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

September 15, 2009

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, beginning at 9:07 a.m.

The Trustees present included:

Nancy K. Kopp, Chairman	Peter Franchot, Vice-Chairman	F. Patrick Hughes	Major Morris Krome
Robert Schaefer	William D. Brown	John Douglass	Sheila Hill
Harold Zirkin	David Blitzstein	James Harkins	
Thurman Zollicoffer, Jr. (via phone)		R. Dean Kenderdine, Secretary	

Agency Staff members attending included:

Deborah Bacharach	Anne Budowski	Margaret Bury	Steve Cichelli	Rachel Cohen
Melody Countess	Jamie Doran	Brian Feilinger	Robert Feinstein	Ira Greenstein
Carla Katzenberg	Dennis Krysiak	Jill Leiner	Mansco Perry, III	Howard Pleines
Kenneth Reott	Brian Rowe	Fred Semko	Janet Sirkis	Patrice Sowah
Toni Voglino	Melissa Warren	Victoria Willard		

Also attended by:

John Kenney	Melissa Moye	Anne Gawthrop	Lisa Campbell	Michael Rubenstein
Dylan Baker	Robert Palumbi	Randy Mickens		

Doug Rowe, Mercer (present during GRS presentation)

Minutes

1. On a motion made by Chairman Kopp and duly seconded the Board approved the minutes of the August 18, 2009 open session meeting.

Investment Committee Report

2. Mr. Robert Schaefer, Chairman of the Investment Committee, reported on the regular meeting of the Investment Committee held on September 11, 2009.

   Mr. Schaefer reported that Mr. Perry presented a review of the investment program's Fiscal Year 2009 results. Highlights from his report:

   - Public Equities - The public equity program returned -28% for the fiscal year. U.S. equities outperformed slightly, while both international and global equities underperformed their benchmarks.
   - Terra Maria Program – This program constitutes approximately 7% of the total fund. Since inception results have been impressive.
   - Fixed Income – The fixed income program has been restructured to focus on core fixed income with both domestic and global segments.
   - Real Return – TIPS and global inflation linked bonds are the foundation of this asset class. Staff anticipates that by the end of the calendar year, the System (i) will have exposure to commodities, infrastructure, energy and timber investments, in addition to real return multi-strategy managers and (ii) will attain the target allocation for this asset class.
   - Private Equity – The portfolio is very diversified and has a global profile. There has been a focus on distressed debt, secondary funds and mezzanine debt opportunities over the past year.
   - Real Estate – After a real estate consultant is selected, a revamping of the real estate program is likely to be undertaken.
   - Absolute Return – The System's three existing managers in this asset class performed well during the fiscal year. Staff continues to deliberately evaluate the program structure for this asset class. Several fund of hedge funds and multi-strategy managers are being evaluated for inclusion in the System's portfolio.

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- Cash – It was noted that existing cash reserves are expected to be drawn down over the next few months, as part of the transitioning of assets.
- Credit Opportunities – First investments were made in February, 2009. Staff is satisfied with the early returns.

Mr. Schaefer reported that the Investment Committee received an update from Ms. Hill, Chair of the Corporate Governance Subcommittee, regarding Iran/Sudan divestment. Ms. Hill noted that at the Subcommittee's August 18, 2009 meeting, it was agreed that Mr. Zollicoffer would work with Ennis Knupp to develop an analysis and proposed recommendations regarding divestment. Ms. Hill indicated that this work continues, and the Subcommittee expects to convene soon to receive and evaluate the analysis and recommendations, for purposes of making a recommendation to the board.

Mr. Schaefer reported that the Investment Committee received Ennis Knupp's 2nd Quarter Performance Report for the System, flash report for the month of July, and information regarding the Asset / Liability study. Ms. Bernard also provided brief comments about year to date market performance. The Investment Committee also received the following investment reports:

- June 30 State Street Performance Reports
- Quarterly TUCS Report (see below)
- Quarterly PE Performance Report
- Quarterly Broker Commission Reports
- Quarterly Directed Brokerage Report
- ORP Performance Report
- OPEB Update
- Proxy Voting Fees

Mr. Schaefer reported that with regard to the June 30, 2009 TUCS results:

- It was noted by Ms. Bernard that the System's policy benchmark was ranked in the first (highest) percentile for the quarter ended June 30, suggesting that the asset allocation decisions made by the Board of Trustees have positioned the System to perform well going forward.
- It was noted by Mr. Perry that, according to State Street, the System's one year ranking in the State Street public plan universe (26 plans greater than $1 billion in AUM) would have been in the 49th percentile.
- Investment Staff was asked to provide the State Street peer comparison information to the Department of Legislative Services.

Mr. Schaefer reported that after discussion, the Investment Committee approved a motion to:

a. Permit the Corporate Governance Subcommittee to present its analysis and recommendations directly to the full Board of Trustees at the Board's October 20, 2009 meeting; and
b. Cancel the Investment Committee's October 9, 2009 meeting.

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On a motion made by Mr. Schafer and seconded by Ms. Hill the Board approved the following five recommendations regarding revisions to the System's asset allocation policy.

1. Utilize futures contracts to create synthetic equity and fixed income portfolios.

2. Utilize futures and other derivatives to develop an overlay program which will enable the System to quickly and easily rebalance the total fund portfolio to the asset allocation targets in the System's Investment Policy Statement.

With regard to items 1) and 2), it was further agreed that staff and Ennis Knupp will develop and provide to the Committee supplemental information regarding how derivatives will be utilized. The supplemental information will describe what derivatives are be utilized and detail the constraints and limitations that will govern their use, specifically addressing leverage and the risks associated with the deployed derivatives.

3. Transition the temporary credit opportunities allocation to a permanent debt-related strategies allocation. The target allocation will be 5%. The asset class will include:
   - corporate and mortgage related credit strategies
   - government sponsored programs (i.e., PPIP, TALF, etc.)
   - distressed debt
   - mezzanine debt
   - bank loans
   - convertible securities
   - high-yield debt
   - emerging market debt
   - preferred securities

The benchmark for the debt-related strategies allocation would be 50% Barclays Capital U.S. Corporate High-Yield Index and 50% Barclays Capital U.S. Corporate Index. To implement an orderly transition, the effective date will be January 1, 2010.

The source of funds for this allocation will be 3% from private equity, 1% from public equity, and 1% from cash.

4. The asset class benchmark for the fixed income asset class will be revised to a combination of 80% Barclays Capital U.S. Aggregate Index and 20% Barclays Capital Global Aggregate Index.

5. Change the annual asset allocation review of the System's total fund portfolio meeting to the spring. This meeting change will allow any changes to the asset allocation to become effective at the beginning of the fiscal year rather than to be applied retroactively or after the fiscal year has commenced.

On a motion made by Mr. Schaefer and seconded by Ms. Hill the Board

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approved permitting staff to develop, and authorizing the Executive Director to submit, a comment letter urging the SEC to refrain from imposing the placement agent prohibition set forth in the proposed rule.

On a motion made by Mr. Schaefer and seconded by Ms. Hill the Board approved the System's participation in the Mercer Strategic Allocation and Scenario Analysis Consortium. Mr. Zirkin, Major Krome, and Mr. Hughes opposed.

The Mercer Strategic Allocation and Scenario Analysis Consortium project is designed to examine the effects that climate change could have on pension plans over time. The cost to the Agency for joining this consortium is $50,000 and will require minimal staff participation. The System will receive two deliverables: (i) a report that presents certain general information regarding the consortium's research findings and (ii) a customized report examining the sensitivity of the System's asset allocation mix to climate change outcomes and government policy response.

On a motion made by Mr. Schaefer and seconded by Ms. Hill the Board approved becoming a signatory to the 2009 Investor Statement on the Urgent Need for a Global Agreement on Climate Change.

On a motion made by Mr. Schaefer and seconded by Major Krome the Board approved the final renewal option in Fidelity's ORP contract for the period beginning January 1, 2010 and ending December 31, 2010.

Administrative Committee Report

3. Mr. James Harkins, Chairman of the Administrative Committee, reported on the regular meeting of the Administrative Committee.

Mr. Harkins reported that the Administrative Committee accepted the reports on the Administrative Expenses and the Management Fees for fiscal year ending June 30, 2009.

Mr. Harkins reported that Mr. Dean Kenderdine presented the Agency's FY2011 budget request that reflected the needs of the System and that were in the best interests of the membership and the System.

The FY2011 request totals $31,623,000 – operational Budget of $25.9 million, plus $5.7 million for MPAS development initiatives. The total budget request of $31.6 million remains under the legislative cap of $34.5 million.

Mr. Harkins reported that the Agency's workload has increased over the last decade, while the work force has realized an increase of 13 employees in that same period. A critical need for the Agency, even in these difficult financial times, is adding positions in three key areas – Investments, Internal Auditing, and Benefits Administration.

Mr. Harkins reported that the staffing requests reflect that:

1. the Investment Division's responsibilities have changed significantly as it implements the Board's asset allocation plan with its increased exposure to markets outside the U.S. and increased use of alternative investments such as private equity, private real estate investment funds, and other

Administrative Committee Report

innovative strategies, requiring additional staff for due diligence and risk management.

2. the Benefits Administration requires additional staff to ensure proper enrollment of all eligible employees, to verify that legitimate retirees/beneficiaries are receiving benefits, and that all IRS regulations are met.
3. the Internal Audit Division needs to be expanded to implement an internal audit team approach that will provide specialists in the areas of Benefits Administration, Investments and Information Systems.

Mr. Harkins reported that in priority order, the 15 positions needed by the Retirement Agency are:

- Investments– six positions (however, it is Mr. Kenderdine's plan to request three of these positions next month through the Board of Public Works' "Rule of 200" process).
- Internal Audit – three positions (investment focus)
- Benefits Administration, Data Control – three positions
- Benefits Administration, Benefits Processing – one position
- Internal Audit – two positions (information technology focus)

Mr. Harkins reported that as part of the submission of the budget request, Mr. Kenderdine stated that he was seeking to reorganize staff and create an Office of External Affairs. His intent is to utilize two current vacancies to hire (1) a Director who would oversee all Agency communications including communications with members, the General Assembly, participating municipalities, as well as the media, both consumer and trade, and (2) a Manager of Member Communications to specifically handle all Agency publications as well as the website. This person would also assist the Office Director with press relations.

On a motion made by Mr. Harkins and seconded by Mr. Schaefer, the Board approved the FY11 Budget Proposal.

Mr. Blitzstein expressed his concern regarding the limited number of Investment staff during a time when the investment deals are increasingly more complicated and require more oversight. He also inquired about if there is a practice of sending a letter to the Governor regarding the importance of our overall budget request, with emphasis on our investment staffing needs.

Treasurer Kopp responded by explaining the budget approval process. She stated that all Trustees are encouraged to attend the Agency's budget hearings before the legislature's budget committees and that traditionally the Board Chair testifies on behalf of the Trustees.

Mr. Harkins reported that Mr. Howard Pleines presented several proposals to the Committee for consideration as part of the Board's legislative packet for 2010. Those recommendations are as follows.

- **Repeal §29-303(h)**: Section 29-303(h) permits former members who elected a vested allowance from the Employees' Pension System (EPS), Teachers' Pension System (TPS), or Law Enforcement Officers' Pension

Administrative Committee Report

System (LEOPS) to request the return of their accumulated contributions (employee contributions with 5% interest) and then receive a benefit based solely upon the employer provided pension. This was part of the original provisions when these plans were non-contributory for the majority of members when at that time, only highly compensated employees paid employee contributions on the portion of their annual calendar year salary that exceeded the annual Social Security Wage Base.

These programs, which now require employee contributions, all provide that the member or former member may withdraw employee contributions. However, this is treated as a refund and withdrawal from the System (forfeit of all benefit rights). No pension benefits are payable after a refund of accumulated contributions. Since the non-contributory benefits in comparison to current benefits are relatively small (even before accumulated contributions are refunded) and will be lower once contributions are removed, staff recommends that this provision be repealed. There is no cost to this provision.

- **<u>REVISIONS TITLE 31</u>**: Title 31 within the State Personnel and Pensions Article pertains to the enrollment, transfer between member systems, and withdrawal from State Systems by Maryland governmental units. Over the years, Title 31 has become more complex. Staff believes that it is the appropriate time to reorganize the title, eliminate obsolete provisions, and add clarifying language as needed. One substantive change would be to add a provision that an employer seeking membership must provide the supporting data for its employees (salaries, prior service credits, etc.) to the Retirement Agency, as requested by the Agency, prior to that employer's entry date. If the employer fails to comply, the Agency may close the enrollment process. There is no cost to the State for this proposal.

- **<u>AMENDING REEMPLOYMENT EXCEPTION</u>**: Within the Employees' and Teachers Retirement and Pension Systems, an individual whose average final compensation was less than $10,000 at retirement and who is reemployed on a temporary or contractual basis is exempt from the normal earnings limitation. In light of the difficulties with reducing what is already a very small benefit, staff recommends that the exemption for retired members be expanded to apply to a retiree with an average final salary of at least $25,000. Staff also recommends that this exemption apply to permanent re-employment as well as temporary and contractual employment as currently provided. There is no cost associated with this proposal.

- **<u>EXPANSION OF BOARD SALARY SETTING AUTHORITY</u>**: The Board has for a number of years, expressed the belief that its authority needs to be expanded so that the Board and the senior managers of the State Retirement Agency (SRA) have the flexibility to manage resources to meet its fiduciary obligations, while ensuring full accountability to all System stakeholders.

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Staff recommends that the Board request an expansion of its salary setting authority to include all SRA Investment staff.

On a motion made by Mr. Harkins and seconded by Ms. Hill, the Board approved the four presented FY10 legislative proposals.

Mr. Harkins reported that the Administrative Committee accepted the MBE report for fiscal year ending June 30, 2009.

Mr. Harkins reported that the Administrative Committee was updated on the performance of the Member Services Unit's Telephone Response Section for the month of July noting that the Agency succeeded in meeting its performance goals with an abandonment percentage of 3.4%, 3.1% under the goal of 6.5% and answering calls in 57 seconds against a goal of 1:30.

Mr. Harkins reported that in response to Trustee interest in the Agency's customer service/customer satisfaction surveys, Ms. Anne Budowski reported that the Member Services Unit sends surveys to (1) members who meet one-on-one with a counselor either in Baltimore or in the field, (2) with members who attend pre-retirement seminars, and (3) members who call in through the call center. The results of these surveys indicate high satisfaction with the counselors and the speakers at the pre-retirement seminars.

Mr. Harkins reported that an MPAS update, as of the Administrative Committee's meeting, was provided by Mr. Steve Cichelli. MPAS-1 remains on track for July 2010 Go-Live and the project remains within budget. Unit testing of the Milestones which contain all of the day-to-day operational components of the Legacy System were completed in June. The synchronization of code with the current versions of the Legacy code has been specified and will be delivered and tested by October. The remaining Milestones - Milestones 8, 9 and 10 - are on schedule to be completed with synchronization to the Legacy System by October also. The project is expected to be completed within the $24.4M budget. Mr. Cichelli indicated that the remaining risk to the project is the great demand being placed on Agency staff (business user/analyst personnel in the Project Management Office, Data Control and Member services) for the remaining PMO acceptance testing, Data Conversions, Regression Testing, and Parallel Testing. The Transition Management Group has planned for ways to mitigate this resource limitation risk, and has prepared a plan that would provide for the possibility of overtime compensation for certain employees called upon to work a high level of overtime.

Mr. Harkins reported that since the Administrative Committee Meeting steps have been completed:

- Milestone 8 - Complete
- Milestone 10 – Complete with the exception of one job
- Milestone 9 - All initial code has been delivered
- SRA has taken delivery of the Production System Hardware
- IS Staff began operations training in anticipation of taking over the MPAS system

GRS

4. Brian Murphy, Brad Armstrong, and Amy Williams, of Gabriel Roeder & Smith (GRS), presented the preliminary results of the State Retirement and Pension System's Actuarial Valuation for the period ending June 30, 2009 for the Board's consideration.

GRS disclosed the following four technical changes to the valuation methodology:

1. assume that normal cost payments for an individual stop when he/ she retires or otherwise exits the active member group;
2. assume that Teachers retire and terminate with a July 1 effective date (no change), and that all other employment exits are mid year;
3. recognize the contribution shortfall that is expected to occur between the valuation date and beginning of the funding period;
4. assume individuals elect option benefits forms in accordance with recent past practice.

GRS recommended to the Board that the actuarial assumption related to Cost of Living Adjustment (COLA) cap be lowered from 3% to 2.75% for those members and beneficiaries whose COLA is currently capped at 3%.

On a motion made by Major Krome and seconded by Mr. Schaefer the Board approved the GRS recommendation. Mr. Douglass opposed.

Executive Director's Report

5. At Mr. R. Dean Kenderdine's request Ms. Deborah Bacharach presented recommendation that the System support the Attorney General's Office signing on to an amicus brief related to a securities litigation case involving Merck & Co. which is before the U.S. Supreme Court. The case involves the limitations period for filing a securities fraud case.

On a motion made by Ms. Hill and seconded by Mr. Hughes the Board agreed to support the Attorney General's Office signing onto the amicus brief.

Trustee Election

6. On a motion made by Mr. Hughes and seconded by Mr. Hill the Board approved the following election schedule:

October 19, 2009 - January 15, 2010	An eligible voter may obtain a nomination form from the Executive Director.
March 17, 2010	Completed nomination forms shall be submitted to the Executive Director by an eligible voter. Deadline is 4:30 P.M.
March 31, 2010	Executive Director certifies that an eligible voter satisfies the conditions set forth in 22.03.01.06 of the Board of Trustees' Regulations.
May 12-14, 2010	Mailing of election notices Personal I.D. Number (PIN) for IVR and website access.
May 24, 2010	IVR (telephone) and voting website (internet) open for voting.

June 18, 2010	Last day for voting. Deadline is 5 P.M.
July 20, 2010	Election results shall be announced at the July Board of Trustees' Meeting.

CIO Report 7. Mr. Mansco Perry, III commented on the portfolio's performance as questions were asked during the Investment Committee report.

CLOSED SESSION

The Board met in a Closed Session (11:24 p.m.) in the Boardroom of the SunTrust Building at 120 East Baltimore Street for the purpose of:

1. to approve the closed session minutes, State Government Article §10-503(a)(1)(i), the exercise of an administrative function;
2. to discuss the Chief Investment Officer's evaluation, State Government Article §10-508(a)(1), personnel matters.

The Trustees present included:

Nancy K. Kopp, Chairman	Peter Franchot, Vice-Chairman	F. Patrick Hughes	Major Morris Krome
Robert Schaefer	William D. Brown	John Douglass	Sheila Hill
Harold Zirkin	David Blitzstein	James Harkins	
Thurman Zollicoffer, Jr. (via phone)		R. Dean Kenderdine, Secretary	

Also in attendance: John Kenney.

The Board ended its closed session at 11:55 a.m. and returned to regular session to complete the agenda.

Medical Board And Supplemental Medical Board Reports 8. On a motion made by Major Krome and seconded by Mr. Hughes, the Board of Trustees accepted all the reports of the Medical Board in connection with applications of members for ordinary, accidental and special disability retirement allowances. The Medical Board's conclusions were reached after its review of the documentation in the file.

Claudia I. Bright 9. The Board considered the recommendation of the Administrative Law Judge in connection with the claim of Ms. Claudia I. Bright for ACCIDENTAL DISABILITY retirement benefits. The Administrative Law Judge's report, a report by the Medical Board, and all related documents submitted by the parties were presented.

Ms. Claudia I Bright represented herself via telephone before the Board to oppose the Agency's position and the Administrative Law Judge's recommendation. Ms. Carla Katzenberg, attorney for the Agency, addressed the Board and argued that the Board should adopt the Administrative Law Judge's recommendations. Following discussion, the Board deferred further consideration to Closed Session.

Linda D. Brooks 10. The Board considered the recommendation of the Administrative Law Judge in connection with the claim of Ms. Linda D. Brooks for ACCIDENTAL DISABILITY retirement benefits. The Administrative Law Judge's report, a report by the Medical Board, and all related documents submitted by the parties were presented.

Ms. Books did not appear before the Board to oppose the Agency's position and the Administrative Law Judge's recommendation.

CLOSED SESSION

The Board met in a Closed Session (12:13 p.m.) in the Boardroom of the SunTrust Building at 120 East Baltimore Street for the purpose of:

1. to discuss the appeal of Claudia I. Bright and Linda D. Brooks pursuant to State Government Section 10-503(a)(1)(iii), the exercise of a quasi- judicial function.

The Trustees present included:

Nancy K. Kopp	F. Patrick Hughes	David Blitzstein	John Douglass
Major Morris Krome	Sheila Hill	William D. Brown	James Harkins

Agency Staff members attending included:
Deborah Bacharach Margaret Bury Rachel Cohen Patrice Sowah R. Dean Kenderdine
Janet Sirkis

The Board ended its closed session at 12:16 p.m. and returned to regular session to complete the agenda.

REGULAR SESSION

The Board reported that during the closed session the Board approved the closed session minutes, and reviewed and decided on the following disability appeals:

Claudia I. Bright	11.	The Board voted to **ADOPT** the Administrative Law Judge's Proposed Decision and **DENY** Claudia I. Bright's request for accidental disability benefits.
Linda D. Brooks	12.	The Board voted to **ADOPT** the Administrative Law Judge's Proposed Decision and **DENY** Linda D. Brook's request for accidental disability benefits.
Adjournment	13.	There being no further business before the Board, the meeting adjourned at 12:17 p.m.

Respectfully submitted,

R. Dean Kenderdine
Secretary to the Board

RDK/pws