

BOARD OF TRUSTEES
FOR THE
STATE RETIREMENT AND PENSION SYSTEM
OF MARYLAND

MINUTES OF MEETING

August 21, 2001

The Board of Trustees for the State Retirement and Pension System of Maryland met in the Boardroom of the SunTrust Building, 120 East Baltimore Street, Baltimore, Maryland, at 9:30 a.m. There were present Richard N. Dixon, Chairman, William Donald Schaefer, Vice-Chairman, Secretary T. Eloise Foster, Arthur N. Caple, Jr., Frank P. Casula, Major Morris L. Krome, Carl D. Lancaster, Debra B. Humphries, Trustees, and Peter Vaughn, Secretary. Agency staff members also attending were Margaret A. Bury, Retirement Administrator, Robert Feinstein, Jill Leiner, Rachel Cohen, Assistant Attorneys General, Carol Boykin, Chief Investment Officer, Tracey Ray, Deputy Chief Investment Officer, Thomas Gighotti, Chief Internal Auditor, Gwendolyn Mulkey, Executive Associate, Howard Plenies, Legislative Director, Rick Harrison, Chief Financial Officer, and Gary Scribner, Chief Information Officer.

Robert Silberman, Attorney for Joy Richards, Ted Smith and Marsha Craver were also present.

Minutes

- 1 Ms. Humphries noted that her vote was incorrectly recorded as negative regarding the Maryland Charities Campaign issue. Ms. Humphries should have been recorded as positive. The correction was recorded as part of the record.

On motion made by Mr. Casula and seconded by Major Krome, the Minutes of the regular meetings of the Board of Trustees for the State Retirement and Pension System of Maryland, held on July 17, 2001, were approved as amended.

Investment

Committee Report

- 2 Mr. Arthur Caple, Chairman of the Investment Committee, reported on the Investment Committee meeting held August 10, 2001.

Mr. Caple stated that the Committee recommended that the Board approve the Real Estate Registry. On motion made by Mr. Casula and seconded by Ms. Humphries, the Board voted unanimously to approve the Real Estate Registry.

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Mr Caple then reported that the Committee recommended the termination of Harbor International for asset allocation reasons, in order to implement an earlier decision by the Board of Trustees to reduce its international equity allocation to approximately 20% of total plan assets. The account was valued at \$457 million as of July 31, 2001. On motion made by Mr Caple and seconded by Ms Humphries, the Board voted unanimously to terminate Harbor International for asset allocation reasons.

Mr Caple advised the Board the Committee recommended engaging State Street Bank to assist the System with transitioning out of the Harbor Account. The Committee asked Staff to develop a report on transition manager selection issues. On motion made by Chairman Dixon and seconded by Mr Casula the Board voted to approve the engagement of State Street Bank and directed the report be issued. Messrs Caple, Casula, Chairman Dixon, Vice-Chairman Schaefer, Secretary Foster, Major Krome and Ms Humphries registered yea votes. Mr Lancaster registered a nay vote.

Mr Caple then advised the Board that the Committee recommended the hiring of Ariel Capital Management as a mid cap value manager, (a) where funding will equal 50% of the Harbor proceeds or approximately \$225 million based upon a valuation of the Harbor account on July 31, 2001, and (b) with a benchmark equal to the Russell Mid Cap Value index + a premium of 150 basis points in alpha + fee. On motion made by Mr Caple and seconded by Ms Humphries, the Board voted unanimously to hire Ariel Capital Managers as a mid cap value manager.

Mr Caple advised the Board that the Committee recommended the hiring of Trust Company of the West (TCW) as a small-to-mid cap value manager, (a) where funding will equal 50% of the Harbor proceeds or approximately \$225 million based upon a valuation of the Harbor account on July 31, 2001, and (b) with a benchmark equal to the Russell 2500 Value index + a premium of 150 basis points in alpha + fee. On motion made by Mr Caple and seconded by Ms Humphries, the Board voted unanimously to hire TCW as a small-to-mid cap value manager.

Mr Caple recommended to the Board the approval of Consent to the purchase of Progress from Liberty by Fleet without signing the consent form. Lack of signature on the consent form is the equivalent to approval. This is a practice that the Board of Trustees has adopted.

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recently for issues where concern has not been expressed over the proposed transactions. On motion made by Mr Caple and seconded by Mr Casula, the Board voted unanimously to approve the Consent of purchase of Progress from Liberty by Fleet without signing the consent form.

Mr Caple also recommended to the Board the approval of Consent to the acquisition of ISS (Institutional Shareholder Services) by Proxy Monitor without signing the consent form. On motion made by Mr Caple and seconded by Mr Casula, the Board voted unanimously to approve Consent to the acquisition of ISS (Institutional Shareholder Services) by Proxy Monitor without signing the consent form.

Mr Caple requested the approval of the Committees appointment of Mr Robert W Schaefer to the Minority Sub-Committee as the public member on the Sub-Committee, replacing the vacancy created by Mr Howard P Colhoun. On motion made by Mr Caple and seconded by Mr Casula, the Board voted unanimously to approve the appointment of Mr Robert W Schaefer to the Minority Sub-Committee as the public member on the Sub-Committee.

The Board accepted Mr Caple's report.

Joy Richards

- 3 The Board considered the report of Stephen J Nichols, sitting as Administrative Law Judge for the Office of Administrative Hearings, in connection with the appeal of Joy Richards. Ms Richards appealed the Medical Board's denial of accidental disability benefits. The Medical Board reasoned that they did not believe that her disability was the natural and proximate result of an accident that occurred in the performance of duty.

The Administrative Law Judge, upon consideration of the record, and following a hearing, affirmed the Agency's decision and concluded that Ms Richards's disability was not the "natural and proximate result" of a work-related accident that allegedly occurred on May 12, 1998. Therefore, her application for accidental disability benefits should be denied.

Mr Robert Silberman, attorney for Ms Richards, presented his arguments opposing the Agency's position and the Administrative Law Judge's recommendations. Ms Jill Leiner, attorney for the Agency, addressed the Board and argued that the Board should adopt the Administrative Law Judge's recommendations. The Board deferred further consideration to executive session.

Marsha Craver

- 4 The Board considered the report of Eleanor A Wilkinson, sitting as Administrative Law Judge for the Office of Administrative Hearings, in connection with the appeal of Marsha Craver. Ms Craver appealed the

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Medical Board's denial of special disability benefits. The Medical Board reasoned that they did not believe that her disability arose out of or in the course of the actual performance of duty.

The Administrative Law Judge, upon consideration of the record, and following a hearing, affirmed the Agency's decision and concluded that Ms. Craver's disability did not arise out of or in the course of the actual performance of duty. Therefore, her application for accidental disability benefits should be denied.

Ms. Craver presented her arguments opposing the Agency's position and the Administrative Law Judge's recommendations. Ms. Jill Leiner, attorney for the Agency, addressed the Board and argued that the Board should adopt the Administrative Law Judge's recommendations. The Board deferred further consideration to executive session.

Ted Smith

- 5 The Board considered the report of William J.D. Somerville, sitting as Administrative Law Judge for the Office of Administrative Hearings, in connection with the appeal of Ted Smith. Mr. Smith appealed the Retirement Agency's denial of ordinary disability benefits. The Agency reasoned that Mr. Smith, by state law was not entitled to ordinary disability benefits.

The Administrative Law Judge, upon consideration of the record, and following a hearing, affirmed the Agency's decision and concluded that because Mr. Smith was retired, he was ineligible to apply for disability benefits. Therefore, his application for ordinary disability benefits should be denied.

Mr. Smith, presented his arguments opposing the Agency's position and the Administrative Law Judge's recommendations. Ms. Rachel Cohen, attorney for the Agency, addressed the Board and argued that the Board should adopt the Administrative Law Judge's recommendations. The Board deferred further consideration to executive session.

On motion made by Mr. Caple and seconded by Mr. Casula, the Board unanimously voted to meet in Executive Session to consider the appeals of Joy Richards, Marsha Craver and Ted Smith. State Government Article Section 10-503(a)(1)(iii) authorizes the Board to meet in closed session to exercise a quasi-judicial function.

EXECUTIVE SESSION

The Board met in Executive Session at 11 07 a m in the SunTrust Building to consider the appeals of Joy Richards, Marsha Craver and Ted Smith. All of the persons present at the beginning of the meeting were present in Executive Session except the following Robert Silberman, Attorney for Joy Richards, Ted Smith and Marsha Craver. The Board adjourned its Executive Session at 11 30 a m and returned to regular session to complete the agenda.

REGULAR SESSION

Joy Richards

The Board considered the record of Joy Richards. Following a discussion, a motion made by Major Krome and seconded by Secretary Foster, to accept the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law failed with a vote of two-to-five. Major Krome and Secretary Foster registered yea votes. Vice-Chairman Schaefer, Ms Humphries, Messrs Lancaster, Caple, and Casula registered nay votes.

On motion made by Mr Lancaster and seconded by Mr Casula, the Board voted 5 - 1 to grant Ms Richards accidental disability benefits. Chairman Dixon, Vice-Chairman Schaefer, Messrs Lancaster, Caple and Casula registered yea votes. Ms Humphries registered a nay vote and Major Krome abstained.

Marsha Craver

The Board considered the record of Marsha Craver. Following a discussion, on motion made by Mr Lancaster and seconded by Vice-Chairman Schaefer, the Board voted to reject the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law and grant Ms Craver's request for special disability retirement benefits. Vice-Chairman Schaefer, Messrs Lancaster, Caple and Casula and Ms Humphries registered yea votes, Chairman Dixon, Secretary Foster, and Major Krome abstained.

Ted Smith

The Board considered the record of Ted Smith. Following a discussion, on motion made by Ms Humphries and seconded by Mr Casula, the Board voted unanimously to adopt the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law and denied Mr Smith's request to apply for ordinary disability retirement benefits.

Executive
Director's Report

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Mr Vaughn reminded the Board that the meeting date for the September Board meeting had been changed from Tuesday, September 18, 2001 to Thursday, September 20, 2001.

Mr Vaughn next informed the Board that the Agency has engaged a vendor to distribute the Maryland Charities Campaign information Mr Vaughn noted that Maryland Charities won't have all of the forms until at least August 30, 2001, which is ten days late and will push back the mailing until at least September 11, 2001

Mr Vaughn also noted that he contacted the Secretary of States Office about active employees social security numbers and addresses being given to the Maryland Charities for the purpose of charitable solicitation Mr Vaughn spoke with Micky Trella, Director of Charities and Legal Services, and expressed the Boards concerns over sharing active employees personal information Ms Trella said she believed it was in the best interest of the State to provide the information but understood the Board's concern

Mr Vaughn informed the Board that the Agency closed the books for the fiscal year ending June 30, 2001 in record time Mr Vaughn noted that all the necessary adjustments to the file and the reconciliation of the data had been made and the books closed by July 26, 2001 Mr Vaughn thanked Ms Marge Bury and Ms Cheryl Hagen and her staff for all their extra efforts

Mr Vaughn advised the Board that the Agency has been sued by Carroll County Government in connection with their withdrawal from the system in 1985 At the advice of counsel to Board decided to deliberate in Executive Session

On motion made by made and duly seconded, the Board unanimously voted to meet in Executive Session to discuss the Carroll County lawsuit State Government Article Section 10-508(a)(7)&(8) authorizes the Board to meet in closed session to discuss pending litigation with staff

EXECUTIVE SESSION

The Board met in Executive Session at 11 35 a m in the SunTrust Building to discuss the Carroll County lawsuit All of the persons present at the beginning of the meeting were present in Executive Session except the following Robert Silberman, Attorney for Joy Richards, Ted Smith and Marsha Craver The Board adjourned its Executive Session at 11 50 a m and returned to regular session to complete the agenda

REGULAR SESSION

Mr Vaughn then updated the Board on the DROP program. The State Police DROP Program currently has 54 Retirees enrolled with an aggregate balance of \$1.2 million. The Leops DROP Program which started November, 2000, has 32 Retirees enrolled with an aggregate balance of \$393 million.

Mr Vaughn informed the Board that Ms Debra Bacharach, the new General Counsel to the Board, was scheduled to begin her employment with the Retirement Agency on Monday, September 10, 2001.

The Board reviewed and accepted the System's financial statements and investment performance comparisons for the period ending June 30, 2001 for the State Retirement and Pension System of Maryland.

The Board accepted Mr Vaughn's report.

Executive
Committee Report 7

Major Krome, Vice Chairman of the Executive Committee, reported on the meeting held August 14, 2001.

Major Krome then asked Executive Director, Peter Vaughn, to update the Board on the 2002 Budget Request.

Mr Peter Vaughn presented the Retirement Agency's FY2003 budget request. He noted that as submitted by the Agency, the request for \$21,219,892 is \$108 under the target set by the Department of Budget and Management (target was \$21,220,000). Mr Vaughn stated that the principal differences in the budget for FY2003 were in the following areas:

\$556,855 for COLA's, increments and benefits of existing staff

\$190,731 for conversion of 4 contractual positions to permanent positions

\$81,273 for travel and training (restores DBM cut)

\$98,500 for outside contract to convert microfilm to imaging (involves years from 1979 to 1983)

\$67,550 for increases to postage costs, both volume and rates

(\$220,908) reduction of 7 contractual positions

Mr Vaughn indicated that the one unknown in the FY2003 budget involves the Strategic System Project. He indicated that it should be clear that there is a need for more time to complete the project, although a new "go-live" date is yet to be agreed upon. As the Retirement Agency continues to work with Syscom on the completion of the project, it is unknown if the Agency will incur any additional costs that will be payable into the FY2003 administrative budget. He indicated that if this occurs, there would be about \$3.5 million in cap room to

seek necessary budget amendments. After viewing the additional data from Syscom, and after determining what items are covered by the existing contract, the Agency will know if there are additional costs it should absorb.

Mr. Vaughn again reminded the Board that he believes that Syscom will honor its commitments to complete this project. He noted that Syscom must satisfy our needs if it is to market this product to other states. In addition, the Agency is holding a portion of the funds from completed and approved deliverables until the completion of the project, and there is also a performance bond.

Mr. Vaughn stated that he has sent letters to the pension and budget committees about potential delays. He will keep the General Assembly informed, as more information becomes known.

Executive Committee recommends to the Board of Trustees that it accept the Retirement Agency's FY2003 budget request as submitted. On motion made by Major Krome and seconded by Mr. Caple, the Board unanimously approved the FY2003 budget request and forward it to the Governor's office.

Major Krome advised the Board that the Executive Committee denied Ms. Clementine Carr a hearing concerning the selection of Option 4, by her sister, the late Celestine Carr. Ms. Carr believed that her sister, who was suffering from terminal cancer, should not have been permitted to make a decision on an option for her retirement without help. She is seeking to change the option selection to Option 1.

After careful consideration and advice of Counsel, the Executive Committee decided that it could not honor Ms. Clementine Carr's request. The Executive Committee believed that the system had functioned properly in this case.

The Executive Committee recommended to the Board of Trustees that it uphold the Executive Director's decision to deny Ms. Carr's appeal for an hearing. On motion made by Major Krome and seconded by Mr. Casula, the Board voted unanimously to approve the Executive Committee's recommendation and deny Ms. Carr a hearing.

Major Krome advised the Board that the Retirement Agency had denied a request from Dr. Donnelly A. Gregory to purchase service while Dr. Gregory worked in a temporary position for Montgomery County Public Schools. Dr. Gregory claimed he worked from September 1978 through December 1, 1980 as a part-time professional without benefits. He claims that he should be eligible to purchase this service credit because contributions were deducted from his pay.

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The Executive Committee determined that the Retirement Agency should contact Dr Gregory and ask him to demonstrate that contributions were deducted from his pay from September 1979 through December 1980. If contributions have been deducted, staff is directed to adjust his service credits accordingly. If there were no deductions, Dr Gregory should be advised that there is no means for him to receive or purchase service credits for this period of time.

Major Krome informed the Board that several months ago, the Retirement Agency had identified a number of retirees who are receiving disability benefits (special, accidental, or ordinary) and who are employed with a participating employer and subject to the provisions of Section 29-115 (e) of the State Personnel and Pensions Article. Under this provision of pension law, a disability benefit may be suspended if re-employed with a participating employer at a salary equal to or greater than the average final compensation at retirement, if re-employed with a participating employer at a salary less than the retiree's average final salary at retirement but in a position similar to the position held at retirement, or if the Board of Trustees determines that the retiree has refused a re-employment offer by the retiree's former employer in a position comparable to the one previously held or at a salary at least equal to the average final compensation at retirement.

Major Krome then informed the Board that the Executive Committee requested staff to draft a proposal to amend 29-115(e), to repeal (e)(1), eliminate the references to compensation under (e)(2), and to alter (e)(3) to provide for a temporary suspension of benefits while employed. The draft will be presented at the September Executive Committee meeting.

Major Krome informed the Board that Mr Robert Dezube from Milliman USA addressed the Executive Committee concerning possible changes to dual life annuity options - Options 2 & 3, and pop-up Options 5 & 6. He again reminded the Committee that last year the Board had requested changes to the re-calculations of Options 2 & 3 when the original beneficiary pre-deceases the retiree. The projected costs for this proposal, however, proved prohibitive. This year, he believed that the Board could recommend changes that would be cost neutral for active and deferred members and less costly for retired members. The Committee directed Staff to draft a proposal for consideration in September.

Major Krome stated that Mr Peter Vaughn advised the Executive Committee members of the following that he was communicating with Kent County Government about their possible participation in the Employees' Contributory Pension System and the Law Enforcement Officers' Pension System. Mr Vaughn noted that the County was seeking to receive credit for contributions that the County made to a defined contribution plan for its employees. During the first 5 years,

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these contributions are considered employer dollars. After the member is vested, the dollars are the employees' monies. The County indicates its employees are willing to agree to transfer their contributions to the State to cover, in part, liabilities Kent County would incur for enrolling in the System with all prior past service credits.

Mr. Vaughn stated that he is not totally comfortable with the County's proposal. He believes it is more appropriate to transfer employee contributions as mandatory employee contributions to be placed in individual accounts. In this manner, if a member withdraws, that member receives a refund of prior employee contributions. Mr. Vaughn also has requested indemnification in the event that there is litigation from members who are part of the transfer. He also has agreed that the County should seek a private letter ruling from the Internal Revenue Service to confirm any agreement on the transfer of employee contributions before it occurs, whether the transfer is in compliance with the IRS code, and to request 414(h) pickup for future member contributions.

Mr. Vaughn concluded his remarks by noting that he is still talking to Kent County and that no definite decisions have been reached. He will continue to update the Executive Committee. He did request that the Committee approve the Retirement Agency cosigning the request for private letter ruling should it be determined that the private letter ruling is needed, and that the Agency's signature is necessary to obtain the IRS response.

Executive Committee recommended to the Board of Trustees that Mr. Vaughn be authorized to cosign a request for private letter ruling if, on the advice of legal counsel, the signature is needed to obtain the ruling. On motion made by Major Krome and seconded by Mr. Caple the Board authorized Mr. Vaughn to cosign a request for private letter ruling if on advice of legal counsel, the signature is needed to obtain the ruling.

Major Krome stated that the Investment Division is recommending that a special exemption from manager fees for alternative investments be presented to the General Assembly for approval. The Executive Committee agreed and asked staff to prepare a draft for this proposal. The draft is to include a definition of alternative investments.

Major Krome stated that Mr. Gary Scribner presented the following monthly Strategic System update. Mr. Scribner noted that while some progress continues to be made, it is clear to him that considerable differences remain between the Agency and Syscom on testing. Mr. Scribner noted that the Agency met with Syscom on July 31, to discuss testing documentation and the continuing need for detailed design documentation. Syscom has implied that such detailed documentation will result in additional costs. He requested a breakdown for these

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costs Mr Scribner also indicated that when this information is received, it would be evaluated against the existing contract to determine if any additional costs are appropriate

He continued by stating that staff has continued to work on various scenarios for testing There is great detail involved in all areas, and it will be determined at a later date the appropriate amount of testing for each scenario He noted that these testing scenario deal with the various vital areas of the system

Mr Scribner stated that the Agency received Syscom's testing plan on August 10, 2001 His brief review indicates it still lacks sufficient detail The Agency will be reviewing the plan and discussing it with Syscom in the next week In concluding his remarks, he stated that the test schedule proposed by Syscom indicates a revised go-live date of June 2002

The Board accepted Major Krome's report Exhibit A

Audit Committee Report 8 The report of the Audit committee meeting was deferred until the next Board meeting

Earnings Limitation Recovery 9 The report of the Agency for offsets of certain retirees was accepted by the Board Mr Lancaster asked Mr Vaughn if there was anything under the law that could be done about the Earnings Limitation Recovery, Mr Vaughn stated that under current law, there was nothing that could be done The Board, on motion made and duly seconded by authorized the reduction of the pensions of affected retirees as provided for under the current law [State Personnel and Pensions Article Sections 22-406 (b)(2) and 23-407 (b)(2)] The pensions offset are based on calendar 2000 earnings that will be offset from pension benefits paid in fiscal year 2001 Exhibit B

Medical Board Reports 10 The Board, on motion made and duly seconded accepted and approved the reports of the Medical Board in connection with applications of members for ordinary, accidental and special retirement allowances The Medical Board's conclusions were reached after its review of the evidence provided by the claimants Exhibit C

Supplemental Medical Board Reports 11 The Board, on motion made and duly seconded the Board unanimously accepted and approved the supplemental reports of the Medical Board in connection with applications of members for ordinary and accidental and special retirement allowances The Medical Board's conclusions were reached after its review of the evidence provided by the claimants The Supplemental Report of the Medical Board is shown as Exhibit D

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Other Business

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There being no further business, on motion made and duly seconded,
the Board adjourned at 12 45 p m

Respectfully submitted,

Peter Vaughn, Secretary



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