



STATE RETIREMENT AGENCY
120 East Baltimore Street
Baltimore, MD 21202-6700

MARYLAND
STATE RETIREMENT
and PENSION SYSTEM

410-625-5555 • 1-800-492-5909
TTY Users: call via Maryland Relay
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**Testimony in Support of House Bill 1091
State Retirement and Pension Systems – Investment Division - Compensation
House Appropriations Committee**

**March 15, 2022
1:00 P.M.**

**Anne Gawthrop
Director of Legislative Affairs
State Retirement Agency**

The Board of Trustees for the State Retirement and Pension System (System) wishes to express its support for House Bill 1091, State Retirement and Pension Systems – Investment Division - Compensation. House Bill 1091 is legislation sponsored by the Joint Committee on Pensions at the request of the Board.

This legislation authorizes the Board to pay any earned, yet unpaid, financial incentives to Investment Division staff at the time of retirement if the individual retires directly from the Investment Division. Additionally, House Bill 1091 authorizes the Board to adjust compensation for Investment Division staff who were hired prior to July 1, 2018, have discretion over investment related decisions, and are currently receiving annual compensation that is less than the salary midpoint received by their peers in similar public pension plans.

Chapters 727 and 728 of 2018 provided the Board with the authority to determine and create positions necessary to carry out the professional investment functions of the Investment Division and to set their compensation, subject to provisions included in the legislation. Specifically, Chapters 727 and 728 require the Board to adopt objective, performance-based criteria for setting the qualifications and compensation of the Chief Investment Officer (CIO) and Investment Division staff, including incentive compensation. The 2018 legislation provides detailed guidance to the Board regarding how it should establish and implement the staffing and compensation program created by Chapters 727 and 728. Included in these bills are provisions that limit the amount by which compensation may be increased to no more than 10% each year for certain Investment Division positions. Additionally, the 2018 legislation also prohibits the Board from paying out any unpaid incentive compensation to the CIO or Investment Division staff after they separate from employment in the Investment Division. Since the enactment of Chapters 727 and 728, we have found that these provisions have unintentionally created inequities among Investment Division staff. The Board also believes provisions of the 2018 legislation will inadvertently place Investment Division staff in a position where they will ultimately have to choose between retirement and receiving financial incentives they have justifiably earned.

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Compensation Levels

One of the issues the legislature was intent on addressing through Chapters 727 and 728, was to provide the Board with the authority to develop objective criteria for setting compensation for Investment Division staff that would be competitive with similar positions in comparable public pension funds across the country. At the time the 2018 legislation was enacted, the majority of the Investment Division staff that had discretion over investment-related decisions were receiving compensation well below the national midpoint salaries of their peers. The legislation provided the Board the authority to set the compensation for staff hired after the enactment of the Chapters 727 and 728 at levels that were very near the midpoint salaries of their peers in other comparable public pension plans. For those individuals who were employed in the Investment Division prior to the passage of the legislation, the legislature included a provision that limits compensation increases to no more than 10% each year. The intent of this provision was to help “fast-track” the existing staff to reach the higher salaries new employees would be receiving.

Following the passage of the 2018 legislation, the Board developed a policy in its Investment Policy Manual that included adopting objective criteria for increasing compensation for the Investment Division staff that had discretion over investment-related decisions. The objective criteria included requiring the Board to: (1) consider comparative qualifications and compensation of employees in similar positions at comparable public pension funds; and (2) set objective benchmarks of investment performance that would need to be met or exceeded by an individual to be eligible for a compensation increase. The Board included provisions stating that when the salary for a particular position is at, or above the salary range midpoint, an increase in compensation should only be considered in years when the fund meets or exceeds policy benchmarks. Conversely, if the position’s salary is below the salary range midpoint, an increase should be considered, even in years when the fund does not meet or exceed its policy benchmarks. To date, no employees hired on or after July 1, 2018, have received a 10% annual increase to their compensation, inasmuch as their starting compensation was already set near the midpoint salaries of their peers in comparable public pension plans.

While the Board fully appreciates the legislative intent of the 10% cap on compensation increases for Investment Division staff that has discretion over investment-related decisions, we believe a review of the compensation received by each of these individuals since 2018 reveals unintended instances of inequity between peers within the Investment Division performing the same functions, and in some instances inequity between a supervisor and a subordinate. Currently, the Investment Division has 27 employees who have discretion over investment-related decisions. Of these, 14 employees are receiving compensation near the national midpoint salary of their peers, placing them within one year of reaching the midpoint salary goal.

Of the remaining 13 employees of the Investment Division that have discretion over investment-related decisions and who were hired before the enactment of Chapters 727 and 728, nine are receiving compensation that would take at least two or more years to reach the midpoint salary range of their peers in comparable public pension plans. These nine individuals include the deputy chief investment officer, four managing directors, and four senior portfolio managers. The compensation for the four individuals serving as senior portfolio managers are lagging significantly behind not just the national midpoint of salaries, but also some of their peers within the Investment Division, because at the time they were hired, their compensation was subject to the salary schedule of the State Personnel Management System. It will take another two years of 10% increases each year, before these individuals reach the national midpoint salary of their peers in comparable plans and the level of compensation received by their peers in their asset group within the Investment Division. Meanwhile, their peers with considerably less service in the

Investment Division who were hired after the enactment of Chapters 727 and 728 will continue to receive compensation increases (albeit not 10% annual increases) that will continually place them above these employees who were hired prior to July 1, 2018.

Because of legislation passed in 2012, the compensation for the deputy chief investment officer and the managing director positions for the Investment Division were removed from the State Personnel Management System and placed in the Executive Pay Plan. While the Board and the Investment Division greatly appreciate the assistance the legislature provided these employees in 2012, since that time, their salaries have also fallen well below the national midpoint salaries of their peers in comparable public pension plans. Assuming consistent 10% annual increases each year, the four managing directors will not reach the midpoint salary for three or four years (depending on their current salary), while a recently hired managing director, performing essentially the same duties as a managing director, will continue to outpace these employees regarding their compensation. Moreover, the deputy chief investment officer who oversees and supervises the managing directors of the Investment Division, has 20 years of service with the Division. Nevertheless, this individual is currently earning less than the managing director that was recently hired and will not reach the national midpoint salary of the deputy's peers in comparable public pension plans for two more years.

Again, we fully appreciate the motivation behind the legislature limiting annual compensation increases to 10% for staff hired prior to the passage of Chapters 727 and 728 of 2018. However, we do not believe it was the legislative intent of the 2018 legislation to maintain such significant disparities among individuals performing the same duties within the Investment Division for, what appears at this time, nearly 10 years after the passage of the legislation granting the Board independent salary setting authority for the Division. This, coupled with the hiring of more individuals each year at the national midpoint compensation level, raises the potential for morale issues that could result in experienced staff leaving employment with the Investment Division. This result would be directly counter to the fundamental purpose of Chapters 727 and 728, which was, in part, to create retention within the Investment Division.

To address this issue, House Bill 1091 would grant the Board the authority to provide the staff of the Investment Division who have discretion over investment-related decisions, were employed prior to the passage of Chapters 727 and 728, and continue to receive compensation that is more than 10% below the midpoint of their respective salary ranges relative to the national midpoint, with not more than two one-time salary adjustments to be approved with the intent to move these individuals up to the midpoint of their respective salary ranges.

Forfeiting Incentive Compensation

A second provision that is included in House Bill 1091 addresses the forfeiture of any unpaid incentive compensation if an employee of the Investment Division ceases employment with the Division. Current law provides that, “[i]f an individual who has earned financial incentives separates from employment in the Investment Division, the Board of Trustees may not pay out any remaining financial incentives due to be paid after the date of separation from employment.” Current law also provides that any incentive compensation awarded to Investment Division staff shall be paid over two years. The intent of paying the award over the two year period of time is to serve as an incentive tool for retention within the Investment Division. If an Investment Division employee ceases employment within the Division, that individual will forfeit 50% of the previous year's incentive compensation and 100% of the current year's award. Such a

financial loss would likely serve as a deterrent to move on to another employer. This forfeiture provision does not provide for an exception for retirement.

As a result of the law being silent with regard to retirements, an Investment Division staff may forfeit incentive compensation they have earned at the time they retire. The lack of an exception for retirements in the provisions addressing forfeiture of incentive compensation could ultimately serve as a disincentive to retire. We do not believe it was the intent of the legislature to penalize an individual for retiring from State service; nor was it the intent of the legislature to incentivize individuals to continue working long past their normal retirement age in order not to forfeit financial incentives the individuals may have earned in their service to the System and the State.

To address this issue, House Bill 1091 provides for an exception to the incentive compensation forfeiture provisions for retirements of Investment Division staff. House Bill 1091 provides that if Investment Division staff retire directly from the Investment Division within 30 days of leaving employment with the Division, they will not forfeit any incentive compensation they have earned, but not received, at the time of their retirement.

We appreciate being given this opportunity to express our support to the Committee for this legislation and would request a favorable report on House Bill 1091.