

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

November 17, 2016

The Board of Trustees for the Maryland State Retirement and Pension System met in the Board Room of the SunTrust Building, 120 East Baltimore Street, 16th Floor Board Room, Baltimore, Maryland beginning at 12:32 p.m.

The Trustees present included:

Nancy Kopp, Chairman, Presiding
Peter Franchot, Vice Chairman
David Brinkley
Eric Brotman
James Bush, Jr.
James C. DiPaula
Kenneth Haines

David Hamilton
James Harkins
Linda Herman
Sheila Hill
F. Patrick Hughes
Charles Johnson
Theresa Lochte

Agency Staff members attending included: R. Dean Kenderdine, Executive Director/Board Secretary
Dimitri Grechenko Andrew Palmer Janet Sirkis
Angie Jenkins

Assistant Attorneys General present included: Kathy Brady, Rachel Cohen, and Kathleen Wherthey

Other attendees included: Susanne Brogan, John Kenney, Larry Jennings and Stefan Strein.

On a motion made by Mr. Bush and seconded by Mr. Johnson, the Board voted to meet in a Closed Session, beginning at 12:34 p.m., in the Board Room of the SunTrust Building at 120 East Baltimore Street, 16th Floor, for the purpose of:

1. reviewing the closed session Board minutes, pursuant to General Provisions Art., § 3-103(a)(1)(i), the exercise of an administrative function;
2. reviewing the Medical Board reports, pursuant to General Provisions Art., § 3-305(b)(13), to comply with a specific constitutional, statutory, or judicially imposed requirement that prevents public disclosures about a particular proceeding or matter namely, General Provisions Art., § 4-312 regarding the prohibition on disclosing retirement records, and General Provisions Art., § 4-329 regarding the prohibition on disclosing medical and personal information; and
3. discussing the System's redemption of an investment in a hedge fund pursuant to General Provisions Art., § 3-305(b)(5), to consider the investment of public funds, § 3-305(b)(13), to comply with a specific statutory requirement that prevents public disclosure, namely, General Provisions Art., § 4-335 preventing the disclosure of trade secrets and confidential commercial or financial information, to consult with counsel to obtain legal advice, pursuant to General Provisions Art., § 3-305(b)(7) and to consult with staff, consultants or other individuals about pending or potential litigation, pursuant to General Provisions Art., § 3-305(b)(8).

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Medical Board Reports The Board reviewed and adopted the medical board reports of October 19, October 27, November 2 and November 10, 2016.

Consent Agenda On a motion made by Mr. Hughes and seconded by Mr. Brotman, the Board approved the consent agenda, which included:

- October 18, 2016 Open Meeting Board Minutes
- November 10, 2016 Audit Committee Meeting Summary

System Active Membership as of June 30, 2016 The Board was presented with the System's Active Membership by percentage as employed by the State, the libraries, community colleges and local board of educations. The certified percentages are provided to determine each System employers' pro rata share of the amount necessary for the administrative and operational expenses of the Board of Trustees and the State Retirement Agency. This report serves as certification of the System's active membership as of the end of the fiscal year and is submitted to the Secretary of the Department of Budget and Management in accordance with State Personnel and Pensions Article § 21-316(c) of the Maryland Annotated Code.

On a motion made by Mr. Bush and seconded by Mr. Brotman, the Board unanimously voted to certify the required membership percentages to the Secretary of Budget and Management, applicable to FY2018.

State Employees	60,610	
State Teachers	1,950	
Local Public Libraries-TCS Teachers	2,396	
Local Public Libraries-ECS Employees	140	
Subtotal State	65,096	34%
Local Boards of Education	109,171	
Local Community Colleges	5,594	
Local Elected & Appointed Officials	61	
Participating Governmental Units	12,191	
Subtotal Local	127,017	66%
Total	192,113	100%

Financial Statement Report for FYE June 30, 2016 Mr. James Bush, Jr., Chairman of the Audit Committee, presented the System's annual audited financial statement report for the year ending June 30, 2016.

Mr. Bush stated that the financial statements were audited by the System's auditors, SB & Company, and that the statements received an unmodified opinion. Mr. William Seymour of SB & Company was present for questions.

Mr. Bush also reported that the Audit Committee unanimously accepted the financial statement reports and therefore, was recommending that the Board

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accept the report for inclusion in the 2016 Comprehensive Annual Financial Report (CAFR).

On a motion made by Mr. Bush and seconded by Mr. DiPaula, the Board accepted the FY2016 financial statements for inclusion in the System's Comprehensive Annual Financial Report.

Final Adoption of
Regulations –
Investment Division –
Brokerage
Commissions
(22.03.05)

Mr. Andrew Palmer reported that at its May 19, 2016 meeting, the Board, at the recommendation of the Investment Committee, approved staff's recommendation to update the Investment Policy Manual and repeal regulations regarding Investment Division-Brokerage Commissions (COMAR 22.03.05.) The proposed regulations were published in the Maryland Register on September 30, 2016. The 45-day period for public comment expired on November 14, 2016 and no comments were received. Therefore, staff is now recommending that the Board of Trustees approve for final action the repeal of the regulations relating to the Investment Division – Brokerage Commissions.

On a motion made by Mr. Haines and seconded by Mr. Hughes, the Board of Trustees, approved for final adoption, the repeal of the Investment Division-Brokerage Commissions regulations (COMAR 22.03.05.)

Recommendation
from the Investment
Committee regarding
the Optional
Retirement Program

Mr. Palmer presented to the Board, information concerning the vendor contracts for recordkeeping services in the Optional Retirement Plan ("ORP").

Mr. Palmer reported that Fidelity is one of the two authorized vendors to offer recordkeeping services in the ORP, and that its initial seven-year contract term expires on December 31, 2017. The contract may be renewed at the sole option of the Board on a year-to-year basis for a period of three additional years.

Mr. Palmer also reported that TIAA is the other approved vendor in the ORP and has been in place since the inception of the program in 1976. While TIAA's contract does not include a finite term, following a review, the Board can terminate the agreement with sixty days notice.

Mr. Palmer reported that the Investment Committee, at its November meeting, approved staff's recommendations as follows:

1. Do not renew Fidelity's contract beyond December 31, 2017;
2. Issue a Request for Proposals ("RFP") for ORP recordkeepers in 2017;
3. Require TIAA to participate in the RFP process; and
4. Defer brokerage implementation until the RFP process is complete.

Kathy Brady, Assistant Attorney General ("AAG") reported that since ORP vendors are consider Key Service Providers as outlined in the Board's Governance Policies, the Board is responsible for the selection and termination decisions. An RFP will be issued.

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The Board was provided with a tentative timeline for the RFP process, as follows:

January 31, 2017	Draft RFP distributed to IC/Board
February 28, 2017	Comments/edits due from IC/Board
March 21, 2017	Final RFP approved by IC/Board
March 31, 2017	RFP issued
April 17, 2017	Vendor questions due
May 1, 2017	Responses provided
May 15, 2017	Proposals due
June 2017	Evaluation Committee Interviews
July 18, 2017 IC Meeting	Finalist presentations & IC/Board decision

Treasurer Kopp asked if staff planned to notify the ORP members of the System's decision regarding the contracts.

Kathy Brady responded that the AAG for the University System was aware and will work with Bob Burd to ensure that both the University System and ORP members are aware.

On a motion made by Mr. Hughes and seconded by Mr. Harkins, the Board approved the Investment Committee's recommendations concerning the vendor contracts for the Optional Retirement Plan.

Executive Director's
Report

Mr. Kenderdine reported that the Ad Hoc Committee on Actuarial Valuations and Assumed Rate of Return would be meeting on Monday, November 21, 2016 at 9:00 a.m.

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Mr. Kenderdine reported that on Wednesday, December 7, 2016, the Joint Committee on Pensions would be meeting at 2:00 p.m. for its third and final time for the 2016 interim and would be receiving the annual "Investment Overview" as prepared by the Department of Legislative Services. Mr. Palmer will, as is customary, be presenting the System's response to the overview. In addition, the Committee will make its decisions with regard to all Board requested legislation.

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Mr. Kenderdine reported that the Agency's Holiday Party and Employee Service Awards event is scheduled for Thursday, December 15, 2016 beginning at 1:00 p.m. and all Trustees are invited to attend.

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Mr. Kenderdine also reported that the regulations concerning the Disability appeals process take effect on November 24, 2016. Mr. Kenderdine further reported that any disability appeals transmitted to the Office of Administrative Hearings after November 24, 2016, will be subject to final decision by the Office of Administrative Hearings. All disability appeals transmitted before November 24, 2016, will still be subject to a proposed

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decision by the Administrative Law Judge and subsequently an exceptions hearing before the Board of Trustees.

Adjournment

There being no further business before the Board, on a motion made by Mr. Hughes and duly seconded, the meeting adjourned at 1:28 p.m.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'R. Dean Kenderdine', written over a horizontal line.

R. Dean Kenderdine
Secretary to the Board

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**AUDIT COMMITTEE MEETING REPORT
November 10, 2016**

Presentation of FY
2016 MSRPS
Financial Statement
Audit Results

Mr. William Seymour of SB & Company presented the Committee with their FY 2016 financial statement audit results. He informed the Committee that the statements will receive an unmodified opinion. The audit noted no significant deficiencies, instances of fraud, or material weaknesses in internal control. He stated that SB & Company had an open relationship with management, and received their full cooperation. The audit included GASB 67 and 68 requirements, as well as GASB 72, which was new this year.

Mr. Seymour discussed SB & Company's audit approach, and indicated that the COSO model was used to assess the Agency's control environment. SB & Company evaluated key processes, and found that adequate controls were in place, and were effective. There were no significant adjustments to major accounts.

Mr. Seymour noted that for FY 2016, contributions plus investment income were less than benefits payments. This was due to investment performance.

Mr. Seymour generally described how investments were categorized for purposes of valuation. Level 1 investments had values that were readily determinable. Level 3 investments had values that could not be readily determined, due to a lack of transparency. Level 2 investments were somewhere in between, with significant observable inputs.

Mr. Seymour told the Committee that there were no significant items disclosed in the Required Communications section. He added that SB & Company received the full cooperation of Agency management. Mr. Kenderdine expressed his appreciation of the relationship that the Agency has with SB & Company. He noted that they were especially helpful in dealing with the System's participating employers for GASB 67 and 68.

Acceptance of FY
2016 MSRPS Draft
Financial Statements

On a motion made by Ms. Lochte, and seconded by Mr. Norman, the Committee accepted the FY 2016 MSRPS Draft Financial Statements.

Credit/Debt
Operational Audit

Ms. Toni Hackett Antrum and Mr. Chris Tobe discussed the Hackett Group's operational audit of Credit/Debt strategy investments. Audit objectives were to determine if Credit/Debt investments were properly monitored and valued, and if they were compliant with the System's investment guidelines. Ms. Antrum noted that 11 of the System's 42 Credit/Debt investments were traditional, public investments, while the remainder are private investments. Traditional controls, such as the custodial bank, are not present for private investments.

Mr. Tobe stated that there are industry-wide problems with private investments associated with valuations, fees, and expenses. He noted that recently-proposed ILPA standards would provide a standard format

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for private investments to report fees, performance, and other metrics. Adoption of ILPA standards would help to provide additional controls.

The audit disclosed the need for additional documentation with regard to the reconciliation of private investments' financial statements, or K-1 forms, to quarterly reports submitted by managers. Specifically, the reconciliations should be signed and dated by the individual performing the reconciliation. The audit also identified a need for a secondary review of public manager invoices

Additionally, the audit found that private manager fees were not always consistent with fee rates specified in contract side letters. To address this, the audit recommended adopting a requirement for private investments to report in accordance with ILPA standards. Mr. Tobe noted that this has started to happen for some of the investments.

Mr. Bush commented that the Agency should compel investment managers to meet its requirements, rather than the other way around.

Ms. Antrum noted that the audit also recommended that staffing be increased to enable the System to properly monitor these complex investments.

FY 2017 Audit Plan
Status

Mr. Rongione provided the Committee with a status update for the FY 2017 audit plan. Staff is currently performing a Power of Attorney audit and a EFT Application Processing audit. The Network and Server Maintenance and Support audit and the Credit/Debt Strategies audit were recently completed.

Open Issues Log

Mr. Rongione provided a summary of open audit issues. For FY 2017, a total of 18 issues were closed, and 11 new issues were added, bringing the balance of currently open issues to 15. The Committee also received a listing of the open audit issues.

Internal Audit Staffing
Update

Mr. Rongione provided the Committee with an organizational chart of the Internal Audit Division, which included potential new positions. These included the addition of two auditors, who would be dedicated to auditing critical controls, similar to what is done for Sarbanes-Oxley. Also proposed are an information technology auditor, and an enterprise risk management (ERM) manager. Two more audit positions would be added to bring currently outsourced employer audits in-house, for cost savings.

Mr. Bush indicated his support for additional Internal Audit staffing. He noted that as more demands on the Agency's business operations need to be met, there are also increased requirements for Internal Audit. He expressed concerns that a business process could break down, but was not audited.

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Completed Audits

Mr. Rongione summarized the results of the recently-completed audit of Network/Server Maintenance, describing the objectives and findings. He noted that the audit had an overall rating of "green". The audit found that the tool used to monitor hardware and software performance did not utilize its tracking feature for documenting the resolution of alerts. The audit also found that user rights were not always rescinded timely for terminated employees. Mr. Rongione noted that this issue occurred only after the Agency's human resources staff was transferred to the Department of Budget and Management. Agency management has agreed to implement corrective actions to address problems identified in the audit.