic low rate of return, underperformance relative to benchmarks, and high management fee structures, DLS requests that SRA comment on the returns of the absolute return asset class, including the market conditions leading to the low level of returns and benchmark underperformance, and whether it is considering reducing its allocation to absolute return as a result of long-term underperformance.

Private Equity Fees and Performance

Management fees for private equity comprised nearly 31% of total management fees while constituting 21.6% of system assets in fiscal 2024. The reason for the higher amount of fees in private equity involves a substantial degree of active management. Fee structures typically include a fixed-base management fee plus a portion of earnings referred to as “carried interest.” The management fees only reflect the base fees, not carried interest. Because of the nature of private equity fee arrangements, carried interest fees are tied to performance. When private equity managers earn strong returns, the system pays higher carried interest fees. SRA advises that private equity returns are reported net of management fees and carried interest.

The private equity return was 5.24%, with a benchmark of 6.31%, marking the second time in several years for which the asset class failed to achieve double-digit returns. Investment in private equity has resulted in positive returns for the system with less experienced volatility than public equity. Returns for the 1-, 3-, 5-, and 10-year periods ending June 30 were 5.24%, 9.53%, 15.38%, and 14.95%, respectively. With the exception of the 1-year return, returns for those same periods also provided excess returns over the asset class benchmarks. Private equity investment performance has also outperformed peer systems consistently, as noted in Exhibit 5, with the system ranking in the top 29% for its 3-year return and the top 5% for its 5- and 10-year returns in the TUCS rankings.

SRA has also been utilizing coinvestments in private equity. Such investments are companion investments to private equity funds that SRPS is already investing in but would not carry the same associated fee structure. Under this approach, SRPS is effectively reducing its fees for any private equity investments that it coinvests by increasing the invested funds, with the coinvested portion of the investment being subject to a lower fee structure. One potential risk in coinvesting is that it can result in decreased diversification by consolidating private equity assets in fewer investments. Management of private equity assets will play a crucial role in the continued success of the asset class.

DLS requests SRA to provide an update on estimated carried interest for calendar 2024. SRA should also comment on the feasibility of including carried interest in its regular fee reports.

Investment Division Staffing

Chapters 727 and 728 of 2018 granted the board authority to set the compensation of personnel in the SRA Investment Division and to establish positions within the division, subject to certain limitations. Investment Division staff are now to be "off-budget" and funded as system expenses. Investment positions are also now outside of the State personnel system. The stated purpose of the legislation by SRA and the board was twofold. First, SRA's Chief Investment Officer (CIO) noted that the ability to create positions and set compensation would reduce compensation-related turnover in the division and help in recruitment to adequately staff the division to perform its existing functions. Testimony submitted in support of the legislation noted that the authority is expected to enhance system investment performance by maintaining and adding staff. The testimony noted that additional staffing resources will "enable the division to expand the universe of potential managers or investments to pursue, enhance the methodology of evaluating those opportunities, or design tactical strategies to adjust the mix of investments for intermediate-term performance." Additional staffing was also intended to free senior investment staff of administrative duties, resulting in increased focus on enhancing investments. The testimony noted that providing the board with authority over positions and compensation "will not result in paying the existing staff more money for doing the same job, but instead, will allow these positions to be more focused on the investment process rather than the administrative and reporting functions." The request for staffing authority contemplated SRA's need to expand its staff resources, as both the complexity of the fund assets and the size of the assets under management is expected to grow.

Since the passage of Chapters 727 and 728, SRA has been able to hire additional staff and move forward into internal management of assets. The Investment Division has grown to 51 approved positions as of June 30, 2024, with 63 positions projected for fiscal 2025. Periodic review of the division's operations will evaluate the need for additional future positions. Chapters 727 and 728 included limitations on the amount compensation may be increased in a fiscal year, which had led to issues with disparate compensation for division staff who were hired prior to the compensation authority being granted to the board. Chapter 356 of 2022 gave the board authority to "catch-up" these employees' salaries to the salary midpoint for their position.

Chapters 727 and 728 also included provisions establishing an Objective Criteria Committee (OCC) to review compensation for the Investment Division and to make recommendations to the board regarding the exercise of its authority to set compensation for the division. OCC scheduled three meetings during the 2023 interim to meet the statutory requirement to review division compensation. The 2018 legislation included a number of limitations on the board's authority to set compensation and, in particular, incentive compensation. The restrictions included in Chapters 727 and 728 were intended to strike a balance between giving the board necessary flexibility to be able to recruit and retain investment division personnel while also being respectful of broader compensation available to other State employees. Consistent with this intent, the authority granted to the board was a narrow authorization to set competitive compensation for positions with job responsibilities that are unique within State government, namely exercising discretion over investments of the multi-billion dollar trust that supports over 400,000 system member, retiree, and beneficiary accounts. With regard to the use of incentive compensation, the legislation required incentive compensation to only be granted based upon objective criteria adopted by the board. OCC is a body charged with making recommendations to the board for the adoption of the objective criteria.

The OCC process has undergone its second round of review over the past year. At the November 2023 meeting of OCC, the board's consultant reviewed the compensation structures for Investment Division personnel, including both base compensation and incentive compensation. The committee discussed a need to find a balance between base compensation and incentive compensation comprising an employee's total cash compensation. There was discussion of the statutory cap on incentive compensation being limited to 33% of base compensation, resulting in limitations on getting employees to the target ranges for total cash compensation. The discussion noted that incentive compensation can align an employee's personal interests with those of the system by encouraging strong investment management performance and that higher base compensation could have the result of "rewarding" underperformance. On the other hand, DLS notes that during the passage of Chapters 727 and 728, there was discussion around the risks that higher weight toward incentive compensation can incentivize an employee to take additional risks when managing system assets. There was also discussion of how Chapters 727 and 728 have impacted division recruitment and retention. It was noted that while there are some positions that have been more competitive to recruit due to national labor market issues, very few investment employees have vacated their positions since the passage of the legislation. State agency personnel vacancies were at an all-time high in fiscal 2021, much of this attributable to low State compensation. That the investment division is faring better than other State agencies suggests that compensation is more line with similar organizations than in most other State agencies.

DLS requests that SRA comment on the use of the compensation adjustment authority provided under Chapters 727 and 728 and Chapter 356 and whether the board has faced any difficulties recruiting and retaining staff since the passage of Chapters 727 and 728. DLS further requests SRA to update the committee on the number of resignations and terminations since the passage of Chapters 727 and 728.

Incentive Compensation

Fiscal 2020 was the first year in which Investment Division staff and the CIO were eligible for incentive compensation under Chapters 727 and 728. Due to restrictions on the payment of

incentive compensation in years in which State employees are subject to a furlough, incentive payments are subject to deferral to ensure compliance with this restriction. Additionally, the statute requires incentive compensation to be paid out over multiple years, and the board's current policy is to pay incentives earned over a two-year period. The Acts included this requirement as a retention incentive and was modeled off a previous existing policy of the board to pay incentive compensation for the CIO over a period of three years. Incentive compensation is earned based on the performance of assets under an employee's management. The incentive compensation earned is based to varying degrees on the performance of assets related to the system's actuarial rate of return, the system's policy benchmark, and asset class-specific performance benchmarks.

OCC explored whether a risk-based metric could be substituted for performance relative to the assumed rate of return, but the OCC consultant as well as the board's investment consultant could not identify a reasonable risk-based metric to use. During the July 2024 investment committee meeting, there was further discussion concluding that a reasonable risk-based metric was not identified but that the board would continue to evaluate options for inclusion of risk-based metrics in the future. As part of the discussion, a motion was adopted to remove performance relative to the actuarial rate of return as a criteria for the CIO's incentive compensation, so that the CIO's incentive compensation would be based 100% on the investment performance relative to the policy benchmark over a three-year period. No such motion was made regarding other positions within the division. The committee recommended incentive compensation performance metric weighting for staff, as shown in **Exhibit 8**, which was adopted by the board at its October 2024 meeting. Investment return relative to the system's actuarial rate of return remains a component for incentive compensation for the positions of deputy chief investment officer, senior corporate governance manager, and senior risk manager. During the OCC process, there was discussion about whether basing incentive compensation on performance relative to the actuarial rate of return for the system made sense for staff that worked primarily or exclusively in a select asset class and for staff that did not have any role in advising the board on the system's asset allocation. As noted previously, the system's asset allocation plays a major role in determining the system's overall returns.

Exhibit 8

State Retirement Agency Investment Division
Incentive Compensation Performance Metric Weighting

Position	Policy Benchmark	Actuarial Rate of Return	Asset Class
Chief Investment Officer	100%	n/a	n/a
Deputy Chief Investment Officer	75%	25%	n/a
Managing Director	50%	0%	50%
Senior Corporate Governance Manager	75%	25%	n/a
Senior Risk Manager I through III	75%	25%	n/a
Senior Portfolio Manager I through IV	50%	0%	50%
Senior Investment Analyst I through III	50%	0%	50%

Source: Investment Policy Manual for the Board of Trustees of the State Retirement and Pension System (October 2024)

The board also had discussions regarding a provision of law that prohibits the payment of incentive compensation in a fiscal year during which State employees are subject to a salary furlough. Incentive compensation has generally been determined and designated for payment around the end of the first quarter of the fiscal year. The discussion noted that the current practice of determining and awarding incentive compensation could happen before it is known whether a furlough might be implemented. The board decided that in years when the September general fund revenue projections are strong and the Department of Budget and Management (DBM) indicates a sound fiscal position for the State budget, incentive payment recommendations will be presented to the board at its October meeting for payments to be made on a date in November. In years when the September revenue estimates appear weak for the current and upcoming fiscal years (or come in lower than expected) and are coupled with an uncertain fiscal outlook from DBM, incentive recommendations would be delayed for review of the December revenue projections. If the fiscal outlook has improved after the December projections and there is greater confidence a furlough would not be issued, incentive recommendations would be presented at the January board meeting for a February payment date. If there is still uncertainty after the December projections, the recommendations for incentives would be extended to the board's February meeting. The discussion noted that historically, all furlough announcements have been issued no later than January.

The statute only prohibits the payment of the incentive compensation during a period of furlough; so, once a furlough has ended, any outstanding incentive compensation that was delayed could be paid out by the system. When passing the legislation in the 2018 session, this was discussed as both a way to preserve equity between division staff and other State employees, as well as serving as a retention incentive, as division staff may not be paid incentive compensation if they terminate their employment prior to the date of a payment. Alternatively, DLS would note

that establishing a practice of paying incentive compensation on June 30 (the last day of a fiscal year) would be the most assured method of not paying out incentive compensation during a fiscal year in which there has been a furlough.

DLS requests that SRA update the committee on the use of incentive compensation for recruitment and retention and provide information on the number of division staff eligible for incentive compensation based on fiscal 2024 returns.

Additionally, DLS requests SRA to comment on the process that led the board to remove fund performance relative to the systems' assumed rate of return as one of the metrics used for determining eligibility for incentive compensation for the position of CIO, as performance relative to the system's assumed rate of return is still a component for other Investment Division staff with lesser involvement in advising the board on the system's asset allocation.

Internal Management of Assets

Another purpose of Chapters 727 and 728 was that the authority over positions and compensation would be necessary to begin moving externally managed assets to internal management by division staff. The timeline indicated for internal management contemplated beginning with passively managed assets. Internal management would be broadened in years 3 through 5 to types of assets directly managed, including coinvestment in private assets. By year 10, as much as 50% of assets could be managed internally. One of the arguments for internal management is that it can reduce fees paid for asset management. SRA indicates that fee savings of just 1 basis point would net the system approximately $6 million. DLS has previously noted that SRA has been effective at negotiating favorable fee arrangements with external managers, and that external management provides SRPS with options to select asset managers and to diversify the management of assets among multiple managers. DLS also previously noted that performance measures would need to be adopted to monitor and evaluate the effectiveness of internal management of system assets compared to external management. Additionally, guidelines and reporting requirements would need to be implemented to track the internal management of system funds as well as any expansion or reduction of internal management once implemented.

Since the passage of Chapters 727 and 728, the system has begun to move assets under internal management. In total, the system has moved $13.5 billion in assets under internal management, which is approximately 20% of system assets. **Exhibit 9** shows the performance of the system's internal management program. The internally managed assets generally exceeded or tracked closely with the asset benchmarks. The internally managed assets do not carry the same fee expenses as externally managed assets, and the performance shown in Exhibit 9 does not reflect fee savings.

Exhibit 9

State Retirement Pension System Internal Management Performance

Investment Performance for Periods Ending June 30, 2024
($ in Millions)

	Total Assets	Fiscal 2024 Actual	Fiscal 2024 Benchmark	Inception Actual	Inception Benchmark	Inception Date
MD TIPS	$2,278.2	2.78%	2.48%	2.09%	2.00%	6/30/2019
MD Long Government Bonds	2,461.8	-5.12%	-5.55%	-8.21%	-8.41%	2/28/2020
MD Investment Grade Corporate Bonds	648.3	4.86%	4.63%	-3.18%	-3.03%	6/30/2021
MD Securitized Bonds	529.7	2.64%	2.38%	-2.97%	-3.10%	9/30/2021
MD Enhanced Cash Fund	30.9	n/a	n/a	2.49%	2.22%	2/1/2024
MD U.S. Large Cap Equity	3,903.6	23.85%	23.88%	14.85%	14.86%	10/1/2020
MD U.S. Small Cap Equity	417.1	8.75%	8.66%	0.85%	0.76%	10/1/2021
MD Global Infrastructure	1,382.8	4.54%	3.77%	2.73%	1.88%	12/1/2022
MD International x U.S. Large Cap Equity	748.0	12.72%	12.43%	14.98%	13.09%	4/1/2023
MD International x U.S. Sci-beta Value	1,162.1	14.04%	14.45%	13.07%	12.82%	5/1/2023

MD: Maryland

TIPS: Treasury inflation-protected securities

Source: State Retirement Agency

DLS requests that SRA comment on the estimated fee savings attributable to internally managed assets.

Additionally, DLS requests that SRA provide an update on the Investment Division's internal management of system assets and the development of necessary compliance and controls on the use of internal asset management. More specifically, SRA should comment on how the Investment Division:

- **has developed proficiency in managing assets currently being managed internally;**

- **will develop proficiency before expanding into internal management of additional asset classes;**

- **will evaluate the performance of internal management compared to available external management services; and**

- **will develop methodologies for determining fee savings achieved through internal management.**

Investment Climate Risk

The impact of climate change on the invested assets of public (and private) retirement systems has been receiving increasing attention over the last few years. As climate-related risk to investments is becoming more well understood and manifest, investment fiduciaries are becoming more aware of the potential risks to current assets and the potential for future opportunities to invest as climate risks manifest. Much of the discussion around climate risk has focused on divesting from carbon-producing and -using businesses or severing relationships with entities who are divesting from carbon producing and using businesses. In 2022, the Maryland General Assembly adopted an approach centered around the requirement for system fiduciaries to prudently invest the assets of the system. Chapters 24 and 25 of 2022 codified the responsibility of a fiduciary of SRPS, when managing assets of the system and in accordance with statutory fiduciary responsibilities, to consider the potential systemic risks of the impact of climate change on the system's assets.

The Acts do not require the system to take any specific action from any particular asset. Instead, the goal is to ensure that the system fiduciaries are well informed of the potential climate-related risks to system assets, just as they have duties to stay informed of any other financial risks to system assets. The Acts are intended to ensure that the system is aware of developing information regarding climate risk so that it is able to respond prudently and efficiently when climate-related risk – or opportunity – arises. In many ways, the Acts codify activity that the system has already established as regular practice. The system has received analysis from its primary investment consultant modeling the impact of climate risk to the system's assets during the system's periodic review of the asset allocation. Previously, the system has noted that its ownership interests in businesses have provided access to engage with companies on climate risk issues. The system's *Investment Policy Manual* also has a number of policies for shareholder proxy voting on climate-related issues.

As Chapters 24 and 25 included requirements that would either continue current practices or require the buildout of new activities for the system's Investment Division, it was expected that additional positions and consultants may be needed. Using the authority to create new positions within the Investment Division granted by Chapters 727 and 728, the system recently created 1 new senior governance manager position in the division to oversee activity related to environmental, social, and governance investment matters. That position is currently vacant.

DLS requests SRA to provide an update on the implementation of Chapters 24 and 25, including the status of recruitment for the Senior Governance Manager position.

Terra Maria Program

The Terra Maria program is the system's emerging manager program. One of the Terra Maria program's stated goals is to achieve returns in excess of benchmarks. The program has demonstrated the ability to achieve excess returns over benchmarks, with instances of significant returns over benchmarks at times. Over the past few years, SRPS reorganized the program to better utilize the asset diversification that the program can bring to SRPS. The program transition included consolidating under 3 program managers (Attucks handles two different portfolios), eliminating mandates for allocations to large-cap domestic equity, and increasing mandates for international small-cap and emerging markets. Program investments in domestic equity in recent years were tracking close to markets, making it more difficult to achieve excess returns in an asset class where it is already difficult to outperform the market in addition to incurring active management fees. The program has maintained a diverse roster of managers through the transition.

Total assets within the program decreased to $2.35 billion in fiscal 2024, from $2.42 billion in fiscal 2023. As a proportion of total assets, Terra Maria decreased from 3.7% of total assets in fiscal 2023 to 3.4% in fiscal 2024. **Exhibit 10** provides an overview of the Terra Maria program by program manager and asset class.

Exhibit 10

Terra Maria Program Performance

Investment Performance for Periods Ending June 30, 2024
($ in Millions)

	Total Assets	Performance			
		Fiscal 2024 Actual	Fiscal 2024 Benchmark	Inception Actual	Inception Benchmark
Program Manager					
Attucks International Equity	$549.3	10.87%	11.22%	10.05%	7.39%
Attucks U.S. Equity/Rate Sensitive	1,050.0	6.57%	6.27%	9.78%	9.53%
Xponance	207.2	9.49%	8.06%	8.19%	8.35%
Leading Edge	546.8	11.61%	11.22%	8.82%	7.39%
Asset Class[1]					
U.S. Equity	$368.0	10.52%	10.03%	7.26%	7.41%
International Developed Equity	1,303.3	10.83%	10.66%	3.74%	2.86%
Rate Sensitive	554.4	3.95%	3.35%	1.67%	1.23%
Total	**$2,353.3**	**9.11%**	**8.93%**	**5.09%**	**4.87%**

[1] Excludes allocations classified as credit/debt.

Note: Actual returns are net of fees; returns beyond one year are annualized. Total assets may not sum to total due to rounding.

Source: State Street – State Retirement Agency of Maryland – Rates of Return – Net Mgr – Periods Ending June 30, 2023

In fiscal 2024, the program as a whole experienced returns of 9.11%, outperforming the program benchmark by 0.19 percentage points. Three of the four program managers had returns above their benchmarks, and three of the four program managers had returns well above the system's 6.8% assumed rate of return. By asset class, only U.S.- and international-developed equity had strong returns while also outperforming the benchmarks. Since inception, all four program managers have had returns above the system's assumed rate of return, with three of the four outperforming their benchmarks.

Of particular note, the actively managed Terra Maria portfolio had significantly better performance in its rate sensitive assets compared to non-Terra Maria assets. For U.S. nominal fixed-income investments, Terra Maria returned 3.95% compared to returns of 2.12% for actively managed non-Terra Maria investments and -2.39% for passively managed non-Terra Maria investments.

Currency Program

Adopted in fiscal 2009, the currency program is designed to protect against losing value when the dollar appreciates relative to some foreign currencies in countries in which the system holds assets. During periods when the dollar is weak, the currency management program's cost manifests as a slight drag on international equity holdings. However, when the dollar appreciates, the program provides gains that help offset the currency losses generated by the strengthening dollar. As of June 30, 2024, the currency program added total value of $419.4 million since inception (up from $398.4 million through June 30, 2023). Gains when the dollar is strong should outweigh losses when the dollar is weak, and the system has taken steps to lock in program gains. The primary objective of the program is to lower volatility related to currency fluctuations.

The currency hedging program has limited application and is only applied to a relatively small portion of the system's total assets. In addition, not all foreign currencies are included in the hedging program. Due to liquidity constraints and higher transaction costs in some currencies, the program is currently limited to the euro, Japanese yen, Swedish krona, Swiss franc, Canadian dollar, Australian dollar, and British pound.

Appendix 3

State Retirement Agency

Response to Questions Received from DLS

December 11, 2024

DLS requests SRA to comment on the fiscal 2024 return performance in relation to the policy benchmarks. For any asset classes and asset sub-classes that underperformed the benchmark, SRA should comment on the factors that led to the underperformance, whether those factors are expected to negatively affect performance in fiscal 2025, and what actions are being taken to mitigate those factors from impacting the fiscal 2025 returns.

In fiscal year 2024, the System achieved an investment return of 6.93%, exceeding the assumed actuarial rate of 6.80%. This performance also outpaced the Board's policy benchmark of 6.34% by 0.59%, or 59 basis points, representing over $380 million in added value. The policy benchmark is the weighted average of each of the individual asset class benchmarks and represents what the System would have returned if the asset class benchmark returns were achieved and is a more appropriate benchmark when evaluating shorter-term performance. The total fund excess return of 59 basis points was a product of strong performance in the asset classes of public equity and real assets. Over the ten years ending June 30, 2024, the System has achieved an average annualized return of 6.32%, beating the policy benchmark of 5.75% by 58 basis points annualized net of all fees and expenses.

The Board of Trustees does not expect each asset class to outperform every year, but instead over time and across economic cycles, in a risk-balanced and efficient manner. The effectiveness of this asset allocation approach is demonstrated by the System's Sharpe Ratio, a commonly-used measure of risk-adjusted returns. Over the last 5- and 10-years, the System ranks in the top quartile on this measure among a peer universe of similar plans. Investment Division staff reviews the performance of underperforming asset classes to assess whether the performance is consistent with expectations, or a sign of a longer-term problem. In fiscal year 2024, three major asset classes trailed the performance of their respective benchmarks – private equity, credit and absolute return.

The private equity portfolio underperformed the State Street Private Equity index by 1.07%, or 107 basis points for the fiscal year. The private equity porfolio provided a 5.24% return versus 6.31% for the index. The System performed slightly better than the index in the buyouts segment of portfolio, which generated a return in excess of 7.5% and represents over 70% of the portfolio and the index. One of the primary drivers of underperformance was due to the composition of the index. Approximately 15% of the index is composed of private credit, which generated a return of 10.33% for the fiscal year. Private credit is a separate allocation in the System's portfolio and is not included in the private equity returns. The other driver of underperformance was the 9% of the portfolio that is invested in legacy secondary funds and Asia focused fund-of-funds, which had a negative 1% return for the fiscal year. The percentage of the portfolio in these legacy commitments continues to decline and they will be less of a drag on performance over time.

While the System's private equity portfolio underperformed its respective benchmarks in fiscal year 2024 due to a mismatch in composition between the index and the System's portfolio, as well as underperformance of the System's fund-of-funds investments, these factors are not expected to persist as the market environment evolves and transitions to another economic regime. Over the longer term, private equity has achieved positive relative performance, as shown in Table 1 below.

Table 1
MSRPS Private Equity Performance
As of June 30, 2024

	1-Year	3-Years	5-Years	10-Years
Maryland Private Equity	5.24%	9.53%	15.38%	14.95%
Private Equity Benchmark	6.31%	8.59%	13.97%	12.20%
Excess	-1.07%	+0.94%	+1.41%	+2.75%

The credit asset class has been a very strong relative performer over all time periods except for the one-year, as shown in Table 2 below:

Table 2
MSRPS Credit Performance
As of June 30, 2024

	1-Year	3-Years	5-Years	10-Years
Maryland Credit	9.83%	3.58%	4.82%	4.40%
Credit Benchmark	10.32%	1.69%	3.46%	3.61%
Excess	-0.49%	+1.89%	+1.36%	+0.79%

The underperformance for the one-year period can be explained by timing differences created by private investments being benchmarked to public indices. When public market benchmarks experience strong returns, like in fiscal year 2024, the appraised private market investments often are not able to keep up. These private structures also experience what is known as the J-curve effect, marked by low, or negative, returns during the early stage of an investment when values are typically held near cost until value creation is realized. During this initial period, the System pays management fees on these investments, which acts as an additional drag on performance. Over the past two fiscal years, the System has committed roughly $2 billion to these private credit strategies. The impact of the J-curve is accentuated when the public market credit benchmark produces a strong return, as was the case in fiscal year 2024. While private credit investments detracted from the fiscal year performance, the longer-term returns have significantly outperformed the public market benchmark, as shown in Table 3 below. These excess returns are expected to persist in the future:

Table 3
MSRPS Private Credit Performance
As of June 30, 2024

	1-Year	3-Years	5-Years	10-Years
Maryland Private Credit	9.70%	8.64%	8.04%	7.65%
Credit Benchmark	10.32%	1.69%	3.46%	3.61%
Excess	-0.62%	+6.95%	+4.58%	+4.04%

While the absolute return segment lagged its benchmark in fiscal year 2024, the portfolio provided significant diversification and downside protection benefits relative to the rate sensitive portfolio, returning +5.86% when bonds generated -1.08%. For the three years ending June 30, 2024, the absolute return portfolio returned +1.92% compared to -6.90% for bonds. The objective of the absolute return portfolio is to generate a positive return of cash plus 4% over time with low correlation to stocks and bonds. Additionally, in the short- to medium-term horizon, the portfolio is benchmarked relative to a custom blend of HFRI indices: 50% relative value, 25% macro, and 25% event-driven. This custom-blended benchmark returned +8.43% during fiscal year 2024. While the portfolio underperformed relative to its custom benchmark in fiscal year 2024, it continued to produce positive absolute returns with negative correlation to public markets.

Staff has positioned the absolute return portfolio to be incrementally more defensive and less volatile than the custom blend benchmark. As a result, the portfolio's benchmark is likely to experience a higher correlation to both public equity and bond markets, as well as realizing a higher annualized volatility relative to the System's absolute return portfolio. Consequently, in a period marked by strong performance in public markets, like equities in fiscal year 2024, the System's absolute return portfolio may experience lower upside participation relative to its benchmark.

Accordingly, given staff's portfolio implementation decision to exhibit low, or even negative, correlation to public equities, the portfolio can be expected to underperform its higher risk-seeking benchmark particularly when public equities experience outsized gains. In fiscal year 2024, broad global equities generated a return of nearly +20%. The custom blend benchmark has a greater correlation and positive beta to this benchmark, which explains its outperformance relative to Maryland's portfolio. Moreover, differences in sub-strategy weights may magnify the portfolio's relative performance in a given year. For example, the System's absolute return portfolio is notably underweight event driven strategies compared to the custom benchmark's weighting, in favor of overweighting opportunistic strategies. Staff expects this sub-strategy allocation decision to generate excess return over the longer term, but with the potential for underperformance in shorter periods.

Staff continues to take incremental steps in reducing the portfolio's concentration and tracking error to the benchmark. In fiscal year 2024, staff terminated underperforming managers, including the manager that was the biggest detractor of performance over the last twelve months, and avoided unattractive investment strategies. Further, staff was able to leverage its existing relationship with certain managers to

increase existing allocations and access previously unavailable strategies where capacity is limited. Staff remains active in identifying and allocating to attractive opportunities and managers, including private investments and co-investment opportunities. Staff expects these changes will reduce downside risk to the portfolio and result in a more consistent return profile.

While the absolute return asset class has been an effective diversifier to the total plan and has provided downside protection in volatile markets, it has not been able to meet performance objectives. Over the past several months, the Board has been working with its consultant and staff to review the System's asset allocation. This review may result in changes to the target allocation to absolute return and the role it plays within the total plan.

DLS requests that SRA comment on the relative TUCS performance rankings by asset class and how overall asset allocation impacts the total system's TUCS rankings.

As noted in the DLS Investment Overview, the System's one-year total fund performance compared against a peer group of other large public pension plans ranked in the 94th percentile. Peer group rankings are driven mainly by two factors – asset allocation and implementation of the asset allocation. Asset allocation refers to the way the fund assets are distributed to the various asset classes, and implementation refers to staff's ability to select skillful managers and tactically position the portfolio to take advantage of market opportunities.

An effective method to determine which of these factors is driving the total fund peer rankings is to analyze the peer ranking of each individual asset class. As noted in the DLS report, most of the System's asset classes have achieved above median returns over time. Private equity, the System's best-performing asset class, representing 21.6 percent of total fund assets, has consistently ranked in the top quartile of the peer group over time. In fact, for the ten-year period ending June 30, 2024, the System's private equity portfolio is ranked in the 5th percentile. That the individual asset class rankings are generally higher than those of the total fund supports the notion that the mix of asset classes is mainly driving the results, and not the performance of the individual asset classes. For example, the System has higher target allocations to non-U.S. equities than the average peer in the universe. Over the past ten years, U.S. stocks have significantly outperformed foreign stocks. The System's relative underweight to U.S. stocks has resulted in a lower peer ranking than would be assumed based solely on rankings of individual asset classes. This is also demonstrated by the System's total equity ranking in the 75th percentile for the fiscal year, while the rankings of the regional components are significantly better.

While the asset class rankings for the System's fixed income portfolio are above median over the last ten years, the performance trailed the peer group in fiscal year 2024. This is due to the longer duration profile of the System's portfolio relative to peers, who typically hold more core and shorter-duration bonds. Yields increased meaningfully over the fiscal year, with the ten-year treasury rate increasing from 3.85 percent to 4.40 percent. Longer-duration bonds are more sensitive to changes in interest rates and lost more in value in fiscal year 2024 than shorter-duration debt. The System allocates more to long-duration bonds for greater protection in disinflationary environments, to better match the plan's

longer-term liabilities and to hedge against stock market drawdowns to preserve principle. The correlation between stocks and bonds is typically negative, meaning as stocks go down, bonds will increase in value.

The System typically reports its peer rankings against a relatively small universe of roughly thirty public pension plans on a gross-of-fee basis. Given the System's asset allocation, with a relatively higher allocation to private market investments like private equity, private credit and real estate, it might also be instructive to measure performance against a larger universe on a net-of-fee basis. Private investments typically do not report gross investment returns, but only performance net of all fees. As a result, the System's gross returns are a combination of gross and net performance. To the extent the System invests more heavily in private investments, the difference between the gross and net numbers will be smaller relative to a peer plan that employs a higher allocation to traditional assets. This is illustrated in Table 4 below, which ranks the System's performance against a larger universe of ninety-five public pension plans after investment expenses have been netted out.

Table 4
Total System vs. Public Plans > $1 Billion Universe
(June 30, 2024 net of fees)

	1 Year	3 Years	5 Years	10 Years
Total System	**6.93%**	**2.28%**	**7.02%**	**6.32%**
Rank	**91**	**79**	**56**	**49**

* **Represents the InvMetrics Public Defined Benefit > $1 billion peer group**

The focus on investment performance tends to be on returns. However, the Board and staff recognizes that risk is equally important. To get a more complete picture of the System's investment program, risk-adjusted returns should also be evaluated. The System's risk profile, as measured by the dispersion of returns around the mean, falls in the bottom quartile of the peer group over the last five years. This lower risk posture has been achieved by targeting a lower relative weighting to public stocks versus the peer group. Sharpe ratio is another metric that accounts for risk in the assessment of investment performance, and represents risk-adjusted returns, or returns per unit of risk. Based on the Sharpe ratio measure, the System ranks in the top quartile (better than 75% of funds over the last five- and ten-years. This is illustrated in Table 5 below, which ranks the System's Sharpe ratio against a larger universe of ninety-five public pension plans after investment expenses have been netted out.

Table 5
Total System vs. Public Plans > $1 Billion Universe
Sharpe Ratio Comparison
(June 30, 2024 net of fees)

	5 Years	10 Years
Total System	**0.6%**	**0.7%**
Rank	**21**	**20**

Represents the InvMetrics Public Defined Benefit > $1 billion peer group

Additionally, DLS requests that SRA comment on the drop in TUCS performance rankings in the fixed income and private equity asset classes over the past three years, and strategies being implemented to improve performance within the asset classes.

As noted earlier, the low rankings of the fixed income asset class over the last three years can be attributed to the longer duration profile of the System's portfolio. The System allocates more to long-duration bonds for enhanced diversification in disinflationary environments, to better match the plan's longer-term liabilities and to provide downside protection against most stock market drawdowns to preserve more principle, as the correlation between stocks and bonds is typically negative, meaning as stocks go down, bonds will increase in value. While long duration bonds perform well in disinflationary environments when interest rates typically decline, they perform poorly when inflation is high, and the Fed must raise rates in response. Since March 2022, the Fed has hiked rates eleven times for an aggregate increase of 5.25%. While all bonds will struggle in this environment, long duration bonds will perform worse than shorter term bonds. While the System's bond portfolio has a low peer ranking over the last four years, we do not expect this to persist. As rates plateau or begin to fall, as has been the case thus far in fiscal year 2025, the long duration positioning should outperform more core, shorter maturity strategies as maturity proceeds and coupon payments are reinvested at higher yields.

For the fiscal year, the System's private equity program ranked in the 75th percentile in the TUCS universe, which appears to be an outlier relative to the top rankings over the longer term. It is difficult to assess this contrast, as there is no transparency into the composition of the TUCS universe or granular detail regarding portfolio characteristics. It appears that most of the relative underperformance occurred in the quarter ending December 31, 2023, which would reflect private equity performance as of September 30, 2023 given the quarter lag associated with private markets performance reporting. During this quarter, publicly-traded stocks performed poorly with the S&P 500 returning -3.27%. The System's private equity portfolio has a large allocation to large buyout funds, which generally appraise more closely to the public equity market and may hold more public stocks in the fund. This higher exposure to large buyout funds may explain the lower ranking for this quarter, given the negative performance for public stocks.

Another factor contributing to the underperformance for the fiscal year was the benchmark exposure to private credit strategies, representing roughly 15% of the index. These strategies generated a return of 10.33% for the fiscal year, far outpacing more equity-focused funds. Private credit is a separate asset class in the System's portfolio and is not included in the private equity returns. Legacy secondary funds and Asia-focused fund-of-funds also added to the System's underperformance for the fiscal year, generating a return of -1%. The percentage of the private equity portfolio allocated to these legacy commitments continues to decline and they will have less of an impact on performance over time.

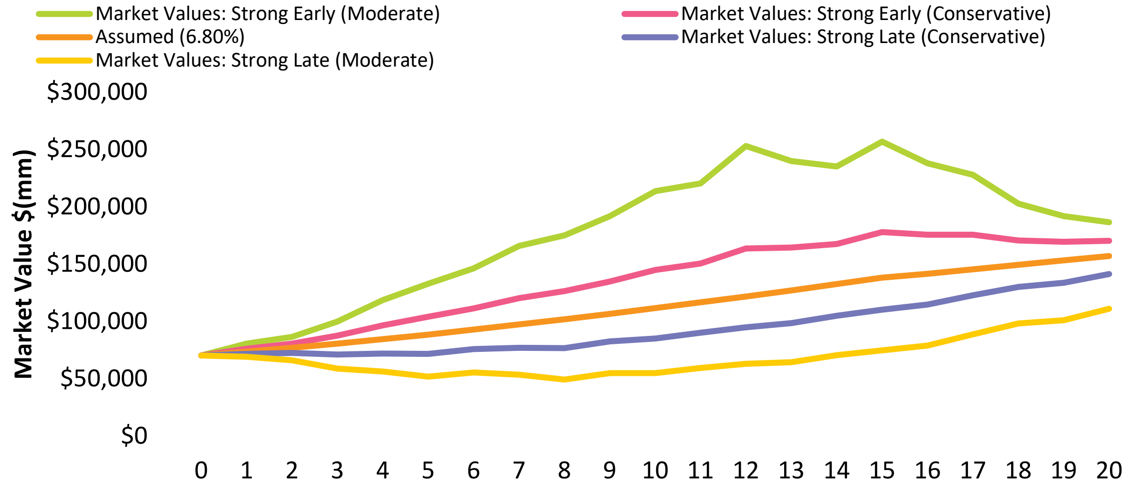
The System's investment focus continues to be generating strong long-term performance. While the performance of the private equity portfolio was below median over the last two fiscal years, the longer-term returns are near the top of the TUCS universe and represent the System's best performing asset class.

DLS requests that SRA comment on how the system's asset allocation strategy affected the system's investment return volatility over the prior five fiscal years and the impact to the system of the mitigated volatility.

The Board's asset allocation policy is designed to achieve the actuarial rate of return over long periods of time by assembling a diversified portfolio of asset classes, each of which may have a large or small, positive or negative return in any given year. By assembling assets that exhibit distinct risk and return characteristics in different market environments, the Board expects more stable investment returns over time than a less diversified portfolio. This lower risk portfolio should result in a larger asset pool for the System's beneficiaries than a more volatile portfolio with the same average return.

Over this five-year period, the System's diversified and balanced asset allocation generated a net return of 7.02%, exceeding the actuarial target of 6.80% by 0.22%. While a 60/40 portfolio of the S&P 500 stocks and U.S. bonds would have achieved a higher return of 9.01% over this period due to the outperformance of U.S. stocks relative to foreign stocks and the shorter duration posture of the bond index versus the System's bond portfolio, the volatility, or risk, of the System's return stream was significantly lower than the 60/40 portfolio. The volatility of the System's monthly returns over this period was 7.96%, compared to 12.35% for the 60/40 portfolio. The System's Sharpe Ratio, a measure of risk-adjusted returns, was also higher than the 60/40 portfolio at 0.61 versus 0.55. Volatility of returns is an important consideration, particularly when there are negative cash flows in any investment portfolio, as it is difficult to recover after a market downturn. Volatility results in a smaller asset pool relative to a portfolio with no cash flows. Since the System must pay monthly benefits and is in a negative cash flow position, mitigating the negative effects of volatility is critically important. Table 6 below shows the impact return volatility has on investment portfolios, with poor investment returns early in the period resulting in significantly lower ending market values compared to portfolios that experience strong returns earlier. Because the sequence of returns and the overall investment environment is uncertain, a diversified portfolio provides the System with the most even and balanced path in achieving its objectives.

Table 6
Impact of Sequence of Returns
on Investment Portfolios



DLS requests that SRA comment on the potential impact of its decision to allocate a higher portion of the system's international developed equity investments to actively managed strategies.

The System allocates more to active management strategies in the developed international allocation because there is greater opportunity to generate excess returns relative to the benchmark in this space than large cap U.S. equity. Table 7 below shows that, except for large cap U.S. equity, active equity managers have been able to outperform their respective benchmarks by a significant margin due to potentially greater market inefficiency and less analyst coverage.

Table 7

Annualized Excess Returns versus Benchmark					
	U.S. Large Cap	U.S. Small Cap	Int'l Large Cap	Int'l Small Cap	Emerging Markets
Median Manager	(0.23)	1.23	0.73	0.95	0.76
Average Manager	(0.33)	1.60	0.79	0.88	1.00

Relative to manager's preferred benchmark. From Q3 2014 to Q3 2024.
SOURCE: eVestment

It is important to note that the current developed international passive mandate is not a broad market strategy representing the total opportunity set of companies, but a mega cap index of the top 200 international developed companies. This is a portfolio management tool to offset an active, small cap international mandate the System has established with a Terra Maria manager-of-emerging managers. Since small cap

companies are not included in the developed international benchmark, the System offsets this small cap bias with the mega cap passive account. In fiscal year 2024, mega caps in the developed international space performed much better than the broad MSCI World ex U.S. index, generating a return of 12.7% versus 11.2% for the broader benchmark. The higher return of the passive mandate for the fiscal year is a function of mega cap stocks outperforming smaller companies, and less attributable to passive management beating active management.

Given the historic low rate of return, underperformance relative to benchmarks, and high management fee structures, DLS requests that SRA comment on the returns of the absolute return asset class, including the market conditions leading to the low level of returns and benchmark underperformance, and whether it is considering reducing its allocation to absolute return as a result of long-term underperformance.

The objective of the System's absolute return asset class is to provide diversification and risk reduction to the total fund by having little exposure, or even negative exposure, to the common risk factors found in the rest of the portfolio. The return objective is to outperform a cash return by 4% over a full market cycle, recognizing that shorter-term performance can deviate from this objective significantly. The portfolio has a further objective of maintaining diversification when equity markets are volatile, and returns are negative. Conversely, when public market returns are positive, the defensive posturing of the portfolio may lead to underperformance relative to the plan and public markets. The portfolio has not met its return objective and has failed to match or exceed its benchmark return. In fiscal year 2024, the underperformance of the absolute return portfolio can largely be attributed to manager selection, where three managers within the portfolio experienced outsized negative performance in absolute terms and relative to the managers' peers. Additionally, the portfolio maintains marginally dissimilar characteristics relative to its benchmark that yields performance dispersion under various market conditions.

Hedge funds comprise most of this asset class, which are often characterized by many diverse trading strategies that attempt to take advantage of relative value, event-driven and global macro opportunities between different securities across the spectrum of asset classes. The most favorable environment for this type of trading is one where realized volatility is high, correlations are low, and dispersion among securities is high. Volatility is the degree to which asset prices fluctuate; correlation is the degree to which assets move in the same direction; and, dispersion refers to the difference in asset price movements regardless of whether they are moving in the same direction. Hedge funds have historically performed best in more volatile markets in which increased uncertainty among market participants is present. Additionally, selecting skilled managers who can take advantage of these conditions is important as aggregate hedge fund universe performance is characterized by a high degree of dispersion among managers.

The absolute return asset class has struggled to outperform its benchmark, which was changed in fiscal year 2022 from the HFRI Fund of Funds Conservative Index plus 100 basis points to a strategy-blended, asset-weighted benchmark consisting of 50% HFRI Relative Value, 25% HFRI Event-Driven and 25% HFRI Macro. Following this change, staff re-evaluated the portfolio's exposures in tandem with its

consultant, implementing several notable changes to further optimize the portfolio's expected risk and return profile. The absolute return asset class has been able to provide significant downside protection during equity drawdowns due to its decreased risk posture and lower equity sensitivity relative to the benchmark. Examples of this protection include the fourth quarter of 2018, first quarter of 2020, and the first half of calendar 2022, when the portfolio significantly outperformed public equities during periods of market stress. Conversely, because of the portfolio's defensive nature, it is expected to underperform public markets during months in which public equities perform positively. Going forward, the portfolio's objective is to continue to preserve capital when equity markets decline, while maintaining and improving performance cadence with the benchmark when equities perform positively.

Staff has continued to focus on improving the performance and efficiency of the portfolio through manager consolidation, upsizing higher conviction managers, improving cash management, and tactically seeking and allocating to higher return or diversifying mandates that will better position the portfolio for improved performance going forward. During the fiscal year, the System continued to receive liquidation proceeds from a handful of managers that were terminated in fiscal year 2022 and 2023. Staff continues to proactively monitor the portfolio, re-underwriting existing managers and canvassing the market to identify attractive opportunities that may substitute current exposures or complement existing portfolio exposures. Staff continues to leverage the portfolio's size, when applicable, with existing manager relationships to reduce the fee expense load paid to these managers. Additionally, staff is focused on expanding and capitalizing on co-investment opportunities. Exposure to these investments is expected to increase in 2024 and beyond, resulting in reduced fees paid to external managers. These changes have led to improved performance over the last several years relative to the portfolio's long-term return target over cash. In calendar year 2024 and fiscal year 2025 through October, the portfolio is exceeding its policy benchmark by 0.63% and 1.47%, respectively.

The recent restructuring, in addition to further implementation changes, should result in a more diversified and balanced strategy allocation that is modeled to marginally increase the portfolio's volatility to a level that more closely resembles the benchmark, while preserving the portfolio's added benefit of diversification to the plan during periods of market stress. Staff is confident the forward-looking opportunity set of the asset class is attractive and believes the portfolio is well-positioned to execute on its diversifying properties to the plan and other asset classes.

While the absolute return asset class has been an effective diversifier to the total plan and has provided downside protection in volatile markets, it has not been able to meet performance objectives. Over the past several months, the Board has been working with its consultant and staff to review the System's asset allocation. This review may result in changes to the target allocation to absolute return and the role it plays within the total plan.

DLS requests SRA to provide an update on estimated carried interest for calendar 2023. SRA should also comment on the feasibility of including carried interest in its regular fee reports.

The System records carried interest earned by its managers on a calendar year basis to align with the reporting schedule for audited financial statements for most of the System's alternative investment vehicles. Currently, there is no standardized reporting structure of carried interest in the private market

industry. Because of this lack of consistent reporting, the process of aggregating carried interest amounts earned by the System's 415 private market investment vehicles is largely a manual process that is very time and labor intensive. In addition, there is a significant time lag from the end of each quarter to the time staff receives the report, particularly the calendar year-end audited financial reports. Because of these challenges, it takes the better part of a year to calculate the aggregate carried interest amounts for the prior calendar year.

In calendar year 2023, the System's managers earned estimated carried interest payments of roughly $222.6 million. It is important to distinguish the difference between management fees and carried interest, or performance incentives, as many private market investors do not consider incentive fees to be management fees. Management fees are contractual obligations that must be paid regardless of performance. Incentive fees, which primarily apply only to private market investments and not traditional asset classes, represent a portion of investment profits that is earned by a manager, and are only paid if performance thresholds are achieved and generally after the investor has recouped all management fees and expenses. They are utilized to motivate the manager to make profitable investments, and to ensure alignment of interests. The percentage of profits that is allocated to the manager is substantially lower than the amount received by the System. Because of this disproportionate sharing of profits, the amounts realized by the System would far exceed any incentive fees paid to managers. Large amounts of carried interest should be considered a positive result, as this would imply much greater gains to the System at a level of roughly fourfold. Based on the amount of carried interest earned in 2023, the implied gains to the System over a period of several years would equate to approximately $890 million. While the System would like to see an improved profit-sharing allocation in favor of the investor, and negotiates contract terms aggressively where possible, the overall market, consisting of both managers and investors, establishes the sharing percentages. If the System avoided these investments based on the fee structure alone, it would not have experienced the superior net-of-fee returns provided by private equity relative to all other asset classes.

DLS requests that SRA comment on the use of the compensation adjustment authority provided under Chapters 727 and 728 and Chapter 356, and whether the board has faced any difficulties recruiting and retaining staff since the passage of Chapters 727 and 728. DLS further requests SRA to update the committee on the number of resignations and terminations since the passage of Chapters 727 and 728.

At the request of the Board of Trustees, during the 2018 session, the General Assembly enacted legislation that provided the Board with the authority to determine and create the type and number of Investment Division staff, as well as compensation for these positions, subject to certain constraints. These constraints included limiting annual increases to no more than 10%. This annual cap on salary increases resulted in a disparity between legacy employees hired prior to the 2018 legislation and newer employees hired under the new classification and salary structure. We were able to offer these recent hires a higher salary closer to the market midpoint, while legacy employees with the similar skills, experience and responsibilities would have to wait several years to reach an equivalent salary level.

During the 2022 legislative session, the Board requested the Joint Committee on Pensions to sponsor legislation to address this disparity. The Joint Committee agreed and on July 1, 2022 this legislation became effective. This legislation authorizes the Board of Trustees to provide two adjustments before

June 30, 2024, to the compensation for legacy employees within the Investment Division whose salary is below the midpoint for their positions. The legislation specifically provides that these adjustments do not preclude the Board from also providing annual salary increases to all employees of the Investment Division.

Nine legacy employees had a salary below the midpoint of the approved range. In October of 2022, the Board approved salary adjustments for these individuals closer to the midpoint of their respective ranges. For employees with a salary closer to the midpoint or target salary, the Board approved a one-time adjustment to be effective in November 2022. For individuals with a significant difference between current salaries and the midpoint or target salary, the implementation of the salary adjustments occurred in two stages. The first increase was effective in November 2022, and the second adjustment was implemented in April of 2023 to coincide with the regular schedule of salary reviews for the entire Investment Division. As a result of these salary increases, there are no remaining compensation disparity issues among investment-focused employees and there we no adjustments under Chapter 356 in fiscal year 2024.

This legislation has been an effective tool in recruiting and retaining Investment Division personnel. Since the legislation was enacted in 2018, the Investment Division has roughly doubled in size. A portion of this growth in headcount was to remediate the level of understaffing that existed prior to the passage of the legislation, and the remaining positions were dedicated to building out the internal management initiative, as well as adding depth and ensuring a sustainable long-term staffing structure with appropriate succession planning resources. This legislation enabled the System to hire qualified and experienced investment professionals, many of whom would not have been applicants under the former compensation structure. The effectiveness of this legislation can be measured by the low level of turnover the Investment Division has experienced since the legislation was passed. Since 2018, only twelve employees of the Investment Division separated from service for various reasons, seven in the administration unit and five investment-focused positions. Three of these twelve employees retired after more than thirty years of service and most of the others left to pursue other career opportunities, and not for compensation reasons.

In 2023, the Objective Criteria Committee convened again to work with the Board's compensation consultant to review the compensation structure of the Investment Division. As a result of this review, several minor changes were recommended by the OCC and the compensation consultant and approved by the Board in February and June of 2024. These changes are effective July 1, 2024.

The OCC and compensation consultant also recommended that the Board direct staff to engage with policy makers to assess the continued appropriateness of the limitations associated with the Investment Division's compensation and incentive program. These limitations were designed to create alignment between Investment Division staff and other state employees. One area of alignment focused on ensuring that during periods of budgetary stress for the state that led to furloughs of state employees, pay actions and incentive payments will be deferred for the Investment Division. Another area focused on maintaining equity for positions within the Investment Division that have close counterparts in other segments of state government by requiring the Board, in exercising its pay setting authority, to reference state pay levels for these positions. Another alignment concern addressed the potential equity challenge

of Investment Division staff receiving very large percentage increases during a fiscal year by limiting pay actions to 10% in any year.

The division has experienced challenges in recruiting for positions in the accounting and operations area, marked by lower response rates to job postings and a mismatch in skills, qualifications and experience. Employees in this unit were included in the 2018 legislation that granted the Board authority to set compensation levels for Investment Division employees, but for these positions that do not involve investment discretion, the Board is limited to the extent it can set compensation by the levels set for other state employees providing comparable services. For most of these positions, given the unique and technical nature of the System's investment function, we have been unable to identify other state employees performing similar functions. Lastly, there is a small number of positions that provide comparable services to other state positions.

This hierarchical treatment has also resulted in disparity within the division where different compensation policies are applied to the three groups. Based on analysis of peer compensation practices and pay scales for non-investment discretion positions, it is likely that harmonizing the compensation authority for the first two groups could be consistent with maintaining equity with other state employees performing similar services and would improve recruiting, morale and teamwork within the Investment Division by moving from a two-class structure to one where all employees are covered under the same compensation policies. We have found that the standard state salary scale is consistent with the salary ranges for the System's industry peers relating to these non-investment discretion positions for entry and mid-level positions. However, the more senior level leadership positions in the areas of accounting and operations are more aligned with investment leadership structures.

The Operations and Accounting group has seen greatest turnover in the division, particularly in leadership positions. Over the last five years, six senior-level managers have left the System for various reasons. In addition, recruiting for these positions have been difficult, marked by two failed recruitments for a Managing Director of Operations and Accounting and a Chief Operations Officer. The challenges in staffing this group have impacted the investment program by slowing down the pace of internal asset management development. While the division has made significant progress in achieving its internal management targets, it is the product of front office staff with investment discretion taking on the leadership and some implementation roles for the operations function, combined with the dedicated work of the small operations team. These non-investment activities have reduced the bandwidth of investment staff with discretion to focus on investing activity. Granting the Board similar authority over the accounting and operations units would improve the division's recruiting efforts, particularly in the senior leadership levels.

The furlough provisions create unique challenges for the incentive payments that can be addressed without losing the alignment intended with the provision. Incentive programs are effective when they are predictable and awarded within the timeframe in which they were earned. Small changes to the expression of this feature could improve the effectiveness. For example, relaxing the requirement that the Board set the payment dates on the date that awards are granted would remove uncertainty for investment staff and allow the board to ensure that no furloughs are expected before setting a payment date.

Another limitation relating to the Board's authority to set compensation levels is the amount by which an employee's salary may be increased in any fiscal year is capped at 10%. While this limit may seem

reasonable and sufficient to keep pace with the public pension plan industry, there are instances that create challenges in its application. During periods of high inflation, like we saw in 2022 with inflation reaching 9%, there may be little to no room to award any merit increases based on individual job performance and contributions to the division. In a scenario where inflation exceeds 10%, salaries will not be able to keep pace with the general level of prices and lose purchasing power. This 10% cap also creates challenges for existing employees when new people are hired at higher market rates. Existing employees, whose annual salary increases are limited to 10%, will not be able to match the compensation levels of recent hires for several years, creating disparity among team members performing similar functions.

The challenges relating to the 10% limit in annual salary increases would be exacerbated by the imposition of state furloughs. The Board may not grant salary increases or pay incentive compensation in fiscal years in which state employees are subject to furloughs. During furlough periods, the System's salary structure would fall behind its industry peers, who are not typically subject to this restriction. Unlike the incentive program which defers incentive payments until a year with no furloughs, there is no catch-up provision to account for the compensation freeze during the furlough duration. As a result, it would take several years for the System to narrow the compensation disparity within the industry.

The compensation consultant also noted that the System's maximum annual incentive of 33% is lower than the industry peer group. For larger public fund peers greater than $60 billion in assets under management, the median maximum incentive for senior-level employees is greater than 100% of base salary, while the median for portfolio managers is 75% of base pay. This lower incentive maximum translates into lower total compensation at the median salary level for the System relative to the peer group. An Investment Division employee for the System who earns a median salary will earn significantly less in total compensation than an employee at a similar public pension plan making the same median salary. This disparity is due to the difference in incentive compensation, as peers can earn more than twice the amount of System employees. This competitive disadvantage can be remediated by increasing the maximum incentive as a percentage of base salary or expanding the salary ranges to account for the shortfall in total compensation.

Table 8 below shows a three-year example comparison of the System's compensation program relative to the peer group median using certain assumptions. The example reflects the same starting salary of $200,000 for both plans. For the initial two years, it assumes furloughs for Maryland resulting in no salary adjustments or incentive payments. The peer plan receives salary increases of 3% in each of the three years of the example and one-half of the maximum incentive payment of 75% of salary. In year three, Maryland receives the maximum 10% salary increase to catch-up to the industry and three years' worth of incentive payments at the target of 22%. At the end of the three years, the median peer plan would have received total compensation of $868,542, representing 115% more than the $752,000 cumulative amount for Maryland.

Table 8
3-Year Compensation Comparison

Starting Salary		Maryland $200,000			Peers $200,000
Year 1	Furlough-no salary increase	$200,000		3% salary increase	$206,000
	Furlough-no Incentive	$0		1/2 of 75%	$75,000
Year 2	Furlough-no salary increase	$200,000		3% salary increase	$212,180
	Furlough-no Incentive	$0		1/2 of 75%	$77,250
Year 3	10% salary increase	$220,000		3% salary increase	$218,545
	Incentive-3 yrs worth (22%)	$132,000		1/2 of 75%	$79,567
	Cumulative Comp at end of 3 years:	$752,000			$868,542

The Board's objective is to ensure a successful and sustainable long-term investment function by offering a competitive compensation program that promotes employee retention and recruitment. This should lead to strong investment performance for the System's participants and beneficiaries. The compensation authority granted to the Board by the 2018 legislation has been an effective tool in incentivizing staff to maximize value relative to the policy benchmarks. Over the last five years, staff has generated annualized excess returns over the total fund policy benchmark of 0.89%, representing over $2.6 billion added value to the plan. As the initial compensation program has been successfully implemented over the last five years and salaries have been adjusted closer to industry peers, it is important for the System to remain vigilant to ensure continued competitiveness in the market for human capital.

DLS requests that SRA update the committee on the use of incentive compensation for recruitment and retention and provide information on the number of division staff eligible for incentive compensation based on fiscal 2024 returns.

Additionally, DLS requests SRA to comment on the process that led the board to remove fund performance relative to the system's assumed rate of return as one of the metrics used for determining eligibility for incentive compensation for the position of CIO, as performance relative to the system's assumed rate of return is still a component for other Investment Division staff with lesser involvement in advising the board on the system's asset allocation.

In June 2019 the Board approved an incentive program for certain positions within the Investments Division based on recommendations from the Board's compensation consultant and the Objective Criteria Committee. This program has been an important tool in recruiting and retaining skilled and experienced investment personnel as only one investment-focused employee resigned from the System in fiscal year 2023 and there have been no departures to date in fiscal 2024. This program is subject to certain constraints, which are highlighted below:

- Financial incentives in any fiscal year shall not exceed 33% of a position's salary
- Any financial incentives paid shall be paid over multiple fiscal years in equal installments
- The Board may not pay out financial incentives in a fiscal year in which state employees are subject to a furlough
- Financial incentives shall be paid on the dates set by the Board at the time of award, and an individual who has been awarded financial incentives but separates from employment in the Investment Division may not receive any remaining financial incentives due to be paid after the date of separation from employment, except for retirement.

The Board also approved the performance metrics for determining incentive awards, which are highlighted below:

- Net total fund returns vs. total fund policy benchmark over 3 years
- Net total fund returns vs. actuarial assumed rate of return over 3 years
- Net asset class returns vs. asset class benchmarks over 3 years

For the three years ending June 30, 2024, the System achieved a net annualized investment return of 2.28%, exceeding the policy benchmark of 1.61 by 68 basis points. This level of excess return resulted in the maximum incentive of 33% for this component of the calculation. A second part of the incentive calculation focuses on the actuarial rate of return, which is 6.8%. For the three years ending June 30, 2024, the 2.28% return did not meet the actuarial target. As a result, staff was not eligible to receive the maximum incentive based on this metric.

The last piece of the incentive calculation is based on the performance of the individual asset classes. Most of the asset class teams exceeded the performance of their respective benchmarks and were eligible for incentive compensation based on this metric, while two were not. In fiscal year 2024, a total of thirty-one employees in the Investment Division were eligible for incentive compensation.

The second iteration of the Objective Criteria Committee met four times between October 2023 and January 2024. During those meetings the committee reviewed analysis and recommendations from the compensation consultant, CBIZ. Among the recommendations was to discontinue or at least reduce the use of the actuarial rate as a metric for incentive compensation. CBIZ cited its lack of prevalence in the industry and the inability of staff to control the outcome over meaningful timeframes as in conflict with the objectives of the incentive program as a retention and recruitment tool. CBIZ's Option 1 recommendation was to remove the actuarial rate for all staff members. After discussion, the committee adopted a recommendation that removed the actuarial rate for most staff and retained it at a reduced importance for the Chief Investment Officer and some other senior staff. The recommendation included a 25% weight for a new risk metric for the Board to consider but, acknowledging the difficulty in identifying such a metric left it as an open item to be determined later.

During its June 18, 2024 meeting, the Investment Committee reviewed the recommendation of Meketa Investment Group, after their analysis of several risk metrics to potentially include as part of the incentive calculation. After considering several measures, the committee determined not to add a risk metric to the incentive calculation. To reallocate the 25% that was initially targeted to the risk measure, the CIO then recommended, and the committee approved, to increase the total plan relative return by 25% for all staff other than the CIO. The Executive Director made the same recommendation for the CIO's incentive. During this discussion the committee adopted an amendment to focus solely on performance relative to

the policy benchmark. During the Board meeting on the same date, the Board adopted the recommendations of the Investment Committee.

DLS requests that SRA comment on the estimated fee savings attributable for internally managed assets.

The Board and Investment Division have a three-pronged plan to enhance the ability of achieving the investment objectives of the plan. The first prong focuses on continual improvement in the asset allocation process. The second is improving implementation of that asset allocation through improved staffing and resourcing of the division and the third is to lower the cost of managing the assets through direct fee negotiations, direct management of public assets and direct management of private assets through co-investment. As of June 30, 2024, the annual management fee savings due to direct management of public assets and private market co-investments is estimated to be $40.7 million. Carried interest savings related to private market co-investments are expected to be significantly higher due to the industry-standard structure that bases this calculation on a percentage of profits, typically 20%. Over several years, the estimated carried interest savings based on these private market co-investments made to date will be over $428 million. As the System expands the internal management initiative into more active strategies and increases its co-investment program, staff expects the longer-term annual savings to be over $150 million.

Additionally, DLS requests that SRA provide an update on the Investment Division's internal management of system assets and the development of necessary compliance and controls on the use of internal asset management. More specifically, SRA should comment on how the Investment Division:

- **has developed proficiency in managing assets currently being managed internally;**
- **will develop proficiency before expanding into internal management of additional asset classes;**
- **will evaluate the performance of internal management compared to available external management services; and**
- **will develop methodologies for determining fee savings achieved through internal management.**

The System has been working to develop its internal management capabilities since 2016. The initial efforts were geared to building the ability to execute trades internally. Elements of this process included establishing procedures to evaluate and select brokers, create operational processes to execute and communicate trades to the custodian and procure contracts with Futures Clearing Merchants. These processes supported the level of activity that was occurring historically and were necessary steps toward building an internal management process.

In 2019, staff worked with the Attorney General's office and external counsel to create policies and procedures for internal management including enhanced policies governing staffs' personal trading, conflicts of interests and handling of material non-public information. These policies and procedures were approved by the Board or codified in the Division's Operations Manual in early 2020. In 2020, the System procured a trade order management system to handle the processing of trades including pre-trade compliance and straight-through processing.

The proficiency of internal staff to manage internal portfolios has come in two ways. Existing staff had prior experience in managing assets directly and prior direct management experience was a major factor in the hiring process for new staff members.

The System has a rigorous product development process, the elements of which include:

1. Identify a potential product for internal management that staff expects to be able to execute as well or better than external managers
2. Develop guidelines that detail the performance objective, portfolio construction limits, and reporting requirements
3. Create portfolio management tools to execute the strategy
4. Manage a paper portfolio with pre-approval of every trade and creation of complete reporting package
5. Test the trading platform and provide training to middle and back office team as needed
6. Engage with the General Consultant for an independent operational due diligence evaluation and address any shortcomings identified
7. After demonstrating proficiency, present a full diligence memo to the internal investment committee and respond to questions and other follow up items
8. With internal investment committee approval, establish a portfolio inception date with the Chief Investment Officer including a source of funding

As of June 30, 2024, ten internal portfolios valued at $13.6 billion had been established following this process: U.S. TIPS, U.S. Long Government Bonds, Russell 1000 large-cap U.S. equity, investment-grade corporate bonds, U.S. small cap equity, U.S. securitized bonds, International large-cap equity, International equity value factor strategy, public equity infrastructure and cash. Staff is currently in the development process to implement additional internal portfolios, including currency hedging and active management within existing passive portfolios.

The division has built a process that is designed to evaluate the internal products in a manner similar to the selection and oversight of external managers. This includes presenting the strategy to the internal investment committee in the same manner as external managers. It also includes independent annual evaluation of the product by the System's general consultant. The division has also created an Internal Management Oversight Committee to provide independent evaluation of the efficacy of the strategies and managers. This group exists so that the investment teams are not put in the position of evaluating their own products. Finally, each quarter, every asset class reports to the internal investment committee on the performance of the asset class including individual manager performance. At these meetings, the committee members often challenge the team on the efficacy of continuing to retain underperforming managers.

DLS requests SRA to provide an update on the implementation of Chapters 24 and 25, including the status of recruitment for the Senior Governance Manager position.

Some of the provisions of Chapters 24 and 25 of 2022 codify existing practices of the System relating to climate change investment risk, while others require the development of new policies and procedures. One element of the legislation requires the System to incorporate its provisions into the System's Investment Policy Manual. The Board approved the addition of these items in February 2023. The Board also approved an Engagement and Advocacy policy as tools to mitigate risks and enhance opportunities for the investment of System assets. Engagement and advocacy work together with proxy voting to promote the best outcomes for active investments by prudently addressing poor corporate governance practices, including those associated with climate risk.

Staff has also updated the Investment Division's Annual Compliance Questionnaire, sent to all investment managers and consultants, to incorporate ESG and climate specific information to assess their policies and practices in this area. The System has also included an analysis relating to the level of climate risk across the total investment portfolio as part of the annual risk assessment to the legislature. Staff has also been actively identifying investment opportunities in the energy transition by meeting with managers who specialize in this area and is tracking these meetings and opportunities as part of normal routine. To create more structure around this effort, the Investment Division has formed a Theme Team to focus on investment opportunities that may benefit form broad macro-economic trends like the energy transition.

To gain insight and education regarding best practices regarding climate change, staff has increased participation with industry climate action groups. These groups provide forums for discussion and exchange of ideas to support both asset owners and managers in setting and implementing investor climate action and energy transition plans. Staff is also in active discussions with industry leaders and academics regarding the most effective way to structure a climate advisory panel or education series to help guide the Board and staff in managing climate risk and evaluating related investment opportunities. Going forward, staff will continue to implement the requirements of this legislation through more direct engagement with managers, companies and industry advocacy groups. Staff will also develop more robust processes to evaluate transition readiness in high-impact sectors using asset class specific metrics and standards.

Chapters 24 and 25 also authorized the Board to establish an advisory panel of experts in the analysis of climate change risk to provide the most current science and data available. The charter for the Climate Advisory Panel (Panel) has been drafted and is in the final stage of approval by the Board of Trustees. The Panel will likely be established as a committee of the Board of Trustees, with the objective of supporting the Board, its committees, and the Investment Division regarding climate change risk in the management of System assets and to assess transition investment opportunities. The Panel will likely consist of at least three outside experts in the analysis of climate change risk who are appointed by the Board. The Panel will collaborate with the Board, Investment Committee, Corporate Governance and Securities Litigation Committee, Investment Division and consultants to develop recommendations and initiatives to effectively address the risks and opportunities associated with climate change. Interest

forms have been distributed to potential candidates to serve on the Panel, and the Board expects to appoint advisors in the first half of 2025.

Meketa Investment Group, the Board's general investment consultant, has incorporated climate scenario analysis into the System's strategic asset allocation modeling for several years. This year Meketa used scenario inputs from the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) to complement its internally developed scenarios. The six NGFS scenarios consider temperature rises ranging from 1.4ºC to 3.0ºC+ with varying amounts of policy coordination and emissions reduction assumptions. Investment Division staff has collaborated with a large global asset management firm on similar NGFS-based analysis. While the modeling does not explicitly incorporate tipping points and involves a great deal of uncertainty, staff believes the output is useful as a starting point to understand potential economic linkages and portfolio outcomes across a range of transition scenarios.

This year's Risk Assessment also includes an analysis of physical risk with respect to the System's private real estate investments. Using data from the National Oceanic and Atmospheric Administration (NOAA), the System's 50 largest individual property holdings are mapped by geolocation coordinates under an extreme scenario where sea levels rise by eight feet. These 50 holdings represent an aggregate value of $1.03 billion, or approximately 1.5% of the System's total assets, and are held in core open-end private fund structures. Eleven of the 50 properties are in impacted areas according to the NOAA sea level rise data, representing approximately 0.3% of the System's total assets. In addition, Investment Division staff discusses physical and transition risks, including effects to insurance premiums, with the System's real estate managers as a matter of regular ongoing due diligence.

As described in last year's Risk Assessment, the System is building out its allocation to private infrastructure investments. The strategic policy target allocation to this asset class is 4%, which translates to approximately $2.7 billion based on total System assets as of June 30, 2024. The private infrastructure portfolio is currently valued at $566 million, or approximately 0.8% of total fund assets. Energy transition has been a major theme in the early stages of portfolio construction. The report highlights several investments in companies that are well-positioned for a lower carbon economy. The System expects portfolio exposures to this theme to grow as additional investments are made and existing investments mature.

To help lead the effort in ESG and other corporate governance initiatives, the System is in the process of recruiting for the open Corporate Governance Manager. The position was posted in September 2025 and staff has conducted first round interviews. We expect to complete second round discussions in January 2025 and hope to fill the position in the first quarter of 2025.

Appendix 4

2025 Board Requested Legislation

The following legislative proposals are recommended by the Board of Trustees for the State Retirement and Pension System (System) to the Joint Committee on Pensions for its consideration to sponsor as legislation for the 2025 legislative session.

Pre-2011 Deferred Vested Members Returning to Service

Provisions of the Employees' Pension System (EPS) and Teachers' Pension System (TPS) provide that a deferred vested member of the Alternate Contributory Pension Selection (ACPS) tier of the EPS or TPS who returns to State employment and resumes membership in the EPS or TPS, shall resume participation in the ACPS tier of the EPS or TPS. Regardless of the break in service that has occurred, a returning vested member will not be enrolled in the Reformed Contribution Pension Benefit (RCPB) tier of the EPS or TPS (which is applicable to new members on or after July 1, 2011) when returning to service. This allows the ACPS deferred vested member to continue to receive the benefits provided for under the ACPS tier and not start anew in the RCPB tier.

While the Correctional Officers' Retirement System (CORS), the State Police Retirement System (SPRS) and the Law Enforcement Officers' Pension System (LEOPS) do not have benefit tiers similar to the EPS and TPS, the 2011 pension reforms did change vesting and average final compensation for any individual who began membership in the public safety systems on or after July 1, 2011. Additionally, these systems do not have a comparable provision that allows for deferred vested members of the CORS, SPRS, or LEOPS to resume membership subject to the pre-July 1, 2011 provisions if they began membership before July 1, 2011, and later return to membership in their former system after incurring a break in service of more than four years (the length of time an individual remains in membership status after leaving employment with a participating employer). For example, an individual who joined the CORS before July 1, 2011, vested in the CORS after accruing five years of service, left employment with a participating employer, and returned to CORS membership after incurring a break in service of more than four years, would now be subject to 10-year vesting and a five-year average final compensation with respect to all service after July 1, 2011. And the Agency is required to maintain two separate accounts for the employee in CORS, because different rules apply to the pre- and post-July 1, 2011 service. Again, this is because the public safety plans do not have a corresponding provision, similar to the provision in EPS and TPS, that allows deferred vested members who return to membership, regardless of the length of their break in service, to be subject to the same requirements that were in effect in the EPS or TPS, on June 30, 2011.

The legislative history indicates that the provisions to preserve an EPS or TPS member's pre-July 1, 2011 membership status beyond a break in service of more than four years, were enacted in response to a deferred vested member of the ACPS tier of the EPS returning to membership after more than a 10-year break in service. Staff for the Agency can find no indication to suggest the public safety plans were deliberately excluded; rather, it appears that the focus of the legislation was limited to the EPS and TPS because of the individual who brought it to the attention of the legislature.

For consistency across the several systems and ease of administration, the Board is recommending legislation that would provide that deferred vested members of the CORS, SPRS, or LEOPS who vested in these plans prior to July 1, 2011, shall be subject to the same requirements that were in effect in their former plan on June 30, 2011, regardless of the length of their break in service.

State Police DROP Participation Clarification

A SPRS member may enter the Deferred Retirement Option Program (DROP) if the member has at least 25 and less than 32 years of service and is less than 60 years old. An eligible member may elect to participate in the DROP for a period not to exceed the lesser of:

1. 7 years;
2. the difference between 32 years and the member's service credit as of the date of the member's election to participate in the DROP and retire from the State Police Retirement System; and
3. the difference between age 60 and the member's age as of the date of the member's election to participate in the DROP and retire from the State Police Retirement System.

Provisions in the State Personnel and Pensions Article provide that a member is entitled to receive one month of service credit for employment for a month or a part of a month if member contributions are received for that month. In 2020, legislation was passed that provides that after 28 years of service as a member of the SPRS, a member does not make any further member contributions, effectively capping the service credit a member may earn at 28 years.

Studying how each of these pieces regarding service credit and participation in the SPRS DROP intersect with each other, staff for the Agency has discovered an inconsistency that we believe requires clarification from the General Assembly. Prior to 2020, SPRS members would continue to make contributions after accruing 28 years of service, and accordingly, continue to earn service credit. A member who continued active membership for 32 years would accrue 32 years of service credit. A member with 32 years of service credit would not be eligible to participate in the SPRS DROP.

With the passage of the 2020 legislation that ended member contributions after 28 years of service, a member who continues active membership after 28 years, will not accrue any additional service credit, capping their service at 28 years, regardless of how long they remain an active SPRS member after that point. Even though their service credit is capped at 28 years, they still continue to receive the benefit of any salary increases earned after 28 years of service in the calculation of their average final compensation used to calculate the amount of their benefit at retirement.

The 2020 legislative change to discontinue member contributions and service credit accrual after 28 years of services has also had a corresponding impact on the provisions governing the DROP participation period for the SPRS. For example, a SPRS member who chooses to work 32

years, will only have 28 years of service credit. Because DROP participation is calculated based on the difference between 32 years and the member's service credit when entering DROP, the 2020 law change has resulted in the member being eligible to participate in the DROP for four additional years after 32 years of active service (32 – 28 years of service credit). If that member chooses to stay in the DROP for the entire four years, the member will be leaving the DROP with 36 years of employment service and not the 32 years currently provided for in the State Personnel and Pensions Article. In fact, current law could potentially allow a member of the SPRS to work indefinitely after accruing 28 years of service (provided they have not reached the mandatory retirement age of 60), and still be guaranteed four additional years of DROP participation, since their service credit will always be capped at 28 years.

Because staff for the Agency is uncertain if this outcome is an untended consequence of the 2020 legislation, the Board is seeking clarification from the Legislature regarding these provisions of the State Personnel and Pensions Article that govern the System.

Disability Earnings Limitations

Current provisions of the State Personnel and Pensions Article exempt EPS and TPS service retirees and all ordinary disability retirees from a reemployment earnings limitation if the retirees had an average final compensation (AFC) at the time of retirement that was less than $25,000. This AFC reemployment exemption was increased for EPS and TPS service retirees from $10,000 in 2010 and was added for the first time for ordinary disability retirees in 2016. An accidental or special disability retiree does not have the benefit of this AFC reemployment exemption. Although retirees receiving accidental or special disability benefits are not subject to an earnings limit, a reemployed accidental or special disability retiree whose reemployed annual gross salary exceeds their AFC at the time of retirement, will have their disability retirement benefit temporarily suspended while they continue to earn a gross salary greater than their AFC.

To illustrate how this lack of an AFC reemployment exemption for accidental and special disability retirees, an accidental disability retiree who at the time of retirement had an AFC of $21,400 and is reemployed in a position earning a gross salary of $21,500, will have their entire disability benefit temporarily suspended while reemployed in this new position. In this example, both the retiree's AFC and reemployed gross salary are less than $25,000, yet this retiree does not have the same AFC reemployment exemption that is available to all other retirees of the several systems.

The Board is recommending legislation that would add a similar AFC reemployment exemption for the temporary suspension of a retirement allowance (State Pers. & Pens. Art. § 29-115), applicable to all disability retirees. Additionally, staff for the Agency is recommending increasing the AFC reemployment exemption for both service and disability retirees from $25,000 to $35,000, the current minimum annual salary on the standard State pay scale, for all retirees of the System. Staff believes this increase is supported by the 2010 legislation that increased the then AFC reemployment exemption from $10,000 to $25,000. At that time, the minimum annual salary on the standard State pay scale was $21,200.

Staff reports that in the past five years, within each group (service, ordinary disability, and accidental or special disability) fewer than 10 retirees per year would have been exempt from the earnings limitation or the temporary suspension if the AFC reemployment exemption had been $35,000 or less.

CORS Security Attendant Supervisors or Managers

Chapters 135 and 136 of 2024 moved members from the EPS to the CORS who were employed by the Maryland Department of Health in security attendant positions at State forensic facilities. Individuals hired into these positions on or after July 1, 2024, at the facilities included in the legislation, will be enrolled in the CORS as a condition of employment. As Chapters 135 and 136 were drafted, many supervisor and manager positions for these security attendants were inadvertently omitted from the legislation. As a result, under current law, an individual serving in a security attendant position who is promoted into a supervisor or manager position that was omitted from the legislation, will be moved back to the EPS at the time of promotion. To avoid this disruption to these members' benefits, the Board is recommending clarifying that the supervisors and managers of security attendants will also be members of the CORS as a condition of employment.

Similar legislation was enacted in 2014, for a correctional officer serving as a security chief, a facility administrator, an assistant warden, or a warden. Prior to the 2014 legislation, correctional officers serving in these positions were members of the EPS. As a result, correctional officers who were serving in the first six job classifications and members of CORS, and who were promoted into one of these positions, were moved out of the CORS and into the EPS. It was reported at the time, that knowing a correctional officer would have to move to the EPS if they were promoted to a security chief, a facility administrator, an assistant warden, or a warden, was serving as a disincentive for correctional officers to apply for these promotions. To address this issue, the 2014 legislation was enacted to move these positions into the CORS.

Staff is currently aware of 45 individuals serving as supervisors or managers of security attendants who would be moved into these positions.

Title 37 Study Group

Title 37 of the State Personnel and Pensions Article governs the transfer of service from any State or local retirement or pension system to another State or local retirement or pension system. Because of this, it is the only pension related title in this Article that applies to the State, all 23 counties, and Baltimore City.

Provisions within Title 37 include those that address the types of service credit that may be transferred from one system to another, the member contributions and interest that must accompany these transfers, and the time frame under which these transfers must be made. Over the years, staff for the Agency has noticed that there are many inconsistencies, duplicative provisions, and ambiguities throughout this title. Staff is very interested in addressing these

issues, though many will require legislative changes. Given that the groups that are impacted by Title 37 include the State, all 23 counties, and Baltimore City, we believe this is an undertaking that should include input from all stakeholders. To accomplish this, the Board is recommending legislation that would establish a Title 37 workgroup that would consist of representatives from the State Retirement Agency, each of the counties and Baltimore City that operate their own retirement or pension system, and the Department of Legislative Services (DLS). The workgroup would meet throughout the 2025 interim to address the issues we have found in Title 37 and any issues the counties may be trying to resolve. The Agency would provide the staff for this workgroup and submit recommended changes to Title 37 to the Joint Committee on Pensions during the fall 2025.

General Assembly Reports Due Dates

Two reports that the State Retirement Agency is required to submit to the General Assembly each year have statutory due dates that make it very difficult for staff for the Agency to meet. We reached out to the DLS library and were told that the Agency may request changes to the due dates of their reports. The Board is recommending legislation that would change the due dates for the annual report regarding the Investment Committee's business relationships with minority business enterprise brokerage and investment management services firms and the annual report addressing the System's private equity/venture capital investments in Maryland technology with TEDCO from September 1 and December 1, respectively, to November 1 and December 31, respectively.

Repeal of Administrative Fees

Prior to July 1, 2011, the administrative budget for the Agency, based on statutory authority, was funded solely through special funds drawn down from the pension trust fund. Chapter 397 of 2011 changed this process and now requires the Agency to apply a per employee charge on all employers participating in the System to fund its operating expenses.

The current process of determining the amount of administrative fees that each participating employer owes the Agency in any given year is based on a formula that involves determining the number of employees for each employer that are also members of the several systems as of June 30 of the second prior fiscal year and dividing this number by the total number of current members in the System. This percentage is applied to the actual amount that the Agency spent during the second previous fiscal year. Each participating employer is then notified in October of each year what they will owe the Agency in administrative fees for the upcoming fiscal year.

When calculating the System's administrative fees, the Finance Division for the Agency and the budget analysts for the Department of Budget and Management (DBM) and DLS continue to use differing methodologies when determining the final close-out number for the Agency for the previous fiscal year. The three agencies met throughout the summer to discuss the

entire process for determining the administrative fees for the Agency and agreed that the current method of funding the Agency's operating expenses continues to be overly cumbersome.

Throughout these discussions, the agencies reviewed the changes that were made to the process during the 2024 legislative session and recent information received by the System's actuary. The 2025 Budget Reconciliation and Financing Act (Chapter 717 of 2024) eliminated a longstanding reduction the State was required to make to the Teachers' Pension System employer contribution. This reduction was a component of the process for determining the administrative fees due to the Agency. To mitigate the loss of this reduction, the annual $75 million the System has received in supplemental payments has been reduced to $50 million. Additionally, the System's actuary reported that the General Accounting Standards Board (GASB) would prefer that actuaries for public pension plans, when calculating the annual employer contribution rate for a public plan, include a certain percentage above the employer contribution rate that serves to cover a plan's operating expenses. The System's actuary also noted that it is unaware of any other public plans that fund their operating expenses through administrative fees similarly to Maryland.

In light of the 2024 legislative changes coupled with the information provided by the System's actuary, the three agencies believe that there is no meaningful benefit to the System, the State, or other participating employers of the System to maintain the current process of funding the System's operating expenses through administrative fees. Therefore, on behalf of the Agency, DBM, and DLS, the Board is recommending returning to the past practice of funding the Agency's operating expenses through funds drawn down from the Trust. These funds would be collected through the additional operating expense percentage added to the employer contribution rate determined by the System's actuary each fiscal year. In addition to significantly reducing the complexity of this process for the three agencies, this proposal would also simplify the payment process for the System's participating employers. This proposal would provide that going forward participating employers would only receive one annual bill from the System.

This proposal would not have a fiscal impact on the System because the operating expense percentage determined by the System's actuary should be comparable to the amount the Agency would otherwise certify as its administrative fees.

Board of Trustees' Compensation Committee

Chapters 727 and 728 of 2018 gave the Board the authority to determine and create positions necessary to carry out the professional investment functions of the Investment Division and to set qualifications and compensation for the positions, including incentive compensation, as specified in the legislation. To assist the Board in adopting objective criteria for setting compensation and awarding financial incentives for the Chief Investment Officer (CIO) and specified Investment Division staff, the 2018 legislation also created the Objective Criteria Committee (OCC).

Under provisions of the State Personnel and Pensions Article, the OCC is required to meet at least once every five years. The OCC includes a senator and delegate who are serving on the Joint Committee on Pensions, the Treasurer (or the Treasurer's designee), the Secretary of DBM

(or the Secretary's designee), two trustees appointed of the Board, and a member of the public with financial industry experience. It is charged with recommending objective criteria for the Board to use when it is determining the compensation and financial incentives for the CIO and certain staff of the Investment Division. The Board is also required to hire a compensation consultant to assist the OCC regarding objective criteria. This consultant may not be a consultant that is actively providing consulting services to the Board or the staff of the Investment Division.

The OCC met throughout the summer of 2018, shortly after Chapters 727 and 728 became effective. At the conclusion of its work, the OCC submitted to the Board a recommended compensation and incentive compensation program for the Investment Division. These recommendations served as the foundation for the expansion of the Investment Division from 2018 to 2023. However, during these intervening five years, as the Investment Division has grown and created new positions, including an internal training desk, we believe the Board would have benefited from having an ongoing committee that could review criteria for compensation and incentive compensation and assist with creating new positions within the Investment Division.

Section 21-108(b) of the State Personnel and Pensions Article provides, in part, that the Board may establish committees of the Board. Section 21-108, therefore, would allow the Board to establish a compensation committee of the Board that would address the Investment Division compensation issues that arise in real time, rather than wait for the OCC, every five years. While the OCC's role is limited to recommending objective criteria, the Board's responsibilities are far broader, including determining the type and number of positions to carry out the functions of the Investment Division, and their qualifications and compensation (including financial incentives). In addition to adopting objective criteria, the Board needs to determine a position classification system and a pay scale, and to review and regularly update these items as the needs of the System change. A compensation committee of the Board could better assist with the broad array of responsibilities that have been assigned to the Board. Additionally, we would also recommend enabling the Board to hire a compensation consultant to assist both the compensation committee and the Board with reviewing and updating its objective criteria as well as creating and maintain a position classification structure, pay scale and financial incentive program for the CIO and Investment Division.

To accomplish this, the Board is recommending legislation that would repeal provisions establishing the OCC. In its place the Board would establish a compensation commission of the Board. This proposal would also enable the Board to hire a compensation consultant to assist both the new committee and the Board.

Appendix 5
Maryland Supplemental Retirement Plans Overview Presentation

MARYLAND SUPPLEMENTAL RETIREMENT PLANS

Joint Committee on Pensions
October 30, 2024

MARYLAND SUPPLEMENTAL RETIREMENT PLANS
6 Saint Paul Street - Suite 200
Baltimore, Maryland 21202-1608
Tel: 410-767-8740 or 1-800-543-5605
Agency Website: www.msrp.maryland.gov
Plan Administrator Website: www.marylanddc.com

MSRP

OVERVIEW

Supplemental Retirement Plans

01 457(b) Deferred Compensation Plan

02 401K Savings & Investment Plan

03 403(b) Tax Sheltered Annuity Plan

04 401(a) Match Plan

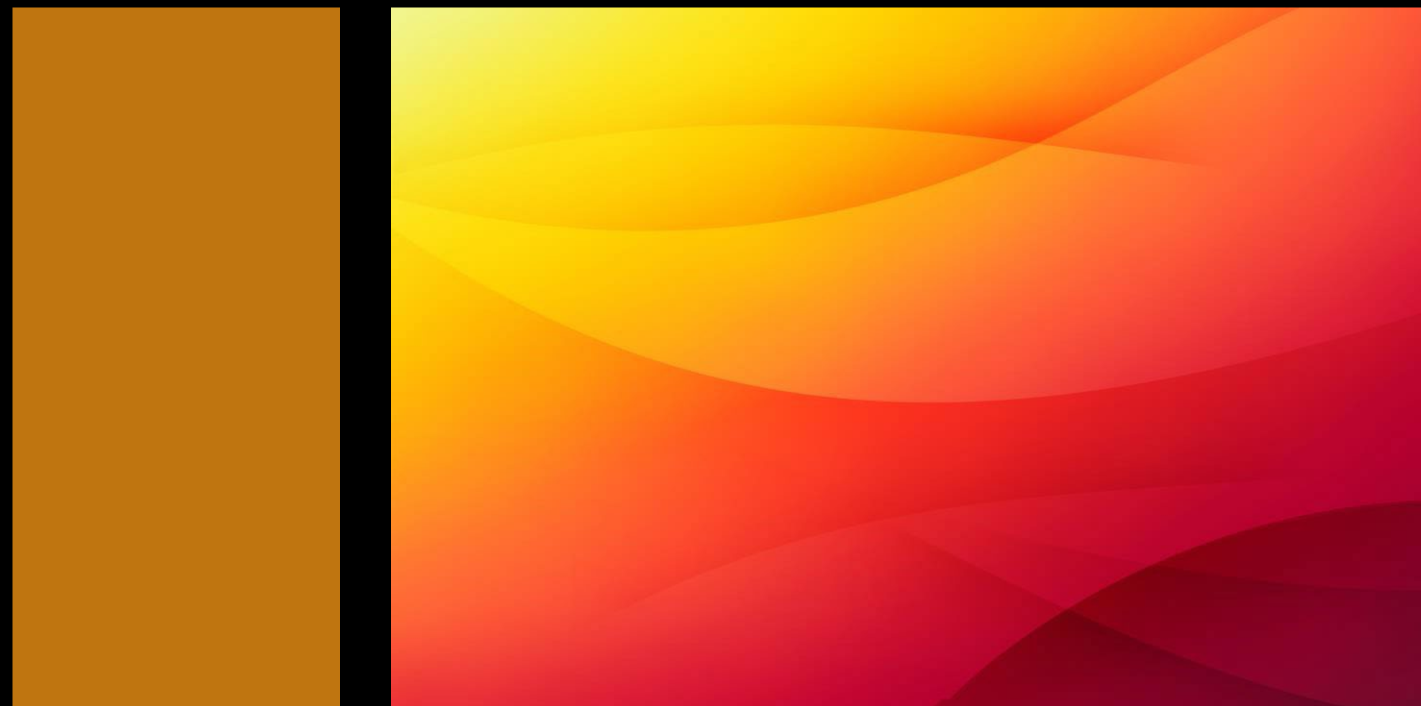
457(B) DEFERRED COMPENSATION PLAN

- Largest of the 4 Plans, with 3,250 of its active 36,439 participants in payout status with 19,479 actively deferring
- Total assets held in trust: $2.46B* (second largest balance of the 4 Plans)

* As of June 30, 2024

401K SAVINGS & INVESTMENT PLAN

- Second largest of the 4 Plans, with 3,508 of its 32,944 participants in payout status with 16,254 actively deferring
- Total assets held in trust: $2.8B* (largest balance of the 4 Plans)



*As of June 30, 2024

403(B) TAX SHELTERED ANNUITY PLAN

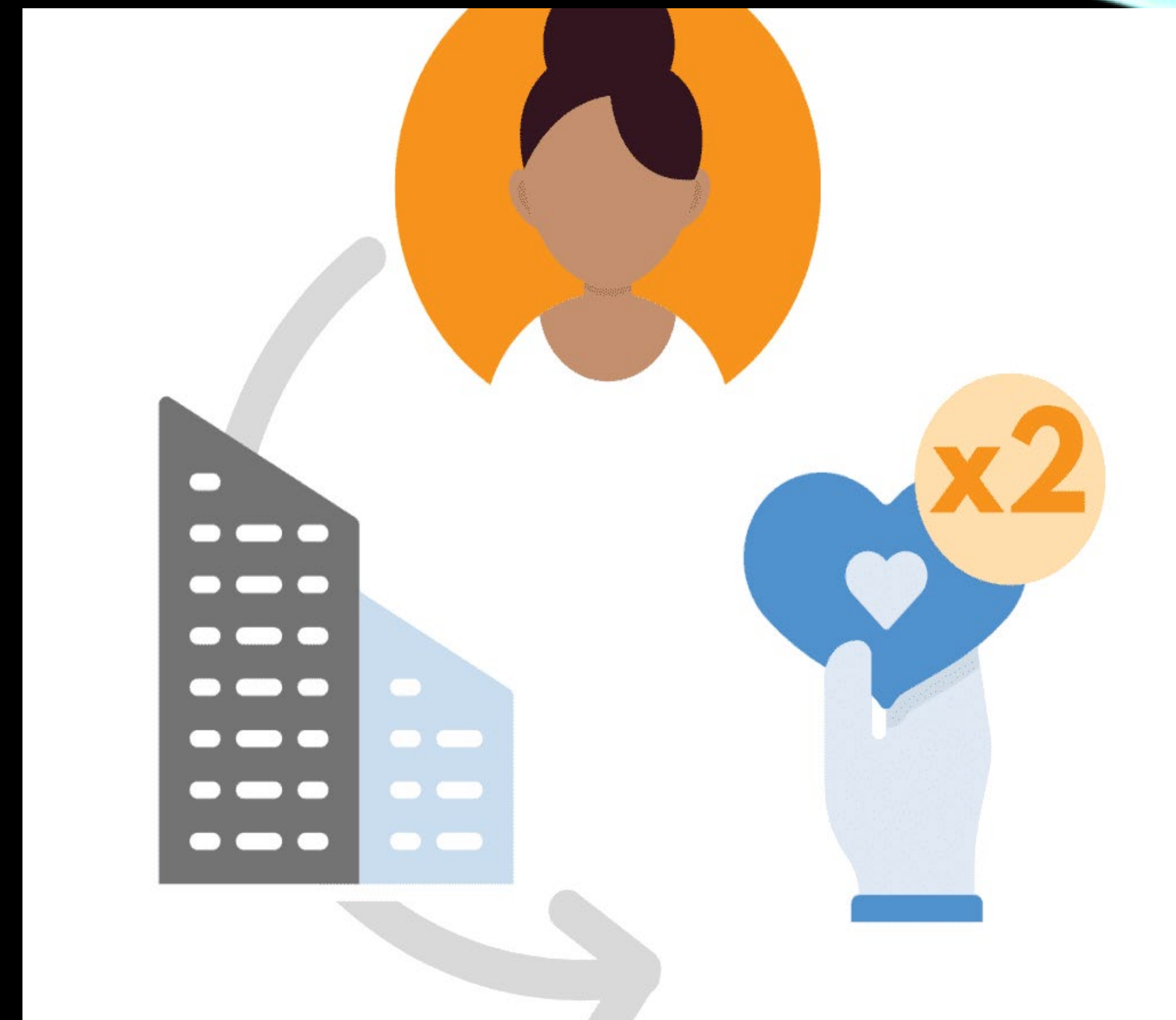
- Smallest of the 4 Plans, with 142 of its 890 active participants in payout status, with 362 actively deferring

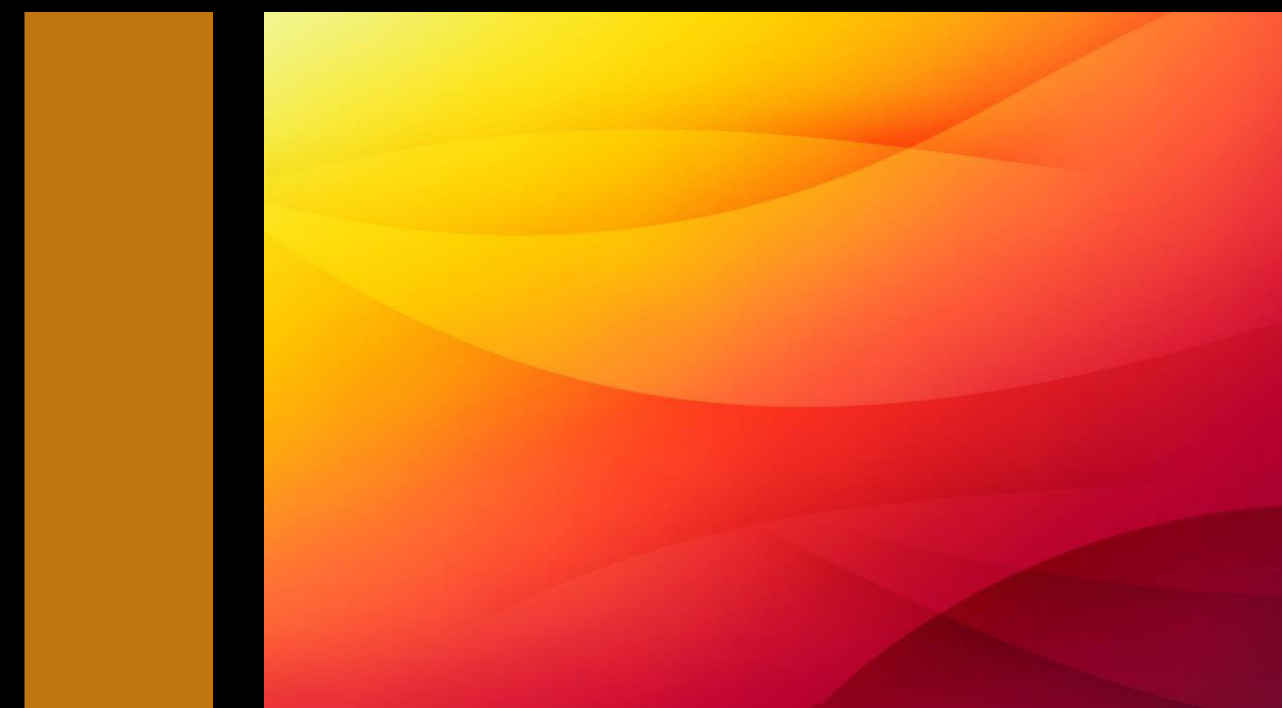
- Total assets held in trust: $123.5M*

* As of June 30, 2024
This Plan is open to individuals in higher education

401(A) MATCH PLAN

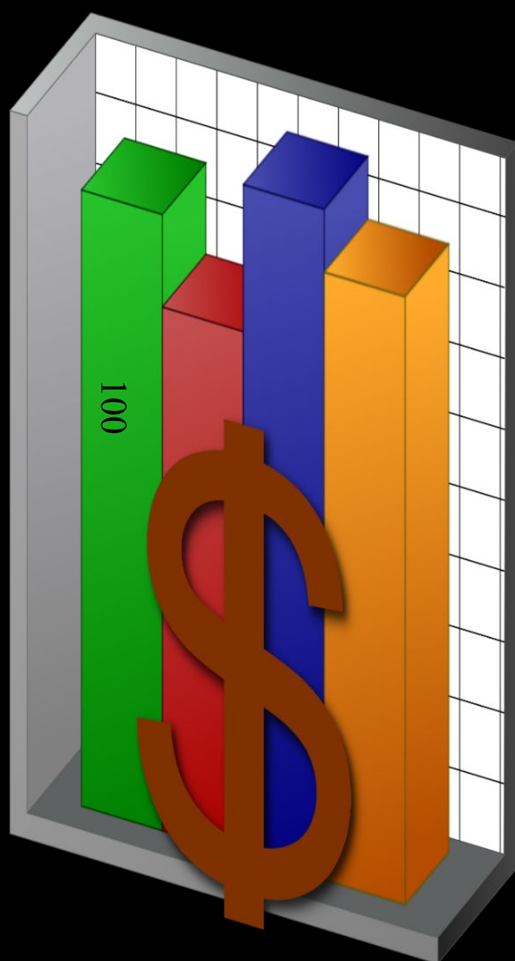
- The Match Plan was reactivated as of July 1, 2023
- The Plan has 39,489 participants, with 3,107 in payout status
- Total assets held in trust: $261.9M* and $3,158,404* in contributions.
- Since reactivated, the match plan has had over $12 million in matching contributions.





*As of June 30, 2024

MSRP Match Program Details



- Reinstated July 1, 2023, as a result of the Speaker's 2023 bill (HB 982)
- This legislation also includes provisions for reimbursement of student loan payments up to $600 made by eligible employees to higher education institutions (effective January 1, 2024).
- CY 2023 Match contributions exceeded $12M
- Implementation process included Central Payroll Bureau and Nationwide Retirement Solutions programming changes
- All contributions posted to participant accounts within 5 business days

FUND PERFORMANCE ANALYSIS

ALL PLANS COMBINED

- U.S. equity markets saw a strong rise, gaining 3.2% (Russell 3000), driven primarily by large-cap technology stocks.
- Large-cap growth stocks continued to outperform their value-oriented counterparts throughout the quarter, with a substantial year-to-date lead of over 1,400 basis points, achieving a return of 20.7% compared to 6.6% for large value stocks.
- International equities experienced a more modest increase, ending the quarter with a 1.0% gain (MSCI ACWI ex U.S.).
- The broad U.S. fixed income market remained essentially flat, posting a slight return of 0.1% (Bloomberg Barclays Aggregate) for the quarter.
- The Federal Reserve kept interest rates unchanged, as inflation pressures persisted across various sectors of the economy. Meanwhile, market expectations for rate cuts were gradually reduced over the quarter, leading to increased volatility at the longer end of the yield curve.
- The U.S. labor market remained tight, although the unemployment rate edged up slightly to 4.1%

INVESTMENT PERFORMANCE
ALL OPTIONS

For the 1-, 3-, 5- and 10- year time frames, MSRP's active investments are in the top 50% or better 93.5% of all time periods. The passive investments are in the top 75% or better 97.5% of all time periods.

Asset Allocation Funds

The T. Rowe Price Retirement Target-date Funds have consistently performed in the top quartile of peers on a 1-, 3-, and 10-year basis.

U.S. Equity Funds

Performance has been relatively strong versus benchmark and peers over all time periods. The Delaware Value fund, which was a persistent underperformer, is a conservatively managed fund which was not able to keep up with such a strong market. This fund was removed from the Plans in December 2023. Other relative underperformance stems from the large growth fund managed by William Blair. Despite its underperformance, the fund remains in the top quartile versus its peers over longer time periods.

INVESTMENT PERFORMANCE ALL OPTIONS

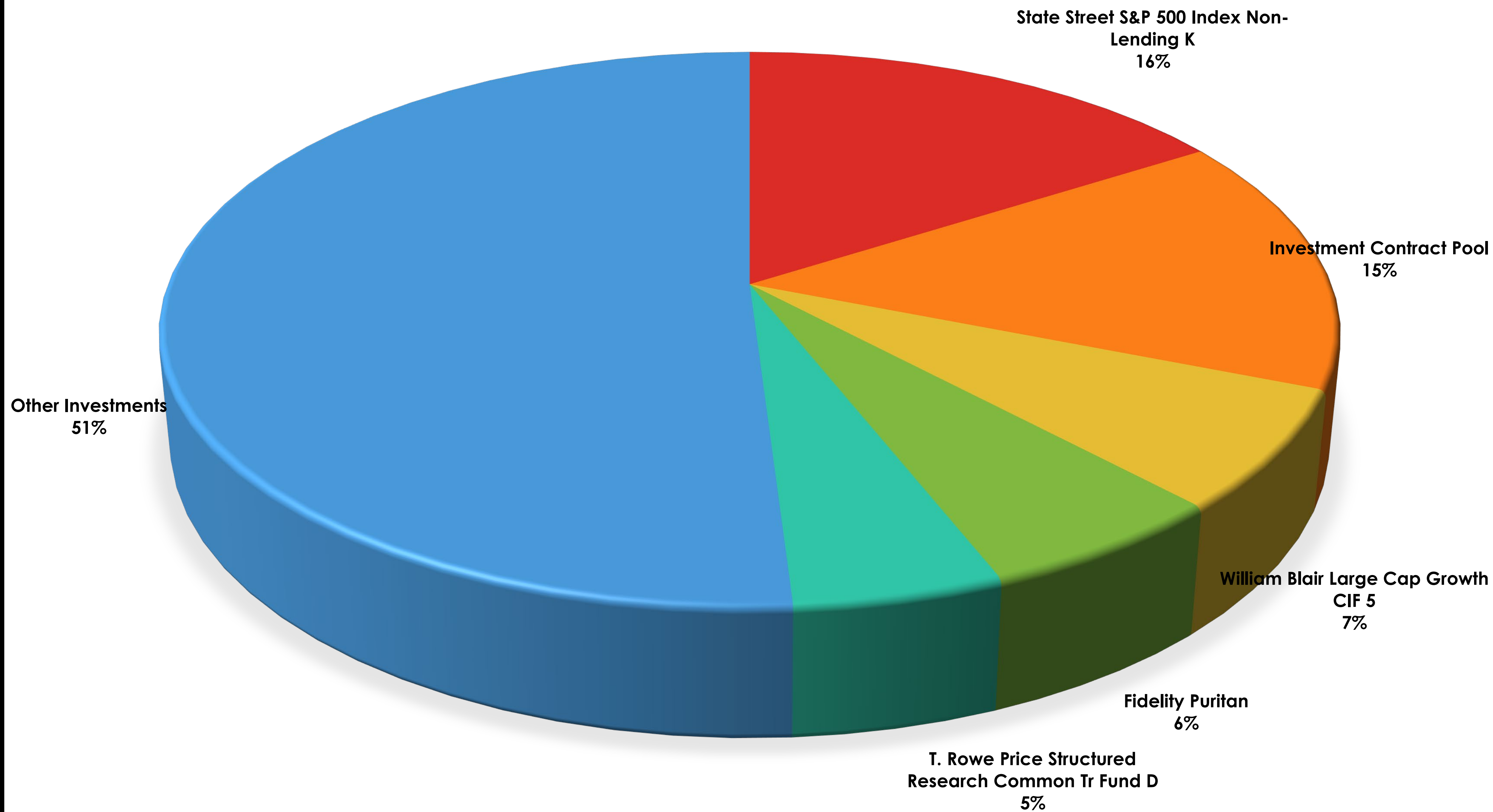
International Equity

The Plans' sole actively managed international equity fund outperformed its index over a 1- and 10-year period; 3-year performance is trailing the benchmark due to the sharp rotation favoring value stocks near the end of 2021 following the news of the Pfizer vaccine announcement. Long-term performance versus the benchmark and peers remains strong.

Fixed-Income Fund

The TCW Core Fixed Income Fund underperformed its index over a 1-, 3- and 10-year time period by narrow margins. A primary source of this underperformance came in 2022 as the fund had a longer duration compared to its index.

TOP HOLDINGS - ALL PLANS



Top 5 Holdings	% of Total
State Street S&P 500 Index Non-Lending K	16%
Investment Contract Pool	15%
William Blair Large Cap Growth CIF 5	7%
Fidelity Puritan	6%
T. Rowe Price Structured Research Common Tr Fund D	5%
Other Investments	51%

FEE STRUCTURE

Charged to participants

- **Asset-based fee**
  - Based on the net assets at the close of the previous month
  - Capped at $2,000 per calendar year
- **Account-based fee**
  - $.50 per account
  - Accounts with <$500.00 balance are exempt

Fee Holidays

- **MSRP Board of Trustees approved a standing 4th quarter asset fee holiday**
- **Contingencies**
  - Reserve balance sufficiently covers a minimum of operational expenses for six months
  - Market conditions permit the fee holiday without exhausting reserve balances too quickly

ORGANIZATIONAL CHART

Maryland Teachers & State Employees Supplemental Retirement Plans

Board of Trustees
The Honorable T. Eloise Foster
Board Chair

Deborah A. Donohue, Esq.
Principal Counsel
Assistant Attorney General
Office of the Attorney General

Ronda Butler Bell, MPA
Executive Director
& Board Secretary

Andrea L. Hill
Assistant to the Executive Director
EEO Officer/HR Liaison

Eula Gautreaux
Accounting Specialist/Internal Auditor

Nakeia Smith
Deputy Executive Director & CFO

Damien L. Word
Operations & Technology
Administrator

Ronald E. Pringle, MA
Fiscal Reporting Specialist

VACANT
Finance & Compliance
Administrative Assistant

Tonya M. Toler, CRC, CPM
Director of Member Services

Angela Anderson, CRC
Member Services
Education Specialist

Jeannie Sutton, CRC, ChFC
Member Services
Education Specialist

Anne P. O'Neill, CRC
Member Services
Education Specialist

Tracee' Church
Member Services
Administrator

Camella Davenport
Member Services
Administrative Assistant

Approved:
October 2, 2024

Ronda B. Bell
Executive Director

MEMBER SERVICES TEAM

- **THE TEAM**
  - Comprised of four (4) Certified Retirement Counselors & two (2) administrative professionals
  - Received numerous awards from Pensions & Investments and the National Association of Government Defined Contribution Administrators (NAGDCA).
- **THE TEAM MISSION**
  - To support, through education, all State employees on the benefits of retirement savings.
- **EVENTS** (over 344 held in 2023 with 28K employees in attendance):
  - In-person and virtual pre-retirement seminars, benefit fairs, lunch and learn workshops, new employee orientations, and Maryland State Employee Save Week presentations.
  - "Plan Today for A Better Tomorrow, Your Future Self Will Thank You" virtual Saving$ Symposium
    - Held October 8th-10th and 22nd-24th
    - A 6-day format covering two weeks, with over 20 session options for State employees.
    - A collaboration of fund managers, state and federal agencies, and our plan administrator in support of Maryland State employees.

WEBINARS AND OTHER OUTREACH ACTIVITIES

- Weekly Webinars – including:
  - ❑ *Saving for a Purpose: Strategies for Achieving Your Financial Goals*
  - ❑ *Putting It All Together for Retirement*
  - ❑ *Success in Planning: Understanding Your MSRP Plans*
  - ❑ *Countdown to Retirement: Understanding Retirement Readiness*
  - ❑ Many webinars have an over 50% attendance rate
- Annual Virtual Saving$ Symposium - "Plan Today for A Better Tomorrow, Your Future Self Will Thank you"
- Pre-Retirement webinars (online) and seminars (in-person)

ADDITIONAL INFORMATION

Annual Reports and Member Publications

https://msrp.maryland.gov/Public-Information/Annual-Reports

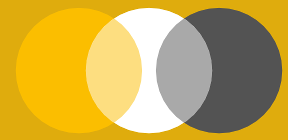
https://msrp.maryland.gov/Education/Educational-Publications

Performance Summary

https://msrp.maryland.gov/Public-Information/Investment-Performance-Reports

Board of Trustees Profiles

https://msrp.maryland.gov/About/Board-of-Trustees



MARYLAND SUPPLEMENTAL RETIREMENT PLANS

THANK YOU

MARYLAND SUPPLEMENTAL RETIREMENT PLANS
The Honorable T. Eloise Foster, Board Chair
Ronda Butler Bell, Executive Director & Board Secretary
6 Saint Paul Street - Suite 200
Baltimore, Maryland 21202-1608
Tel: 410-767-8740 or 1-800-543-5605
Agency Website: www.msrp.maryland.gov
Plan Administrator Website: www.marylanddc.com

Appendix 6
Maryland Supplemental Retirement Plans
Automatic Enrollment Presentation

Automatic Enrollment

Maryland Supplemental Retirement Plans

Presentation to the Joint Committee on Pensions

October 30, 2024

Maryland Supplemental Retirement Plans

- MSRP is a State employee benefit available to all eligible Executive, Legislative, and Judicial branch employees.

- As of the third quarter of 2024, 40.50% of all eligible State employees were actively participating in MSRP.

- MSRP's staff are all State employees, including our Certified Retirement Counselor® Director of Member Services and Education Specialists.

- The Member Services Team provides State employees with one-on-one consultations (as requested) and numerous webinars and education sessions on a variety of retirement readiness and financial literacy topics.

Maryland Supplemental Retirement Plans

- MSRP is governed by a nine-member Board of Trustees that is appointed by the Governor.

- By law, 6 of the 9 members must be active or plan-eligible State employees (State Personnel and Pensions Article § 35–202), and only one-third of the Board seats are designated for members of the public.

- The Board oversees and makes decisions on the Plans' investment offerings based upon the expert advice of its external investment advisor contractors (currently, NFP Retirement, Inc. and T. Rowe Price).

- The Trustees are fiduciaries who have a statutory duty to act solely in the best interest of Plan participants.

Automatic Enrollment

- Auto enrollment is an industry best practice that has been widely used by the private sector since the Pension Protection Act of 2006.
- Maryland is one of 25 states that does not allow automatic enrollment in any public sector plan.

State	Start of Auto Enrollment	Lowest State Salary FY 2025	Lowest State Salary at Start of Auto Enrollment	Auto Enrollment Deduction Amount	Defined Benefit Pension Percent of Salary Deducted
Maryland		**$36,093**			**7%**
Ohio	10/1/2022	$28,122	$26,000	$25 per pay	10%
Kentucky	7/1/2019	$18,984	$15,948	$15 per pay	9%
South Dakota	7/1/2009	$26,956	$15,080	$25 per pay	6%
Texas	9/1/2008	$24,893	$17,376	1% of salary per pay	6%

- All State employees hired after 7/1/2011 are vested at 10 years of service instead of the previous 5 years and will need the extra benefit of supplemental retirement due to reduced pension benefits and retiree prescription drug benefits.

Reductions in Maryland Retiree Benefits

1. Pension benefit multiplier reduced from 1.8% to 1.5%.
2. Pension compensation calculation now based on 5 highest annual salaries instead of 3 highest.
3. Pension COLAs capped at 2.5%, and at only 1% when pension rate of return goals are not met.
4. Retirees need 25 years of creditable service instead of the previous 16 years to receive full health benefit premium subsidy.
5. Employees hired after 6/30/2011 and those who retire after 12/31/2019 are ineligible for all 3 State Retiree Prescription Drug Programs.

MSRP Participant Account Fees

Current MSRP Plan Fees

1. $6.00 annual flat fee ($0.50/month for all accounts with balances of $500 or more)
2. 0.12% asset fee
3. Fund expenses ranging from 0.02% to 0.83%

This does not include fees for a managed account *(which is an optional third-party add-on service and **would not apply to automatic enrollment;** employees must make an affirmative decision to use this service).*

Assuming an employee only invested in the most expensive fund MSRP offers, the highest fee possible is 0.95% + $6/year. ***In the highest case scenario, this means that fees are less than 1% of the employee's invested balance.*** Fees could be as low as 0.14% plus $6 if the employee only invested in the S&P 500 Index Fund.

Research Findings

A 2024 Principal Financial Services Study Found

- Young employees and employees who earn low salaries are less likely to self-enroll.
- A majority (59%) of employees who were not participating in their workplace supplemental retirement plans believed they were already participating, and 49% of this group thought they were auto-enrolled by their employer; 41% thought they had self-enrolled; 70% believed that payroll deductions into their retirement savings plans were happening; and 77% thought they had begun participating in their retirement savings plans a soon as they were eligible.
- Automatic savings features, such as auto enrollment, will benefit employees who will be impacted by the reduction or elimination of COLAs in their defined benefit (pension) plans.

Social Security and a Pension May Not Be Sufficient

- The 2024 Congressional Budget Office projection is that the Social Security Administration will be forced to provide benefit payouts at lower percentages (23% less) after the trust funds are exhausted in FY 2034. Those born in 1969 and after will experience the greatest impact.

Vanguard Research reported the following from its 2021 study of 813,918 auto-enrolled new hires:

- Automatic enrollment triples the participation rates of new hires.
- After a 3-year period, 92% of auto-enrolled employees were still in the plans, while 29% of voluntary enrollees were still in the plans.

Principal Retirement Research conducted a 2021 survey that reported the following:

- 84% of employees indicated that being automatically enrolled is the reason they began saving for retirement and they wouldn’t have started as soon if they had to enroll on their own.

Maryland & National Data

DBM's Annual Statewide EEO Report for FY 2023 noted:

- 56% of State employees are female.
- 55% of State employees are Black (44%) or "other non-white" ethnicities (11%).
- State salaries are lower for women than men and are also lower for Black employees than white employees.

Numerous national research sources cited in the MSRP study found:

- Women make lower salaries than men, have lower net worth, and are less prepared to retire.
- Women are more likely than men to take time away from work to care for family members, which lessens the amount they're able to contribute to their retirement savings and Social Security benefits.
- Black and Latino employees make lower salaries than white employees, have lower net worth, and are less prepared to retire. They also have a higher probability of carrying various types of debt than white employees.
- People of color are much more dependent upon Social Security for retirement income and are much less able to rely on family wealth transfers for future financial support. They also contribute a significantly smaller amount to their employer-sponsored retirement savings than white employees.

Important Details

Effective Date and Eligibility

- If the legislation is passed, effective January 1, 2026, all eligible employees hired on or after this date will be auto-enrolled in MSRP.
- Eligible employees are regular and contractual employees of the Executive Branch, Judicial Branch, Legislative Branch, and State higher education employing institutions.

Employee Opt-Out Feature

- If the bill passes, new employees will receive multiple notifications and have 90 days after the first payroll deduction to opt out of MSRP and receive a refund (subject to regular tax guidelines). The 90-day opt-out period is the industry standard. New employees will receive the following:
    - ✓ notification of automatic enrollment in the MSRP benefit from their State Benefit and Retirement Coordinators and/or HR Directors during new employee orientation/onboarding;
    - ✓ an automatic enrollment FAQ document (detailing the opt-out process) during new employee orientation/onboarding;
    - ✓ an acknowledgement of receipt of the State's automatic enrollment policy and education for signature;
    - ✓ education from a member of MSRP's Member Services Education Team of Certified Retirement Counselors, including comprehensive information on automatic enrollment and the MSRP benefit during new employee orientation sessions; and
    - ✓ a hard copy letter from MSRP's Plan Administrator (currently, Nationwide Retirement Solutions) with the appropriate notifications and information on automatic enrollment and an additional copy of the automatic enrollment FAQ document.

- At any time after the 90-days, employees have the option to cease all payroll deductions, increase their contributions, decrease their contributions, and can stop and start contributions at their discretion.