ADMINISTRATIVE COMMITTEE MINUTES
BOARD OF TRUSTEES
MARYLAND STATE RETIREMENT AND PENSION SYSTEM

October 3, 2017

The Administrative Committee met in the Boardroom of the SunTrust Building, 120 East Baltimore Street, 16th Floor, Baltimore, Maryland, beginning at 9:34 a.m.

The Trustees present included:
James Harkins, Chairman, Presiding
Theresa Lochte, Vice Chairman
Susanne Brogan
Sheila Hill
Marc Nicole
Richard Norman

Agency Staff members attending included: R. Dean Kenderdine, Executive Director/Board Secretary
Melody Countess
Anne Gawthrop
Michael Golden
Ira Greenstein
Angie Jenkins
Van Lewis
Andrew Palmer
Harvey Raitzyk
Ken Reott
David Rongione
Janet Sirkis

Assistant Attorneys General present included: Rachel Cohen, William Mandycz and Kathleen Wherthey

Other attendees included: Phillip Anthony, Matt Jackson and Dana Tagalicod

Minutes

On a motion made by Ms. Lochte and seconded by Mr. Nicole, the Administrative Committee approved the September 5, 2017 open session meeting minutes.

Appeal of Joseph Bennett

Mr. Bennett declined to personally appear before the Administrative Committee, but instead submitted a written position statement. On October 3, 2017, R. Dean Kenderdine, Executive Director submitted a written response to Mr. Bennett's letter. Both letters were provided to the Administrative Committee.

Kathleen Wherthey, Assistant Attorney General, explained that Mr. Bennett was requesting that the Board accept and administer the retirement forms he submitted on behalf of his late wife, Kathy L. Bennett, after her death.

Ms. Wherthey argued that the Agency could not process Mrs. Bennett's retirement paperwork because she was required to submit it during her lifetime, and she had failed to do so prior to her death. The Agency notified Mrs. Bennett of her eligibility for a vested allowance in a letter dated November 6, 2013, and had sent her a requested estimate and the required paperwork, but unfortunately, the Agency did not receive any completed retirement application forms from Mrs. Bennett prior to her death, and the forms were only submitted by Mr. Bennett after Mrs. Bennett's death. Ms. Wherthey also explained that Mrs. Bennett's retirement records show that she received a full refund of all of her previously accumulated contributions and interest, and therefore, there was nothing due and payable on her account.

Ms. Lochte asked whether this was a situation where special legislation could provide some relief. Ms. Wherthey indicated that legislation could potentially be an option for Mr. Bennett to pursue.

On a motion made by Ms. Lochte and seconded by Mr. Nicole, the Administrative Committee voted to adopt the Executive Director's recommended summary decision to deny the appeal, for recommendation to the Board of Trustees.

Board Requested Legislation

Ms. Anne Gawthrop presented a document outlining the details of several legislative proposals for the Administrative Committee's consideration to propose to the Board of Trustees for inclusion in its 2018 legislative proposals to the Joint Committee on Pensions (JCP). (*See Attachment 1.)*

The legislative proposals, which are intended to clarify or correct perceived inconsistencies within existing law and remove obsolete provisions within the State Personnel and Pensions Art., include the following topics:

- Non-vested Accounts
- Judges' Retirement System – Retirement by Order of the Court of Appeals
- Board of Trustees Oath
- Reduction of Accidental Disability Benefits by the Amount of Related Workers' Compensation Benefits

Two additional proposals were presented that would address the funding of employer contributions by participating governmental units and the staffing and governance of the Investment Division:

- Modification of Municipal Pension Surcharges
- Investment Staffing and Governance

On a motion made by Ms. Lochte and seconded by Mr. Norman, the Administrative Committee approved the legislative proposals for recommendation to the Board of Trustees.

Member Services Update

Mr. Raitzyk reported that the Member Services unit was able to meet its performance goals for both the call abandonment rate and for the average call wait time for August 2017. The unit's call abandonment rate was 6.23% and the average speed of answer was 0:88.

Ms. Hill asked who sets the curriculum for the Agency's retirement seminars, and explained that one of her union members recently contacted her with the concern that he was not informed that he could not receive service credit for the annual leave that he accrued during his employment.

Mr. Raitzyk responded that the Retirement Agency is responsible for the content of the defined benefit portion of the pre-retirement seminars. Staff would modify our presentation to ensure that the treatment of annual leave balances for State employees is addressed going forward. Additionally, the Agency will incorporate an article regarding annual leave balances for State employees in our "Mentor" newsletter.

In connection with a member satisfaction survey response, Ms. Brogan asked why the Agency, when providing a retirement estimate, is not able to provide a member who has a Domestic Relations Order a breakdown of the portion of the estimated benefit that will be payable to the member and the portion payable to the former spouse.

Mr. Raitzyk responded that domestic relations orders are often complicated and the calculations must be done manually. Manual calculations take time and there is risk associated with such calculations, therefore, the Agency does not provide members with estimate percentages payable to the former spouse before retirement.

Rachel Cohen, Assistant Attorney General, further responded that domestic relations orders do not normally assign a fixed dollar amount or a fixed percentage, but a percentage of a fraction, where the numerator is the total number of months of service credit received by the member during the parties' marriage and the denominator is the total number of months of the member's service credit in the System.

Ms. Lochte asked if the Agency knows who completes the surveys.

Mr. Raitzyk responded that the Agency could tell who completes a survey, unless it was completed anonymously.

Regarding the second member satisfaction survey response, Ms. Hill asked whether the Agency sends a member an acknowledgment that it has received a request for estimate.

Mr. Raitzyk responded that the Agency does not, at this time, send any type of acknowledgement when it receives an application for retirement estimate. Mr. Raitzyk further responded that MPAS-III will be beneficial to members, in that regard, as it will allow the Agency to notify members of the receipt of their requests.

Ms. Brogan asked what the "blackout period" was, that the member mentioned in the survey response.

Mr. Raitzyk responded that the Agency does not use the term "blackout period," but believes it was this particular member's way of referring to the time from submitting an estimate request to the time their estimate is sent.

Ms. Lochte asked how many estimate requests the Agency receives each year.

Mr. Raitzyk responded that the Agency receives approximately 15,000 estimate requests per year.

Ms. Lochte asked how hard it would be to send out a post card acknowledging receipt of a request for estimate.

Mr. Raitzyk responded that it would not be hard, but would be an added cost to the Agency.in terms of staff resources being pulled from other work.

ADMINISTRATIVE COMMITTEE MINUTES
BOARD OF TRUSTEES
MARYLAND STATE RETIREMENT AND PENSION SYSTEM

October 3, 2017

On a motion made by Mr. Norman and seconded by Ms. Lochte, the Administrative Committee voted to meet in a Closed Session beginning at 10:24 a.m. in the Boardroom of the SunTrust Building at 120 East Baltimore Street, 16th Floor, for the purpose of:

1. reviewing the closed session Administrative Committee meeting minutes, pursuant to General Provisions Art., § 3-103(a)(1)(i), the exercise of an administrative function; and

2. discussing the offset of retirement benefits of one participant under State Personnel and Pensions Art., § 21-113, pursuant to General Provisions Art., § 3-305(b)(13), to comply with a specific constitutional, statutory, or judicially imposed requirement that prevents public disclosure about a particular proceeding or matter, namely, General Provisions Art., § 4-312 regarding the prohibition on disclosing retirement records.

CLOSED SESSION

The Trustees present included:

James Harkins, Chairman, Presiding	Sheila Hill
Theresa Lochte, Vice Chairman	Marc Nicole
Susanne Brogan	Richard Norman

Agency Staff members attending included: R. Dean Kenderdine, Executive Director/Board Secretary

Melody Countess	Harvey Raitzyk	David Rongione
Michael Golden	Kenneth Reott	Janet Sirkis
Angie Jenkins		

Assistant Attorneys General present included: Rachel Cohen, William Mandycz and Kathleen Wherthey

On a motion made by Ms. Brogan and seconded by Ms. Lochte, the Administrative Committee returned to open session at 10:40 a.m. in the Board Room of the SunTrust Building at 120 East Baltimore Street, 16th Floor.

During closed session, the Committee discussed and took action on the following matters:

Closed Session Minutes	The Committee reviewed and approved the September 5, 2017 closed session minutes.
Correction of Errors – Offset of Retirement Benefits	The Administrative Committee adopted staff's recommendations regarding the offset of retirement benefits of one participant.
Adjournment	There being no further business before the Committee, on a motion made by Mr. Nicole and seconded by Mr. Norman, the meeting adjourned at 10:41 a.m.

Respectfully submitted,

R. Dean Kenderdine,
Secretary to the Board

ATTACHMENT 1

2017 Board Requested Legislation

The following legislative proposals are offered by the Board of Trustees for the State Retirement and Pension System for the Joint Committee on Pensions' consideration for the 2018 legislation session. These legislative proposals are intended to clarify or correct perceived inconsistencies within existing law and remove obsolete provisions within the State Personnel and Pensions Article. In addition, some of these proposals will result in more freedom for staff to complete the tasks required to help the Agency and System run efficiently. These proposals, if approved by the board, will be presented to the joint committee for its consideration to sponsor as legislation for the 2018 legislative session.

Non-vested Accounts

The State Retirement Agency (Agency) was notified in April of a member who had accrued one and one-half years of service in the Alternate Contributory Pension Selection (ACPS) of the Employees' Pension System (EPS) from 2010 and 2012. In June 2012, the member left State employment but did not withdraw her member contributions from the EPS. After an absence of more than four years, she returned to State service in January 2017. Because she was not vested in the ACPS when she left State service in 2012, and because her membership status had lapsed (she had a break in service of greater than four years), she was enrolled in the Reformed Contributory Pension Benefit (RCPB) of the EPS. Additionally, her ACPS member contributions are no longer earning interest, since her membership in the ACPS has terminated.

Upon returning to service in January 2017, this member requested a return of her ACPS membership contributions. However, because she was now once again a State employee, the Agency informed her this would be considered an in-service distribution under Internal Revenue Code provisions, Treasury regulations, and Revenue Rulings, and could jeopardize the qualified status of the State Retirement and Pension System (System). Additionally, refunding her ACPS member contributions could also subject her to a 10% federal tax penalty. While the member understands why she cannot receive a return of her contributions, she rightly pointed out that the Agency will now be holding these funds (her money) while she is a member in the RCPB, and she will not be earning any further interest on these funds. She described her funds as being in "pension purgatory".

To address this issue, staff is recommending amending provisions of the EPS that would allow this member (and others similarly situated) to move her non-vested inactive ACPS service into her active RCPB account. Currently, only members with vested accounts in one tier of the EPS may combine their service with their current active EPS accounts. If the member chooses to take advantage of this provision, she would be responsible for making up any difference in membership contributions for her ACPS service. Nevertheless, it would allow her an opportunity to make use of the service in her abandoned ACPB account.

While the employer contributions associated with these non-vested accounts initially remain in the EPS after these members end their State service, the actuary for the System treats these employer contributions as gains to the System since no benefit will be paid on this service.

As gains to the System, the actuary allocates these employer contributions to reduce future employer contributions; thus, these funds are technically no longer in the EPS. Staff estimates that there are approximately 445 ACPS inactive accounts that could be impacted by this legislation. Because of this number and the fact that the employer contributions associated with this service have been allocated to fund other EPS benefits, it should be expected that there would be a cost with this legislation. At this time, staff is unable to determine what that cost would be, since we have no way of knowing how many of the 445 would opt to take advantage of this proposal.

If the legislature's actuary determines that this proposal would have a significant cost, staff would further recommend an alternative proposal that would allow these individuals to transfer their non-vested ACPS service into the RCPB, but would only allow these members to apply this service towards their eligibility service. This alternative would have a much lower cost (likely insignificant) because any individuals opting to take advantage of it, would not be able to use this service towards the actual calculation of their final benefit.

To assist the Board and the legislature in their deliberations of this proposal staff has asked the System's actuary to calculate the cost of these proposals under various scenarios (25% of the non-vested members opt to participate, 50% opt in, etc.).

JRS Retirement by Order of the Court of Appeals

Provisions included in the Judges' Retirement System (JRS) provide in part that an individual who becomes a member of the JRS on or after July 1, 2012, is entitled to a JRS retirement allowance "…***when retired by order of the Court of Appeals,*** with less than 5 years of eligibility service, if the member has eligibility service equal to the mandatory retirement age required by Article IV, § 3 of the Maryland Constitution minus the member's age when the member first becomes a member…."

This provision was added through Chapter 150 of the Acts of 2015. The intent of this legislation was to ensure that if an individual who was older than age 65 when appointed to the bench on or after July 1, 2012, that individual, when reaching mandatory retirement age, would receive a benefit equal to the years of service the member had accrued equal to mandatory retirement age for judges minus the member's age. As drafted, it appears that "retired by order of the Court of Appeals" was intended to mean the same as being required to retire due to reaching mandatory retirement age. This interpretation of Chapter 150 is supported by the Fiscal and Policy Note for the legislation, wherein it states "[a] JRS member who must retire by order of the Court of Appeals with less than five years of eligibility service may receive a prorated allowance if the member's service equals the mandatory retirement age in the Maryland Constitution minus the member's age when the member first became a JRS member."

Legal counsel for the Agency has informed staff that language stating, "when retired by order of the Court of Appeals", is not the same as stating a JRS member is required to retire due to reaching mandatory retirement age, and in fact, the pension statute distinguishes between retirement at the mandatory retirement age and retirement by order of the Court of Appeals.

Reported judicial decisions consistently have used the phrase "by order of the Court of Appeals" to signify a particular order of that Court in a particular case, and usually one involving the Court's disciplinary role. Therefore, to distinguish between requiring a member to retire due to reaching mandatory retirement age and being required to retire by order of the Court of Appeals, we recommend amending the provisions of the State Personnel and Pensions Article that address eligibility for retirement for JRS members to clarify that a member who has reached mandatory retirement age is eligible for an allowance even if he or she has fewer than 5 years of service.

Inasmuch as this would codify the existing practice of the Agency, staff does not anticipate any cost associated with this proposal.

Board of Trustees Oath

Section 21-104(c) of the State Personnel and Pensions Article requires any individual elected or appointed as a trustee to the Board of Trustees for the System to take and subscribe to an oath of office that charges trustees with certain duties of diligence and honesty when administering the affairs of the Board of Trustees. However, Article I, Section 9 of the Maryland Constitution and Article 37 of the Maryland Declaration of Rights address oaths of office that elected or appointed individuals are required to take. Specifically, Article I, Section 9 of the Maryland Constitution provides in part that "every person elected, or appointed, to any office of profit or trust, under this Constitution, or under the Laws, made pursuant thereto, shall, before he enters upon the duties of such office, take and subscribe the following oath…." Moreover, Article 37 of the Maryland Declaration of Rights provides in part that "…nor shall the Legislature prescribe any other oath of office than the oath prescribed by this Constitution."

Legal counsel for the Board and the Agency have advised that in light of these provisions included in the Maryland Constitution and the Declaration of Rights, new trustees to the Board should not take the oath required under § 21-104(c) of the State Personnel and Pensions Article. Accordingly, since 2014, new trustees have only taken the oath as provided for in Article I, Section 9 of the Maryland Constitution. In light of this, staff recommends replacing the existing language in § 21-104(c) of the State Personnel and Pensions Article with language that specifically references trustees taking the oath provided for under Article I, Section 9 of the Constitution.

Inasmuch as this proposal would conform the statute to the Agency's existing practice, staff does not anticipate any cost associated with this proposal.

Reduction of Accidental Disability Benefits by the Amount of Related Workers' Compensation Benefits

See Attachment A

Modification of Municipal Pension Surcharges

The 2011 legislative reforms substantially revised the benefit provisions and employee contribution rates for the MSRPS Municipal Employees' Combined System. When plan changes such as the 2011 reforms affect different PGUs differently, equity relationships can be affected to the systematic benefit of some and to the systematic detriment of others. It is recommended that legislation be introduced to convert or phase in a more equitable allocation of contribution requirements among the PGUs.

The 2011 reforms caused the pooled employer cost to decrease by about 2% of pay. Most of that decrease was due to the increase in employee contribution rates for the Alternate Contributory Pension Selection (ACPS) participants, from 5% to 7%. PGUs with participants subject to the Non-Contributory Pension Benefit (NCPB) or the Employees' Contributory Pension Benefit (ECPB) (nine employers) benefitted from the decrease in employer contributions although there was no offsetting increase in employee contributions from their NCPB and ECPB participants. This was the result of a specific provision included in the 2011 reforms that exempted these nine employers from having to participate in the Reformed Contributory Pension Benefit.

The Board of Trustees is recommending the establishment of a new surcharge of 2% of pay for each of the nine employers participating in the NCPB or ECPB. Because of the magnitude of the proposed changes to the employer contribution rate and the impact on these nine PGUs, the Board is also recommending these changes be implemented over a period of five years. This 5-year phase-in would begin with the December 2019 billing and would be fully implemented by the December 2023 billing.

Investment Staffing and Governance

See Attachment B, which will be distributed at the meeting.

ATTACHMENT A

Abolishing Statute Requiring the Reduction of Certain Accidental Disability Benefits by the Amount of Related Workers' Compensation Benefits

Background:

Maryland law generally prevents a government retiree covered by both workers' compensation and a governmental pension or retirement plan from recovering twice for a single injury. The General Assembly has enacted two intersecting laws to prevent double recovery.

Md. Code Ann., State Personnel & Pension Art. ("SPP"), § 29-118 provides:

> (1) Except as otherwise provided in this subsection, this section applies to a retiree and any designated beneficiary.
> (2) (i) This section does not apply to:
> 1. a retiree of a participating governmental unit, or a designated beneficiary of that retiree; or
> 2. a retiree of the Employees' Pension System or the Employees' Retirement System who receives a disability retirement benefit as a former employee of a county board of education or the Board of School Commissioners of Baltimore City, or a designated beneficiary of that retiree.
> (ii) A retiree described in subparagraph (i) of this paragraph, or a designated beneficiary of that retiree is subject to § 9-610 of the Labor and Employment Article.
> (b) Reduction in retirement allowance. --
> (1) The Board of Trustees shall reduce an accidental or special disability retirement benefit by any related workers' compensation benefits paid or payable after the effective date of retirement if the workers' compensation benefits:
> (i) are paid or payable while a pension is paid or payable; and
> (ii) are for an accidental personal injury arising out of and in the course of the retiree's employment by a participating employer.

Under SPP § 29-118, the Board of Trustees (the "Board") must reduce the accidental or special disability retirement benefit of a State retiree or a Teachers' Pension System/Teachers' Retirement System ("TPS/TRS") retiree by any related workers' compensation benefit paid or payable after the effective date of retirement if the two benefits are paid or payable during the same time period.[1]

Md. Code Ann., Labor & Employment Art. ("LE"), § 9-610 provides that:

> Except for benefits subject to an offset under § 29-118 of the State Personnel and Pensions Article, if a statute, charter, ordinance, resolution, regulation, or policy, regardless of whether part of a pension system, provides a benefit to a covered employee of a governmental unit or a quasi-public corporation…, payment of the benefit by the employer satisfies, to the extent of the payment, the liability of the

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[1] The retirement allowance is not reduced "to be less than the sum of the retiree's annuity and the amount authorized to be deducted for health insurance premiums; or for workers' compensation benefits that are reimbursements for legal fees, medical expenses or other payments made to third parties and not the retiree." SPP § 29-118(b)(2).

> employer and the Subsequent Injury Fund for payment of similar benefits under this title.

Under this statute an employer, such as the State or a participating governmental unit ("PGU"), is required to offset a disability retiree's workers' compensation award payments by the amount of similar pension benefits that are not subject to an offset under § 29-118.

Because the Maryland State Retirement and Pension System ("MSRPS") is not involved in the workers' compensation process, its statutory duty regarding reducing an accidental disability award is often not fully understood by the Commission. Moreover, the Commission, the disability retiree and the attorneys that practice before the Commission, often do not understand the intricate interplay between LE § 9-610 and SPP § 29-118. Therefore, the Commission's awards may not acknowledge or consider the MSRPS's required reduction of certain accidental disability benefits when they grant or approve employer and insurer offsets to workers' compensation awards if an MSRPS accidental disability allowance is also being paid or will be paid.

The complicated statutory scheme for offsets and reductions for workers' compensation and retirement disability awards have resulted in a process that is disjointed, and sometimes inconsistent in its application. Moreover, the Retirement Agency finds that administering and monitoring the mandatory reduction of an accidental benefit in many instances can be unduly burdensome and time-consuming. Highlighted below are some examples of issues that the Retirement Agency has encountered with administering SPP § 29-118:

Issue 1: Retroactive Accidental Disability Awards

When an accidental disability retirement is *retroactively* awarded, the Retirement Agency has found it nearly impossible to recover the related workers' compensation payments if an offset based on LE § 9-610 for the ordinary disability award has been granted to the employer/insurer.

In these cases, the employer or insurer has already been credited an offset, thereby reducing the workers' compensation payments actually received by the disability retiree. Nonetheless, SPP § 29-118 requires the Retirement Agency to reduce the retiree's accidental benefits to recoup the amount of the workers' compensation award. To adhere to SPP § 29-118, the Agency would have to recoup money from the disability retiree that he or she never received, or seek a return of the money the employer/insurer.

For obvious reasons, the Retirement Agency has been reluctant to reduce a retiree's accidental disability retirement in this situation. Moreover, the Agency has been unsuccessful in recouping this money from the employer. Thus far, no employer has agreed to repay money to the disability retiree or the System, or to stop an ongoing offset. The employers' claim that the offset was based on a valid order or settlement signed by the Commission, and that at the time of the award or settlement, the offset was proper. In one case, the Retirement Agency went before the Commission to reopen a case. However, the Commission ruled that the Retirement Agency did not have standing to challenge the award.

Example:

- TPS employee was injured in a workplace accident on Jan. 1
- On Feb. 1, TPS member is granted and accepts an ordinary disability retirement by the Board ($800/mo. ($200/week)), but is appealing award for accidental disability.
- On March 1, TPS retiree receives a workers' compensation award of $200/week for Jan. 1 injury

- Under LE § 9-610, the Commission awards TPS retiree's former employer, a local school board, an offset of $200/week because of the overlapping ordinary disability award
- On July 1, Board retroactively grants TPS retiree an accidental disability award of $1200/mo ($300/week) for Jan. 1 accident
- Under SPP § 29-118, the Agency should recoup the $200/week workers' compensation award since March 1 (approx. $1600), and should reduce any overlapping accidental disability award by $200/week going forward.

Issue 2: Erroneous Commission Awards

The Agency has uncovered at least one instance where the Commission erroneously awarded an offset for an employer/insurer despite the fact that the retiree was granted an accidental retirement benefit subject to a SPP § 29-118 reduction. It is the Agency's position that it must reduce the accidental retirement allowance in accordance with § 29-118, regardless of the Commission's erroneous award. Nonetheless, this could create a hardship for the retiree who must seek to have the Commission amend the award, or take other legal action.

Example:

- TPS employee was injured in a workplace accident on Jan. 1
- On Feb. 1, TPS employee is granted and accepts an accidental disability retirement by the Board ($1000/mo. ($250/week))
- On March 1, TPS retiree is awarded workers' compensation ($200/week) for the Jan. 1 injury
- Under LE § 9-610 the Commission erroneously grants the employer, a local school board, an offset based on the accidental disability award. Because of the offset the TPS retiree is not receiving any money for workers' compensation award.
- Under SPP 29-118, the MSPRS must reduce the accidental disability award by $200/week based on the related workers' compensation award. Therefore, the TPS retiree is subject to two offsets, resulting in a monthly compensation of $50/week.

Issue 3: Delayed Notice of a Workers' Compensation Award

A workers' compensation award is often granted after an accidental disability has been awarded. Accidental disability retirees are instructed to notify the Agency if they are subsequently granted a workers' compensation award for the same injury for which they are receiving the accidental disability benefit. Many times, however, the disability retiree does not notify the Agency, and the Agency does not discover the related workers' compensation award until many months or years after the award. Recouping the double payment can lead to an almost total reduction of the retiree's monthly retirement allowance, resulting in claims of real or perceived hardship to the disability retiree.

Example:

- On March 1, EPS state employee is granted and accepts an accidental disability retirement for a Jan. 1 workplace accident for $1000/month.
- Agency instructs EPS retiree to report any subsequent workers' compensation awards
- July 1 Commission awards EPS retiree a $20,000 lump sum award
- EPS retiree does not report award to the Agency
- Two years later the Agency learns of lump sum award

- Agency reduces EPS retiree’s monthly accidental disability benefit to maximum allowed to recoup the lump sum award, leaving little for retiree to live on.

Proposed Legislative Amendments:

Abolishing SPP § 29-118 and deleting reference to SPP § 29-118 from LE § 9-610

Abolishing SPP § 29-118 would mean the Board would no longer reduce accidental disability awards for related workers’ compensation award payments. However, the retiree would not receive both accidental and workers’ compensation benefits for the same injury. If SPP § 29-118 were abolished, LE § 9-610 would prevent the disability retiree from being paid for the same injury twice. In fact, LE § 9-610 would prevent the disability retiree from receiving any “similar” workers’ compensation benefits. The employer or insurer that pays the workers’ compensation award would reduce or “offset” the workers’ compensation payments, based on the accidental disability award. In fact, this is the way all ordinary disability allowance offsets are handled now. In the case of State retirees, the State, through its third-party administrator, the Injured Workers’ Insurance Fund (“IWIF”), would receive the offset.[2] In the case of TPS retirees, the respective local school boards would receive the offset. The Agency reports that because the local school boards now share in the costs of teachers’ retirements their receipt of the workers’ compensation offset is not a windfall to the local school boards.

The following charts demonstrate how the offset is taken when a MSRPS disability retiree receives a similar or related workers’ compensation benefit currently and under the proposed amendments:

Offsets under the current law

	TPS/TRS retiree	State retiree	PGU retiree
Ordinary Disability	Employer reduces retiree’s workers’ compensation award (LE § 9-610)	State (IWIF) reduces retiree’s workers’ compensation award (LE § 9-610)	Employer reduces retiree’s workers’ compensation award (LE § 9-610)
Accidental/Special Disability	MSRPS reduces retiree’s disability allowance (SPP § 29-118)	MSRPS reduces retiree’s disability allowance (SPP § 29-118)	Employer reduces retiree’s workers’ compensation award (LE § 9-610)

Offsets under proposed amendments

	TPS retiree	State retiree	PGU retiree
Ordinary Disability	Employer reduces retiree’s workers’ compensation award (LE § 9-610)	State (IWIF) reduces retiree’s workers’ compensation award (LE § 9-610)	Employer reduces retiree’s workers’ compensation award (LE § 9-610)
Accidental/Special Disability	Employer reduces retiree’s workers’ compensation award (LE § 9-610)	State (IWIF) reduces retiree’s workers’ compensation award (LE § 9-610)	Employer reduces retiree’s workers’ compensation award (LE § 9-610)

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[2] The State of Maryland’s workers’ compensation program is self-insured. LE § 10-102(d). IWIF is the third-party administrator of workers’ compensation benefits to the State of Maryland. *Id.*

🟦 =MSRPS offsets under the current law
🟩 =Offset provisions changed under the proposed legislation

Attachment B

TO: Administrative Committee

FROM: Andrew C. Palmer, CIO

THROUGH: R. Dean Kenderdine, Executive Director

DATE: October 3, 2017

RE: Requested Legislation for Board Authority for Investment Division Budgeting

The investment staff recommends the Board of Trustees request the Joint Committee on Pensions (JCP) sponsor legislation to invest the Board with budgetary authority of the Investment Division's operating expenses. This would permit the Board to establish competitive compensation levels for the Investment Division staff to promote recruitment and retention of division staff, as well as improve the alignment of interests of staff with the System. The bill would further permit the Board to create (or eliminate) PINS as necessary to effectively implement the investment program. Finally, this authority would permit the Board to approve additional expenses for investment related services and products necessary for the program.

From a budgetary perspective, the legislation would move the Investment Division's expenses from the annual administrative expenses that are paid by the State and Participating Governmental Units to investment management expenses paid from the fund's assets. For fiscal 2018, the division's share of the agency's $34,800,000 budgeted expenses is $ 8,300,000. If the legislation were in effect today, the $8,300,000 would be paid out of the system's assets and the sponsors would retain that amount.

This request was approved by the Board and submitted to the JCP last year. However, the committee requested additional information in the form of a summer study before moving forward with possible legislation. Staff is preparing this information to be presented to the JCP on October 25, 2017.

Attached you will find the presentation staff made at the September Investment Committee meeting that reported on the summer study, as well as our work to evaluate the prospects for lowering costs to the system by managing assets internally. Below is the memo that was presented to the Administrative Committee in October 2016 for the original request. The memo provides details of the process that prompted the request. It is presented as background material for new Trustees and a refresher of the issues for veteran trustees.

TO: Administrative Committee

FROM: Andrew C. Palmer, CIO

THROUGH: R. Dean Kenderdine, Executive Director

DATE: October 17, 2016

RE: Investment Division Organizational and Compensation Changes

Executive Summary:

The MSRPS Investment Division is seeking legislative changes to invest the Board of Trustees of the Maryland State Retirement and Pension System with budgeting authority for the Investment Division. Specifically, the Board would have the authority to set compensation levels for staff, create and eliminate positions and approve investment-related expenditures to preserve and enhance the value of the System's assets. This recommendation is intended to alleviate the resource constraints faced by the division in attracting and retaining qualified personnel, creating additional positions, and providing other investment-related resources in a timely and responsive manner. These suggestions come after a review by the CIO found that the System's assets are at risk under the current process and the System is challenged to reduce fees through internal management and more broadly, meet the investment objectives of the System requires with the current level of budgetary flexibility.

Within existing statute, the CIO and the Board have authority to incur investment-related expenses, but excludes the work of the investment division from the definition of investment management expenses, which has been interpreted as fees paid to external managers. This legislative change would recognize the work of the investment division as investment management.

These requests stem from the CIO's assessment that:

1. The current level of staffing could put the System's ability to achieve its return objective at risk.
2. The compensation structure of staff contributes to turnover and poor alignment of interests between staff and the plan, which exacerbates the risk to the plan from low levels of staffing.
3. The level and compensation of staff are an impediment to internal management initiatives that are contemplated to lower System costs and improve the potential of achieving the System's return objectives.

4. The System’s intention to create an internal investment capability and improve the System’s potential to achieve its investment objectives requires more flexibility in obtaining investment management-related products and services.

Background:

Having joined the MSRPS Investment Division as CIO in July 2015, I have had the opportunity to review and analyze the division’s staffing level and operations. I have found that the sophistication, size and complexity of the investment portfolio have outpaced the staffing levels. From the end of 2005 to the present, the plan has grown from 7 investment strategies and 50 accounts to 18 strategies and 380 investment accounts by 2016. During that same time, fund assets have grown from $33.7 billion to $46.2 billion, while Investments Staff has grown from 15 to 23.

During the past year, we have been examining our structure to identify opportunities to streamline processes and improve productivity and efficiency through software tools. Currently, we are evaluating client relationship management software to enhance our process to source, diligence and monitor the managers we engage. Another area of focus is the potential use of internal management to reduce the number of managers employed and the related fees. Internal management could also add value through tactical positioning of the portfolio based on perceived market opportunities.

While more accounts and a larger asset base may suggest that more staffing is appropriate, they do not provide guidance on the appropriate level of staffing. In 2015, the New York City Comptroller’s Office contracted with the Funston Group to perform an operational review of the five pension systems and the investment office that supports them. The study is available on the Comptroller’s website and provides some guideposts for staffing. A second, more limited study was performed for the New York Common Retirement Fund and is available on the state comptroller’s website.

The reports suggest that the peer median number of investment professional staff with respect to asset size is .6 FTE/$1 billion. At 16 investment staff and $46 billion in assets, the MSRPS Investment Division has .35 FTE/$1 billion. The peer median investment professional staff for the System would be 27 full-time employees in addition to the investment division staff assigned to operations and accounting.

Funston further provided suggestions on the appropriate level of staffing per asset class. They found significant business risk in asset classes that were managed by only one person. The risks result from the lack of coverage depth, the lack of institutional continuity, periods of reduced oversight and opportunity cost from a reduced scope of inquiry into better investment alternatives. Currently, MSRA has six asset classes that are each managed by one person: fixed income, credit, absolute return, real estate, commodities and natural resources. In fact, four people are responsible for these six asset classes as well as the risk management function.

Lastly, Funston recommends a robust human resources function to reduce the risk of turnover. The elements they recommend are:

- Recruit superior investment talent
- Create strong onboarding practices
- Implement a robust training program
- Provide opportunity for career advancement

At present, MSRA does not have a robust human resources function. While the agency is able to recruit qualified individuals to work at the System, the compensation structure and lack of career advancement opportunities available in the division have limited the System to individuals who self-select into the agency because of geographic preference or the opportunity to rapidly gain experience that will be valuable to a subsequent employer.

The opportunity for career advancement within the Investment Division is limited due to the lack of hierarchy. Currently, there are two position levels, Senior Investment Analyst and Managing Directors. Barring turnover at the Managing Director level, analysts have no opportunity for advancement in position or salary, regardless of how their skills, experience or responsibilities expand. Managing Directors and the Deputy Chief Investment Officer have been offered some salary opportunity through the 2012 legislation that placed them in the Executive Salary Plan, but many of them are near the top of that pay scale. One recent Managing Director departure cited the pay cap as the primary reason for leaving.

Training and onboarding practices are weak given the limited overlap in asset classes to provide training to new employees.

In the New York City study, Funston noted that the poor compensation structure added to the risk of the System stemming from personnel issues. However, New York City was able to bypass this issue, highlighted in the study, because the Comptroller had already implemented a plan to improve compensation. For the New York Common Fund study, Funston found that:

"…While the fund is currently well-managed, compared to most peers, it remains severely understaffed for its scale and complexity, with underdeveloped risk analysis and management capabilities and an over-reliance on outsourced investment management and support functions. In addition, independent compensation benchmarking indicates that PICM" (Division of Pension Investment and Cash Management) "staff compensation levels are in the bottom quartile for similar public pension funds. There is justifiable concern that current staff will leave if compensation is not increased, and it is likely that PICM will struggle to recruit needed new staff and stem turnover at current compensation levels."

The System's ability to attract and retain qualified personnel will depend on its ability to change the compensation structure within the division. Using publicly available data on compensation for state plans of similar size and structure, MSRA found that staff was in the bottom quartile of pay for most positions. This data compares MSRA salaries for 2015 against peer salaries from 2012 to 2015.

			2015		**PUBLIC**		
	MSRA	**MSRA**	**MSRA**		**DATA 2012-15**		
Position	Title	Number	Mean Salary	Low Q	Median	Upper Q	Average
Executive Director	Executive Director	1	150.5		249.5	0	249.5
CIO	CIO	1	330	244	295	324	287
Deputy CIO	Deputy CIO	1	143.1	173	253	309	245
Team Leader Traditional Products	Managing Director	1	123.4	171	183	233	203
Team Leader Alternative Products	Managing Director	2	130.2	171	183	233	203
Senior Manager Ext	**NA**	**6**	**100**	**118**	**141**	**168**	**141**
Senior PM Fixed Income	Senior Analyst	**0**	0				
Senior Analyst Ext	Senior Analyst	**2**	94.3	100	110	126	111
Senior Compliance	Senior Compliance	1	90.7	n/a	n/a	n/a	n/a
Total/Average Investment Staff		13	108.2	122.6	143.7	174.5	147.8

The Peer group is highlighted in green in the table below and represents funds of similar size but only modest or no internal management.

Name	Total U.S. DB assets	% OF ASSETS MGD INTERNALLY
California Public Employees' Retirement System	$283,879	67%
California State Teachers' Retirement System*	$181,294	38%
New York State Common Retirement Fund	$173,541	57%
State Board of Administration of Florida	$139,231	43%
Teacher Retirement System of Texas	$125,327	36%
New York State Teachers' Retirement System	$101,828	63%
State of Wisconsin Investment Board*	$90,926	NA
North Carolina Retirement Systems	$85,511	26%
Ohio Public Employees Retirement System	$85,256	35%
New Jersey Division of Investment	$73,008	71%
Washington State Investment Board	$71,133	22%
Teachers Retirement System of Georgia	$62,529	100%
Retirement Systems of Alabama	$32,185	100%
Tennessee Consolidated Retirement System	$41,164	74%
Public Employees' Retirement Association of Colorado	$42,042	73%
State Teachers' Retirement System of Ohio	$68,676	70%
Employees Retirement System of Texas	$25,101	62%
State of Michigan Retirement Systems	$59,407	37%
Virginia Retirement System	$65,375	36%
Pennsylvania Public School Employees' Retirement System	$47,569	31%
Arizona State Retirement System	$33,680	26%
Oregon Public Employees Retirement Fund	$68,122	10%
Illinois Municipal Retirement Fund	$33,429	1%
Teachers' Retirement System of the State of Illinois	$43,450	0%
Minnesota State Board of Investment	$60,125	0%
Massachusetts Pension Reserves Investment Management Board*	$58,840	0%
Connecticut Retirement Plans & Trust Funds	$28,093	0%
South Carolina Public Employee Benefit Authority	$27,699	0%
Iowa Public Employees' Retirement System	$27,190	0%
Utah State Retirement Systems	$26,723	0%
Public School and Education Employee Retirement Systems of Missouri	$36,741	0%
Public Employees' Retirement System of Nevada	$32,991	0%
Commonwealth of Pennsylvania State Employees' Retirement System	$25,922	0%
Texas Municipal Retirement System*	$24,010	0%
Maryland State Retirement & Pension System	$43,691	0%

Source: P&I

In addition to the staffing issues, we have identified additional resource issues that present challenges to the division under the existing budget process. The System's requirement for additional services and products changes from year to year as the asset allocation changes and markets evolve. In addition, staff's ability to engage in any level of internal management will require more flexibility in budgeting and timing than is afforded in the present process. The changing regulatory landscape is an additional driver of the need for responsiveness in the budgeting process.

Legislative Solution:

The staffing levels of the Investment Division present two areas of concern: systemic risk of understaffing and insufficient resources to develop an internal management function. The legislature has recognized the compensation issues facing the System and has made a number of changes that have provided the MSRPS Board salary-setting authority for the CIO, and with limitations, the Deputy CIO and Managing Directors. This authority has been effective in improving the System's ability to attract and retain senior staff, but has proven to be of temporary effectiveness as industry compensation has continued to expand. In addition, the compensation for the remainder of staff has become increasingly uncompetitive, and has been a significant impediment in attracting and retaining qualified staff.

Existing statute provides that investment management expenses are excluded from the state's budgeting process and are considered an expense of the fund. The work of the Investment Division has been interpreted to be an administrative expense and has been included in the State's annual budgeting process. In fact, the investment division performs the services of a fund-of-funds manager for the entirety of the System's assets. Its primary function is to preserve and enhance the value of the System's assets through advising the Board on asset allocation, making recommendations to the CIO on manager selection and termination, and monitoring the System's managers for compliance. All of these are investment management functions. In addition, to the extent the System manages assets internally, it will be directly supplying investment management services.

Expanding the Board's authority to encompass all of the resource needs of the Investment Division, both personnel and services, and redefining investment management expenses to include the expenses of the Investment Division will provide the needed flexibility to meet the System's needs and provide effective control of the expenses. In addition to the Board's oversight of these expenses, existing statute places a cap on investment management service costs incurred in public markets. MSRA expenses could be included in this maximum, providing an additional level of control.

Maryland State Retirement and Pension System

Update on Summer Study and Internal Management Study

September 19, 2017

MARYLAND
STATE RETIREMENT
and PENSION SYSTEM

Summer Study and Internal Management Study: Background

- The Investment Division has been engaged in two projects focused on preparing for the future
  - Summer Study for the JCP
    - Provide detail on how Board authority for investment related budgeting would be implemented
      - One focus is on the specific changes to the number of personnel and the compensation plan for the Investment Division
      - The other focus is on personnel management to ensure accountability is integral to any change in compensation structures
  - Internal Management
    - Staff engaged the Cutter Group and Funston Advisory Group to provide an evaluation of the business case for internal management and a roadmap for implementation along with milestones to evaluate effectiveness.

Summer Study

Charge to the Agency in the Joint Chairmen's Report, 2017 Session:

"During the 2016 Interim, the Board of Trustees of the Maryland State Retirement and Pension System (SRPS) requested the Joint Committee on Pensions (JCP) sponsor legislation giving the board the authority to set compensation levels for staff, create and eliminate positions, and approve investment related expenditures to preserve and enhance the value of SRPS assets. JCP decided to hold the request pending additional information. The committee requested SRPS to submit a report detailing the potential effects of being granted the authority it seeks. In particular, the report should address the following topics:

- The number of new positions within the Investment Division that it would establish and the timeline for establishing and filling each position;
- The title, job description, and first-year compensation for each new and existing position within the Investment Division
- The range of compensation that would be authorized for each position;
- The basis used for determining compensation levels for ID personnel
- Any incentive compensation for which employees of the ID would be eligible and the criteria for determining payment of incentive compensation;
- How staff will be evaluated; and
- The process for determining adjustments to compensation, both positively and negatively."

Summer Study

MARYLAND
STATE RETIREMENT
and PENSION SYSTEM

To Respond to the JCP, staff is preparing a report that answers the questions in the context of discussing

- Section 1. Vision and Background
- Section 2. Current State
- Section 3. Implementation
- Section 4. Internal Management

Summer Study : Vision and Background

Investment Division governance has long been a focus of the Legislature and the Board

- As far back as the 1980’s the legislature has been addressing the difficulty of forcing the needs of a growing and increasingly complex investment function into the process of balancing the budget on an annual basis.
    - Early on the Legislature recognized that investment fees would grow at the pace of the fund instead of the pace of state budgets and removed them from the budget process.
    - More recently, the Legislature addressed staffing and continuity by permitting the Board to set salaries for senior Investment Division staff within the Executive payscale
- Looking out 5, 10 and 20 years, the system will continue to grow and the expenses will grow proportionally.
    - In 10 years the external management fees are projected to grow from $370 million to $570 million as assets grow to an expected $70 billion

Summer Study : Vision and Background

MARYLAND
STATE RETIREMENT
and PENSION SYSTEM

- The requested legislation will allow the Investment Division to address the current challenges it faces and provide the basis for preparing for the future with better options.
  - Staff anticipates that the legislation will enable the Investment Division
    - to generate higher gross returns
      - Improved investment process via more consistent and additional staffing
      - The ability to broaden the scope of investments available to the system
        - Staffing constraints reduces the number of managers that can be researched and maintained
        - Provide scope to tactically emphasize investments with higher near term return prospects.
    - Higher net returns through fee reduction initiatives
      - That lower the cost of investing with the same types of managers
      - That emphasize staff driven investing to replace external managers.

Summer Study : Current State

The Board has reviewed previous presentations on the need for additional staffing, competitive pay and flexibility on budgeting for services, systems and research.

- Previous presentations have focused on staffing shortfalls in positions directly engaged in asset management (Front Office)
- Staff recently undertook an evaluation of Accounting and Operations (Middle/Back Office) staffing and have identified needs for this group.
    - Staffing levels are unchanged from 2007 when the number of accounts was about 100. Today, the number is larger than 400 and the increased number of private funds has produced a more than linear increase in workload.
- Working with Cutter/Funston has highlighted the need for some additional specialized support in the areas of training and development, procurement and compliance.

Summary Study : Current State - continued

- Interim progress
  - In fiscal 2017, DBM approved the creation of two new title classifications to address the lack of career progression in the agency and to reduce our reliance on hiring mid career staff.
    - Senior Portfolio Manager – Many Senior Analysts had significant years of experience and were performing a portfolio manager role.
      - DBM approved and funded reclassifying 9 Senior Analysts and associated pay actions
    - Associate – Entry level analysts to provide support across the division and train for future openings.
    - DBM approved an additional 3 pay actions to address shortfall versus peers in the Accounting and Operations Group
  - For fiscal 2018, DBM recommended reassignment of 4 PINS from vacant positions within the agency and approved funding for pay discrepancy.
    - Senior Analyst for Risk - The risk management function has been understaffed
    - Senior Portfolio Manager Fixed Income – currently 2 people oversee more than 30% of system assets in the Fixed Income, Commodities and Credit portfolios.
    - 2 Associates – Entry or mid level Analysts to support the division's activities and train candidates for future senior positions
      - Although DBM approved 4 PINS, only 3 were available for transfer so only one Associate position will be filled

Summer Study : Current State - continued

Compensation levels for staff are significantly below peers for many positions, particularly in the Front Office.

POSITION	CURRENT NUMBER (UNFILLED)	MSRA SALARY RANGE ($1,000'S)	2016 MCLAGAN PEER SALARY RANGE (LOW QUARTILE TO HIGH QUARTILE) ($1,000'S)	2016 McLAGAN PEER MEDIAN AS A % OF MSRA MID RANGE
DEPUTY CIO	1	133-178	165-251	135%
MANAGING DIRECTOR INVESTMENTS	4	115-153	190-264	162%
SENIOR PORTFOLIO MANAGER - NEW POSITION	9 (1 OPEN, 1 NEW)	84-135	145-234	148%
SENIOR ANALYST	3 (1 NEW)	65-104	100-142	142%
ASSOCIATE - NEW POSITION	2 (NEW, 1 LIMBO)	57-91	60-108	160%
HEAD OF OPERATIONS/PORTFOLIO ADMIN	1	92-123	122-158	130%
HEAD OF INVESTMENT ACCOUNTING	2	60-97	97-142	134%
CHIEF COMPLIANCE OFFICER	1	84-135	102-145	114%
SENIOR STAFF	2	47-75	72-80	123%
EXECUTIVE ASSOCIATE	1	41-66	NA	NA

McLagan is a compensation consultant. The 2016 report surveyed 51 large public plans.

Summer Study : Current State - continued

MARYLAND
STATE RETIREMENT
and PENSION SYSTEM

Staff performing in line with peers at the asset class level.

TUCS Performance Universe (greater than $1billion)

Asset Class	MSRPS 5 year Investorforce Percentile Ranking	Number of Peer Funds	MSRPS 10 year Investorforce Percentile Ranking	Number of Peer Funds
U.S. Equity	52	47	79	42
Developed Equity	56	35	51	15
Real Estate	27	27	43	18
Private Equity.	15	33	13	17
Total Fund	79	75	96	68

Summer Study : Implementation

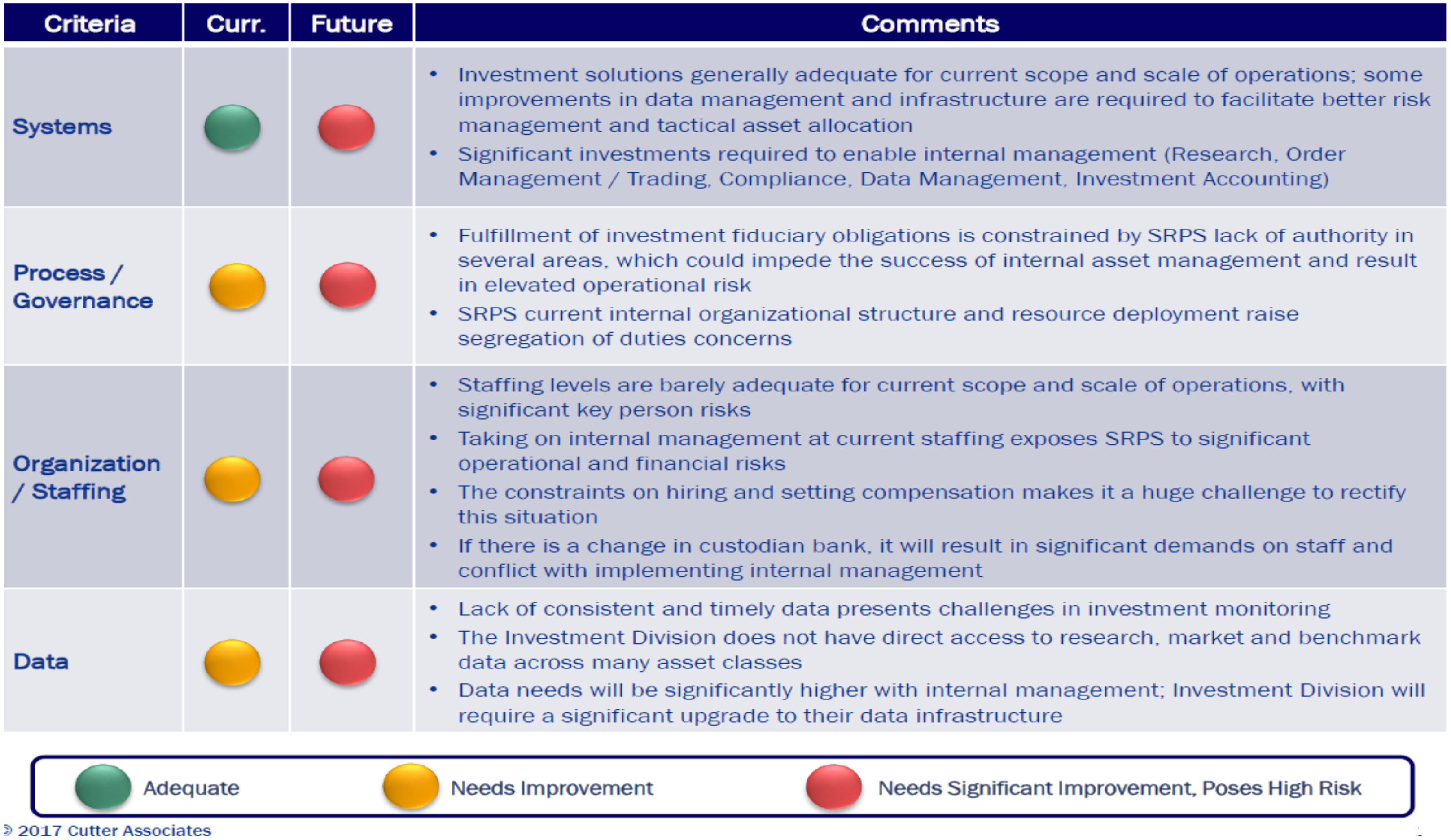
- With passage of the legislation, Board will need to:
    - Approve a compensation process for the division
        - Objective: to create a compensation program that supports attracting and retaining qualified staff while promoting accountability and alignment with System objectives
        - For front office staff, target 90% of McLagan peer universe (or similar provider, updated periodically) and create and incentive plan based on investment performance criteria
        - For middle and back office staff target McLagan peer universe.
        - Implement a robust performance review process to promote accountability through feedback and guidance
            - Hold staff to high standards of performance to maintain positions.
    - Evaluate, review and approve annual budgets for the investment division separate from the annual state's budget process.

Summer Study: Internal Management

- At $50 billion and growing, the System will suffer from diseconomies of scale with external management and can reap significant economies of scale from internal management.
  - In many asset classes, the System faces capacity constraints with managers because it shares capacity with other investors
    - E.g. Emerging Market Equity, Small Cap Equity, Private Equity, Hedge Funds
    - Capacity constraints at the manager level require the system to invest in more funds at higher cost than is optimal
  - The costs of internal management include personnel costs and a relatively small set of fixed costs for space, systems and services.
    - These costs may be similar to external manager fees when System assets are modest but after $25-50 billion in assets size, the value of internal management becomes compelling.
    - Internal management can improve the outcome by reducing the frequency of netting of positions between external managers.
      - E.G. One manager underweighting Amazon and another overweighting Amazon with a net effect of having an index like position
    - Internal management may also reduce costs other than management fees that accrue through trading and fund expenses.
- Internal Management of assets is one of the options the legislation will provide the system
- Staff began a process to build a roadmap to internal management and engaged Cutter Associates and the Funston Advisory Services
  - Evaluated the Current State
  - Developed the Business Case
  - Provided a Roadmap for the next ten years.
    - Roadmap has 2, 5 and 10 year phases with evaluation milestones for each
    - Roadmap provides guidance on functions and systems required at each stage but allows for flexibility in timing and implementation

Summer Study: Current State

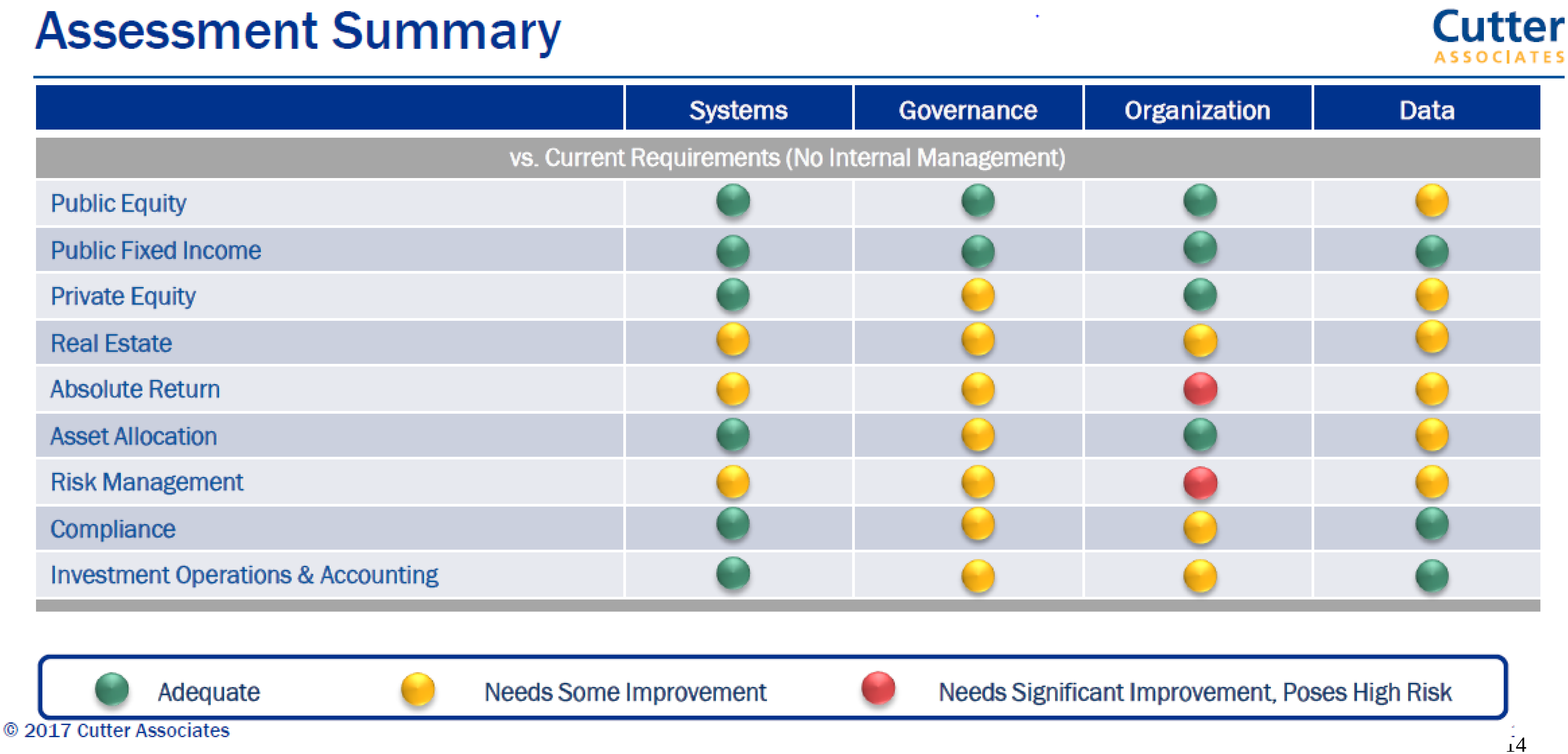
How is the System addressing its current responsibilities and what risks will need to be addressed as it contemplates internal management?



Criteria	Curr.	Future	Comments
Systems	🟢	🔴	• Investment solutions generally adequate for current scope and scale of operations; some improvements in data management and infrastructure are required to facilitate better risk management and tactical asset allocation • Significant investments required to enable internal management (Research, Order Management / Trading, Compliance, Data Management, Investment Accounting)
Process / Governance	🟡	🔴	• Fulfillment of investment fiduciary obligations is constrained by SRPS lack of authority in several areas, which could impede the success of internal asset management and result in elevated operational risk • SRPS current internal organizational structure and resource deployment raise segregation of duties concerns
Organization / Staffing	🟡	🔴	• Staffing levels are barely adequate for current scope and scale of operations, with significant key person risks • Taking on internal management at current staffing exposes SRPS to significant operational and financial risks • The constraints on hiring and setting compensation makes it a huge challenge to rectify this situation • If there is a change in custodian bank, it will result in significant demands on staff and conflict with implementing internal management
Data	🟡	🔴	• Lack of consistent and timely data presents challenges in investment monitoring • The Investment Division does not have direct access to research, market and benchmark data across many asset classes • Data needs will be significantly higher with internal management; Investment Division will require a significant upgrade to their data infrastructure

🟢 Adequate
🟡 Needs Improvement
🔴 Needs Significant Improvement, Poses High Risk

Summer Study: Current State



Assessment Summary

Cutter ASSOCIATES

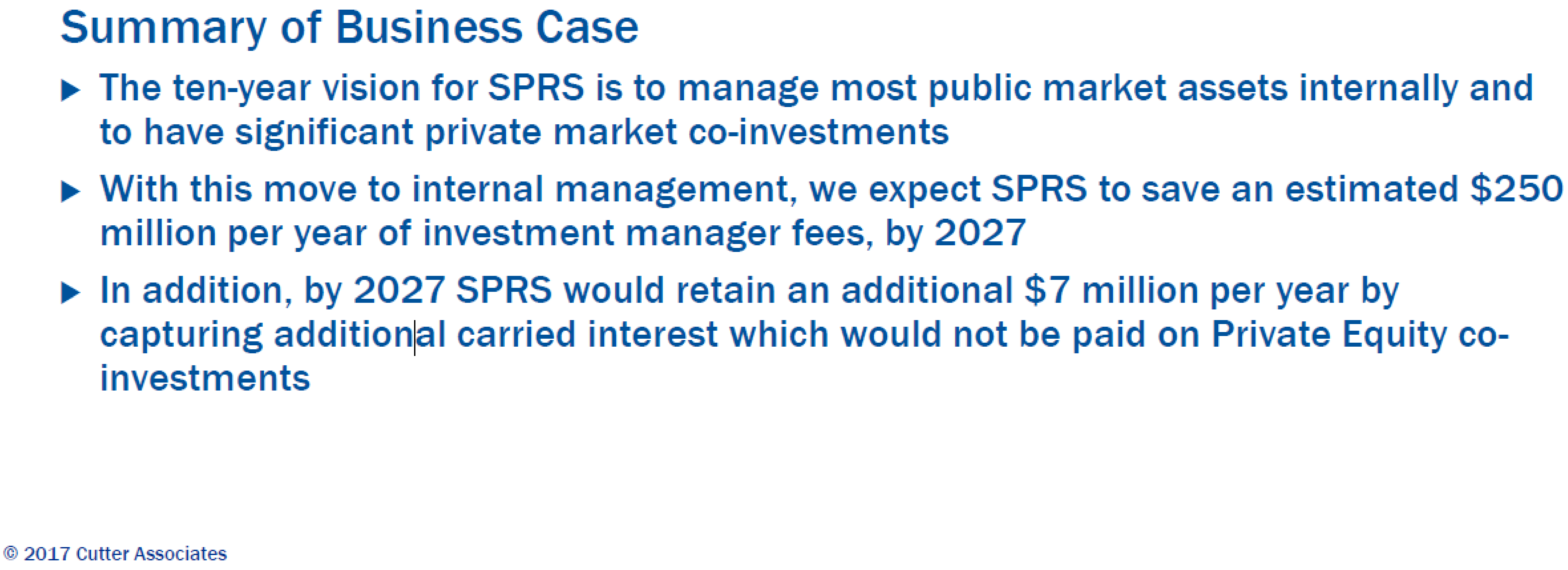
	Systems	Governance	Organization	Data
vs. Current Requirements (No Internal Management)				
Public Equity	🟢	🟢	🟢	🟡
Public Fixed Income	🟢	🟢	🟢	🟢
Private Equity	🟢	🟡	🟢	🟡
Real Estate	🟡	🟡	🟡	🟡
Absolute Return	🟡	🟡	🔴	🟡
Asset Allocation	🟢	🟡	🟢	🟡
Risk Management	🟡	🟡	🔴	🟡
Compliance	🟢	🟡	🟡	🟢
Investment Operations & Accounting	🟢	🟡	🟡	🟢

🟢 Adequate 🟡 Needs Some Improvement 🔴 Needs Significant Improvement, Poses High Risk

Summer Study: Current State

- Summary of yellow and red Current State dots
  - Systems
    - Some areas rely on manual processes
  - Governance
    - Improvements in operational process – Being corrected with Code Red/Factset work flow software roll out
    - Potential conflicts with staff providing oversight functions reporting to CIO – Risk, Compliance, Accounting and Operations
    - Risk Management process is a concern– systems have trouble with data integrity and frequent benchmark changes
  - Staffing
    - Key person risk, insufficient staffing, hiring delays
  - Data
    - Insufficient data sources on benchmarks and markets, reliance on consultant for data

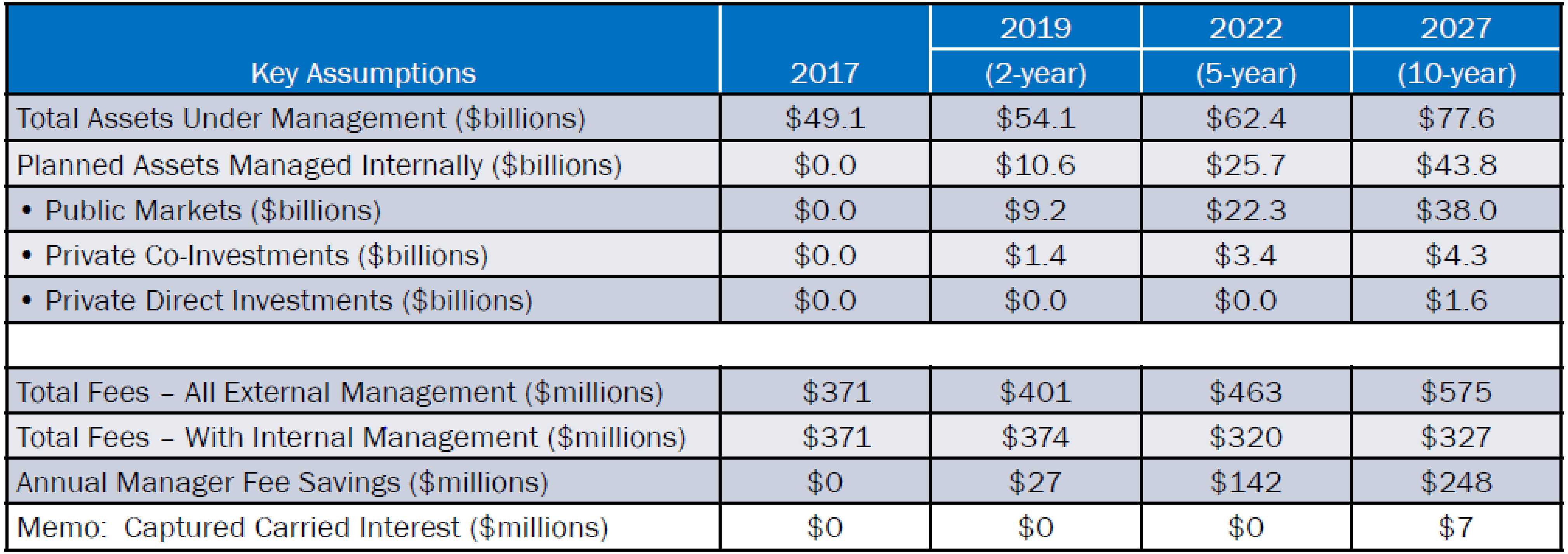
Summer Study: Business Case



Summary of Business Case

- The ten-year vision for SPRS is to manage most public market assets internally and to have significant private market co-investments
- With this move to internal management, we expect SPRS to save an estimated $250 million per year of investment manager fees, by 2027
- In addition, by 2027 SPRS would retain an additional $7 million per year by capturing additional carried interest which would not be paid on Private Equity co-investments

Summer Study: Business Case



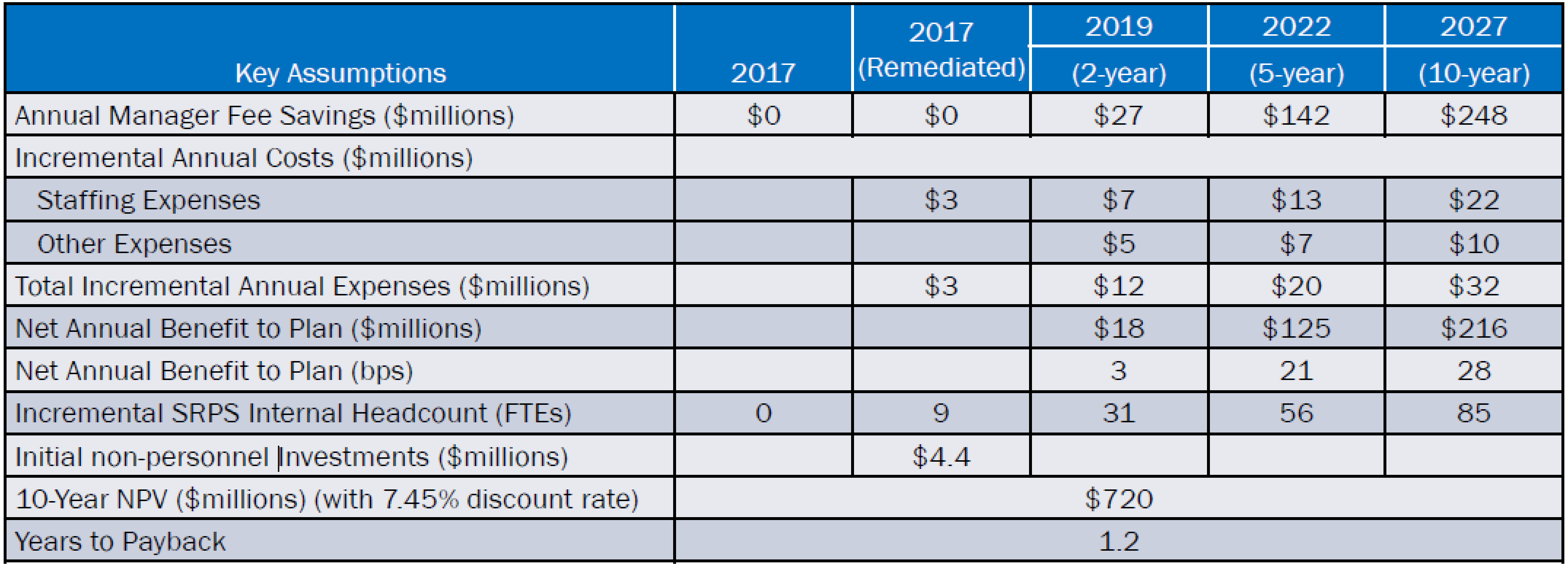
		2019	2022	2027
Key Assumptions	2017	(2-year)	(5-year)	(10-year)
Total Assets Under Management ($billions)	$49.1	$54.1	$62.4	$77.6
Planned Assets Managed Internally ($billions)	$0.0	$10.6	$25.7	$43.8
• Public Markets ($billions)	$0.0	$9.2	$22.3	$38.0
• Private Co-Investments ($billions)	$0.0	$1.4	$3.4	$4.3
• Private Direct Investments ($billions)	$0.0	$0.0	$0.0	$1.6
Total Fees – All External Management ($millions)	$371	$401	$463	$575
Total Fees – With Internal Management ($millions)	$371	$374	$320	$327
Annual Manager Fee Savings ($millions)	$0	$27	$142	$248
Memo: Captured Carried Interest ($millions)	$0	$0	$0	$7

Summer Study: Business Case

Summary of Business Case (continued)

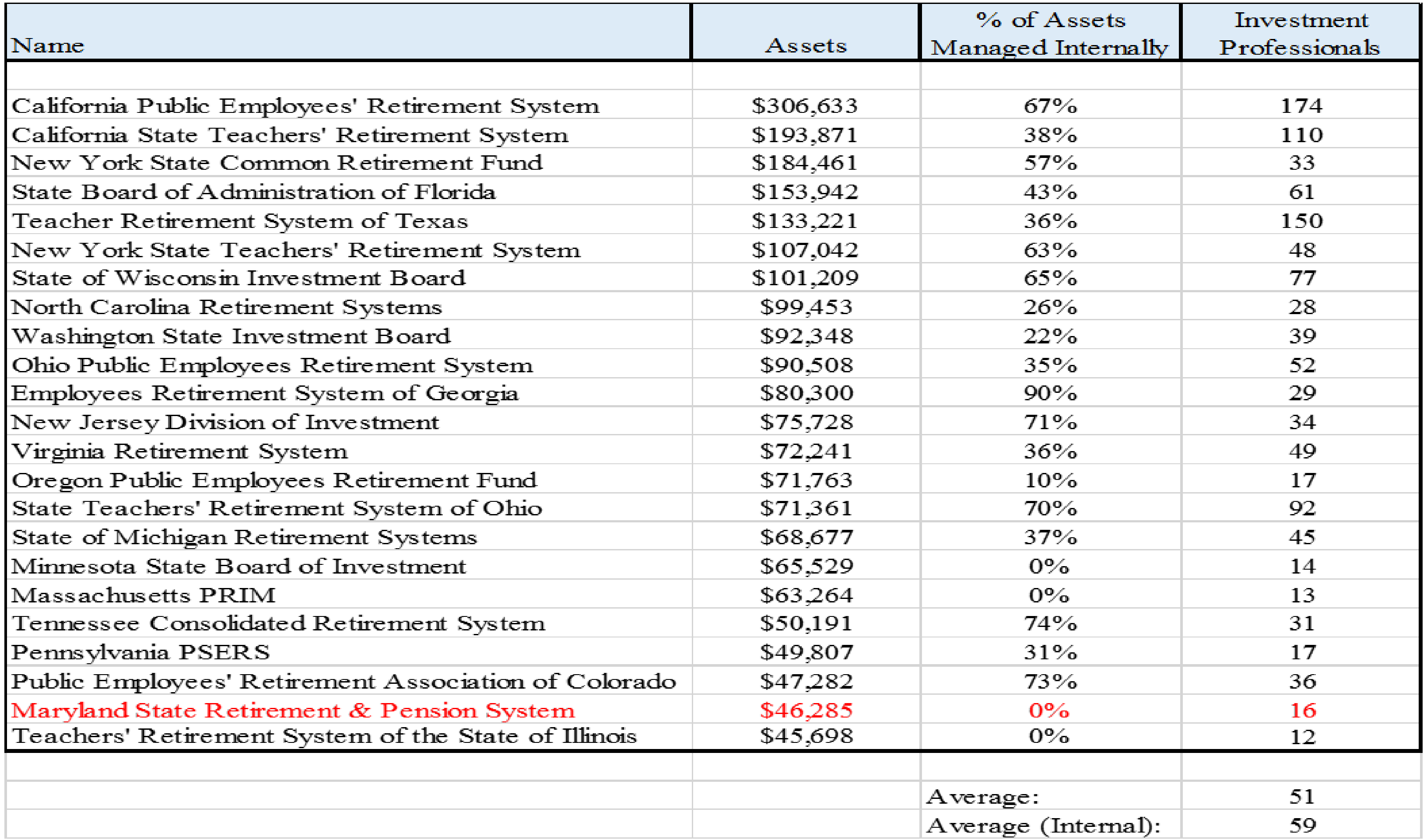
- The added cost per year to achieve $250 million per year in fee savings, would be $32 million – this includes cost of additional resources and infrastructure
- Under these assumptions, the Net Present Value (NPV) of the SPRS's investment in its internal management program would be $720 million over ten years
- The incremental investment, excluding staffing costs, is estimated at no more than $5 million, resulting in a payback period of 1.2 years
- The net benefit to the plan would exceed $215 million per year by 2027

Summer Study: Business Case



Key Assumptions	2017	2017 (Remediated)	2019 (2-year)	2022 (5-year)	2027 (10-year)
Annual Manager Fee Savings ($millions)	$0	$0	$27	$142	$248
Incremental Annual Costs ($millions)					
Staffing Expenses		$3	$7	$13	$22
Other Expenses			$5	$7	$10
Total Incremental Annual Expenses ($millions)		$3	$12	$20	$32
Net Annual Benefit to Plan ($millions)			$18	$125	$216
Net Annual Benefit to Plan (bps)			3	21	28
Incremental SRPS Internal Headcount (FTEs)	0	9	31	56	85
Initial non-personnel Investments ($millions)		$4.4			
10-Year NPV ($millions) (with 7.45% discount rate)	$720				
Years to Payback	1.2				

Summer Study: Business Case



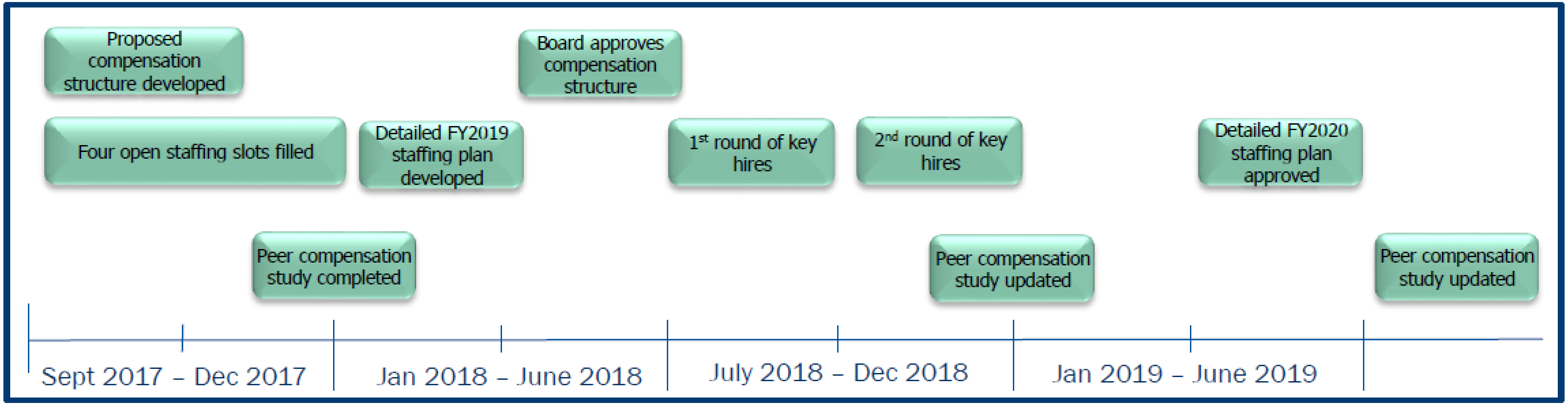
Name	Assets	% of Assets Managed Internally	Investment Professionals
California Public Employees' Retirement System	$306,633	67%	174
California State Teachers' Retirement System	$193,871	38%	110
New York State Common Retirement Fund	$184,461	57%	33
State Board of Administration of Florida	$153,942	43%	61
Teacher Retirement System of Texas	$133,221	36%	150
New York State Teachers' Retirement System	$107,042	63%	48
State of Wisconsin Investment Board	$101,209	65%	77
North Carolina Retirement Systems	$99,453	26%	28
Washington State Investment Board	$92,348	22%	39
Ohio Public Employees Retirement System	$90,508	35%	52
Employees Retirement System of Georgia	$80,300	90%	29
New Jersey Division of Investment	$75,728	71%	34
Virginia Retirement System	$72,241	36%	49
Oregon Public Employees Retirement Fund	$71,763	10%	17
State Teachers' Retirement System of Ohio	$71,361	70%	92
State of Michigan Retirement Systems	$68,677	37%	45
Minnesota State Board of Investment	$65,529	0%	14
Massachusetts PRIM	$63,264	0%	13
Tennessee Consolidated Retirement System	$50,191	74%	31
Pennsylvania PSERS	$49,807	31%	17
Public Employees' Retirement Association of Colorado	$47,282	73%	36
Maryland State Retirement & Pension System	$46,285	0%	16
Teachers' Retirement System of the State of Illinois	$45,698	0%	12
		Average:	51
		Average (Internal):	59

- Larger funds opt for internal management
- Investment Professionals do not include middle and back office.
- Cutter 10-year projection for investment professionals is 73
- Different levels of investment complexity help explain staffing differences
- Source: P&I 2016 data, MSRA Staff

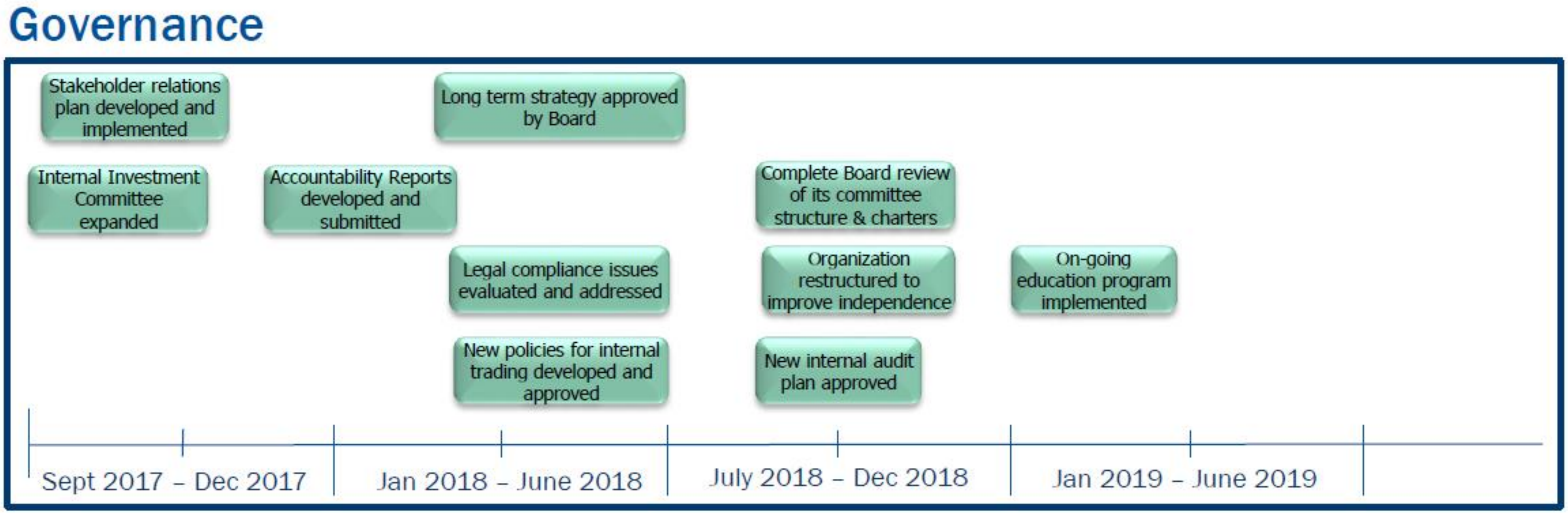
Summer Study: Roadmap

Cutter/Funston have provided detailed timelines for implementation that provide guidance on how best to proceed. There is some flexibility in the order and timing of these functions.

Staffing and Compensation



Summer Study: Roadmap



Governance

Stakeholder relations plan developed and implemented

Internal Investment Committee expanded

Accountability Reports developed and submitted

Long term strategy approved by Board

Legal compliance issues evaluated and addressed

New policies for internal trading developed and approved

Complete Board review of its committee structure & charters

Organization restructured to improve independence

New internal audit plan approved

On-going education program implemented

Sept 2017 – Dec 2017

Jan 2018 – June 2018

July 2018 – Dec 2018

Jan 2019 – June 2019