

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

MINUTES OF MEETING

September 20, 2001

The Board of Trustees for the State Retirement and Pension System of Maryland met in the Boardroom of the SunTrust Building, 120 East Baltimore Street, Baltimore, Maryland, at 9:40 a.m. There were present Richard N. Dixon, Chairman, William Donald Schaefer, Vice-Chairman (departed 12:15 p.m.), Secretary T. Eloise Foster (departed 12:18 p.m.), Colonel David B. Mitchell (departed 12:19 p.m.), Major Morris L. Krome, Carl D. Lancaster, Debra B. Humphries (via telephone until 10:00 a.m.), William D. Brown, Ali A. Alemi, and Arthur N. Caple, Jr. (arrived 9:58 a.m.), Trustees, and Peter Vaughn, Secretary. Agency staff members also attending were, Debbie Bacharack, Robert Feinstein, Jill Leiner, and Carla Katzenberg. Assistant Attorneys General, Carol Boykin, Chief Investment Officer, Tracey Deputy Chief Investment Officer, Thomas Gighotti, Chief Internal Auditor, Howard Pleines, Legislative Director, Rick Harrison, Chief Financial Officer, Gary Scribner, Chief Information Officer, and Gwendolyn Mulkey, Executive Associate.

Eugene Kowalczyk, Esq., Attorney for Florence Matthews, and Florence Matthews were present. James Hoffman and JoAnn McFee were also present.

The Chairman requested that the Board observe a moment of silence in regard to the tragic events which took place on September 11, 2001 in New York City, Washington D.C., and Somerset, PA.

The Chairman permitted Dr. Alemi to address the Board regarding the tragic events which took place on September 11, 2001.

Minutes

1

On motion made by Mr. Lancaster and duly seconded, the Board voted to defer approval of the Minutes of the August 21, 2001 Board meeting until the October meeting to correct the disability appeal votes for Marsha Craver and Joy Richards.

Florence Matthews 2

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

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

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

James Hoffman 3

The Board considered the report of Joan B. Gordon, sitting as Administrative Law Judge for the Office of Administrative Hearings, in connection with the appeal of James Hoffman. The Medical Board report included a report by an Administrative Law Judge and related medical documentation including documents inadvertently omitted for the Record. Mr. Hoffman appealed the Medical Board's decision that the medical evidence submitted did not prove that he is permanently incapacitated or unable to perform his job duties.

Mr. Hoffman presented his arguments opposing the Agency's position and the Medical Board's recommendations. Ms. Jill Leiner, attorney for the Agency, addressed the Board and argued that the Board should accept the Medical Board's report. The Board deferred further consideration to executive session.

JoAnn McFee 4

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

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

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

On motion made by Major Krome and seconded by Mr Brown, the Board unanimously voted to meet in Executive Session to consider the appeals of Florence Matthews, James Hoffman and JoAnn McFee. State Government Article Section 10-502(i) authorizes the Board to meet in closed session to exercise a quasi-judicial function.

#### EXECUTIVE SESSION

The Board met in Executive Session at 10:55 a.m. in the SunTrust Building to consider the appeals of Florence Matthews, James Hoffman and JoAnn McFee. All of the persons present at the beginning of the meeting were present in Executive Session except Eugene Kowalczyk, Esq., Florence Matthews, James Hoffman and JoAnn McFee. The Board adjourned its Executive Session at 11:10 a.m. and returned to regular session to complete the agenda.

#### REGULAR SESSION

Florence Matthews The Board considered the record of Florence Matthews. Following a discussion, on motion made by Major Krome and seconded by Colonel Mitchell, the Board voted 8 - 1 to adopt the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law and denied Ms Florence Matthews' request for accidental disability retirement benefits. Chairman Dixon, Vice-Chairman Schaefer, Colonel Mitchell, Major Krome, Secretary Foster and Messrs Lancaster, Brown and Caple registered yea votes. Dr Alemi registered a nay vote.

James Hoffman The Board considered the record of James Hoffman. Following a discussion, on motion made by Colonel Mitchell and seconded by Mr Brown, the Board voted 7 - 2 to adopt the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law and denied Mr Hoffman's request for ordinary disability retirement benefits. Vice-Chairman Schaefer, Colonel Mitchell, Major Krome, Secretary Foster, Dr Alemi and Messrs Brown and Caple registered yea votes. Chairman Dixon and Mr Lancaster registered nay votes.

JoAnn McFee

The Board considered the record of JoAnn McFee. Following a discussion, on motion made by Dr. Alemi and seconded by Mr. Caple, the Board voted unanimously to adopt the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law and denied Ms. McFee's request for accidental disability benefits.

Executive  
Directors Report

5. Mr. Vaughn informed the Board that Maryland Charities Campaign was supposed to deliver their Pledge Packets to the Agency on August 20, 2001 to enable us to meet a target mail date of August 31, 2001. However, due to a delay in the delivery until September 13, 2001, by Maryland Charity of all the required documents, the vendor could not begin to insert the forms into the envelopes. The final delivery of the packets may now take until October 5, 2001.

Mr. Vaughn asked Ms. Carol Boykin to update the Board on the on the impact from the September 11, 2001 terrorist attacks.

Ms. Boykin provided the Board with an overview of the Trust's impact from the September 11, 2001 terrorist attacks. She distributed a 9-page handout, which covered the following topics: Exhibit A

- State Street Corporation's Continuity Planning Program
- Recent bond market changes as depicted by the U.S. Treasury yield curves on 9/10/01 and 9/19/01
- Recent equity market changes for the same period by index, sector and specific security
- Historic DJIA losses
- A summary of LaSalle's insurance coverage for real estate properties

Ms. Boykin began with an overview of the recent market response. She identified the areas of the stock market, which had been most dramatically impacted, and she noted that the bond market had initially risen but had subsequently declined. Interest rate increases were attributed to inflation fears, rebuilding costs and military cost expectations. She also noted fears of a recession as a negative impact and the potential for positive impact due to patriotic buying.

A market value estimate of \$26.4 billion as of September 18, 2001 was provided for the total plan compared to \$28.3 billion as of August 31, 2001, representing a decline of 6.7% for that period. Ms. Boykin noted that this decline was smaller than that of the broad equity markets, thanks to the benefits of diversification. She also stressed the fact that the System is a long-term investor, and she encouraged the Board to hold the course from an asset allocation perspective.

Ms Boykin next discussed areas that she had investigated for potential market disruptions. She noted that State Street had reported that all of the System's trades had settled in a timely and orderly manner during the affected period. She also informed the Board that the Custodial Bank has off-site back-up capabilities, as do most of the System's investment managers.

Mr Scribner provided an overview of State Street's Continuity Planning Program, as delineated on pages 1-4 of the handout. Overall, he said that it appeared that the plan was comprehensive.

Mr Lancaster asked what the impact could be to the System if State Street were to suffer personnel losses in addition to data losses. Ms Boykin responded by saying that the organization had both personnel and data in multiple locations. She also offered to provide a more complete answer for the Board.

Ms Boykin then informed the Board that the transition out of Harbor International and into the new domestic value managers was underway at the present time, and the disruption to the markets could cause the transition to take somewhat longer than normal. She also noted that the System was fortunate that 50% of the proceeds from Harbor would be in cash. In addition, a significant amount of the remaining balance of equities was expected to benefit from crossing opportunities through the Custodian.

Ms Boykin and her staff surveyed all of the System's investment managers. In terms of manager impact, several of the firms, which manage funds for the System did sustain personnel losses, but none had personnel losses within the ranks of the teams directly managing funds for the System. Advent, one of the System's convertible managers, was forced to temporarily relocate, but they have already returned to their headquarters. Three of the Chapman DEM MET managers had not responded yet, but none of them were headquartered in Manhattan.

Ms Boykin reported that unfortunately, there were several news reports of lost trading relationships. Brokerage firms who were impacted by loss of life and/or displacement from headquarters locations included Cantor Fitzgerald, May Davis, Lehman Brothers and Merrill Lynch.

Ms Boykin then provided an insurance overview for the System's direct Equity Real estate Program. The System does not own any properties in lower Manhattan. Property Casualty Insurance coverage via LaSalle Advisors amounts to \$200 million per property, which exceeds the value of any of the individual properties held in the System's direct program. LaSalle also carries a \$3 billion umbrella policy. Mr Lancaster asked additional questions about this coverage, and Ms Boykin offered to further research his questions and provide answers to the Board.

Mr. Brown asked about trading in puts by the terrorists, and another question was raised about the impact on international equity markets. Ms. Boykin offered to respond in more depth at a later date.

Mr. Vaughn asked Mr. Harrison to update the Board on the financial transactions of the System for the year ended June 30, 2001. Exhibit B

Mr. Harrison noted for the Board changes in the un-audited "Statements of Changes in Plan Net Assets for the fiscal year ended June 30, 2001 and 2000", and "Statements of Plan Net Assets as of June 30, 2001 and 2000". Contributions totaled \$824 million for the year, slightly less than last year. Investment Income totaled a negative \$3 billion for the fiscal year due primarily to depreciation of the value of investments. Deductions from plan assets totaled \$1.3 billion. The majority of which was to pay benefit payments. The Fund balance of \$33.1 billion for fiscal year 2000 decreased \$3.6 billion overall to yield to a fund balance at fiscal year 2001 of \$29.5 billion.

The Board reviewed and accepted the System's financial statements and investment performance comparisons for the period ending July 31, 2001 for the State Retirement and Pension System of Maryland.

The Board accepted Mr. Vaughn's report.

Executive  
Committee Report 6

Mr. William Brown, Chairman of the Executive Committee, reported on the regular meeting held September 11, 2001. Exhibit C

Mr. Brown advised the Board that members that legal staff had prepared draft language for review of five proposed bills to be included in the Board of Trustees 2002 legislative program. The five involved

1. Tax Related changes (415 limits)
2. Fee Cap exemption for external alternative investment managers.
3. Revisions related to earnings after receiving disability benefits (amendments to SPP 29-115)
4. Revisions to Options 2,3,5 and 6, concerning re-designating a beneficiary following the death of the original beneficiary.
5. Technical corrections for the payment of employee and employer contributions from the Boards of Supervisors of Elections.

Mr. Brown informed the Board that of the five proposals three of them still requiring revisions and would be held over until the October Executive Committee meeting, therefore two proposals would be discussed the before the Board.

Mr. Brown informed the Board that the tax proposal related to several technical revisions needed because of changes to regulations made by the Federal Government that impact public retirement systems. The first relates to eligible rollover distributions. Under a revised definition of eligible plans, the federal government has added 403(b) and 457 plans. Therefore, amending Maryland law will enhance portability.

The second issue relates to the purchase of service credits. Current law permits members to purchase up to 10 years of certain types of service credits at full cost (employee and employer costs). Federal regulations, however, may limit the purchase of service, in certain instances, to 5 years. During the Committee meeting Mr. Feinstein suggested the law reflect this limit so that members are not confused by the conflicts in the amount of time that is stated in Maryland's pension law.

Mr. Brown noted that during the committee meeting Mr. Carl Lancaster indicated that it seemed inappropriate to reduce our benefits, to reduce the current rights of a member. He suggested instead that the Board seek an exemption to this limit since it negatively impacts on our members. The Executive Committee concurred and asked that the draft be redone without this section. It will be resubmitted to the Committee in October.

Mr. Brown then informed the Board that in the last 2 years, the Board has hired 4 external investment managers who employ alternative investment strategies, such as limited partnerships investing in private equity, venture capital, leveraged buyouts, and opportunistic real estate development and rehabilitation. These investors have unique annual management fees based on committed capital as well as a percentage sharing of future profit. Each of the 4 current managers has a different management fee, and several have different profit sharing approaches. The concern is that potential excellent returns in the future could cause fees to exceed the cap, a situation that the Board does not want to occur. Mr. Brown noted that the proposal would remove the cap on fees for these alternative investment managers.

Mr. Brown then informed the board that Mr. Howard Pleines indicated to the Board that he had been advised by Legislative Services that the Board should seek technical corrections to Section 21-307 of State Personnel and Pensions. In this section, payment of employee and employer contributions is to be paid directly to the Board. However, in practice, the state generally receives these payments and then pays the Board. The technical corrections provide the flexibility to permit the current practice of payment by the State to the Retirement Agency of both employee and employer contributions to continue as well as to

permit a Board of Supervisors of Election to pay the Retirement Agency directly.

The Executive Committee agreed to accept these proposals. It also directed Mr. Feinstein to present revised drafts for the remaining 3 proposals at the October Executive Committee meeting.

Mr. Brown recommended to the Board of Trustees that its 2002 legislative package include proposals for the Alternative Manager Fees (elimination of the cap) and Technical Corrections for payment of Board of Supervisors of Election contributions. On motion made by Mr. Brown and seconded by Chairman Dixon the Board voted unanimously to include proposals for the Alternative Manager Fees and technical Corrections for payment of Board of Supervisors of Election contributions.

Mr. Brown stated that the Executive Committee had requested the cost to permit members of a pension system to transfer a vested retirement system account into their existing contributory pension system accounts. Mr. Brown then stated that Delegate Wheeler Baker had asked the Board to consider this issue because a teacher in his district found that she was not permitted to transfer and combine her accounts. She sought to combine her accounts so that she could retire after 30 years, rather than be required to continue to work until she reached normal retirement age (would not accrue 30 years in the contributory pension system on its own).

Mr. Brown then informed the Board that in the 1998 legislation that established the contributory pension systems, language had been added by the General Assembly to prohibit the transfer of benefits from a retirement system into a contributory pension system.

Mr. Brown noted that the Actuary had established a cost for permitting the transfer of 290 current members of the System who were active members of a pension system and held a vested retirement system account. There is an additional liability for the State of about \$9.04 million. Participating governmental Units would experience an increase of \$139,066.

Mr. Brown stated that based on these costs, the Executive Committee is reluctant to recommend legislative action to the Board. Instead, the Committee believes that it is more appropriate at this time to advise Delegate Baker that he may wish to pursue this matter on his own with the Joint Committee on Pensions.

Mr. Brown advised the Board that the Executive Committee recommended that it not seek legislation to permit members of the contributory pension systems to transfer service credits from a retirement system to combine their accounts. Furthermore, the

Retirement Agency is directed to advise Delegate Wheeler Baker of its decision and provide him with all of the information, including the actuarial costs, on which the decision was based. On motion made by Mr. Brown and seconded by Secretary Foster, the Board voted unanimously not to seek legislation to permit members of the contributory pension systems to transfer service credits from a retirement system to combine their accounts.

Mr. Brown reported that Mr. Peter Vaughn had received 4 additional requests from members of the State Police Retirement System and the Law Enforcement Officers Pension System to appeal the denial of their participation or length of participation in the Deferred Retirement Option Program (DROP). Those members are Kenneth L. Thrasher, State Police Retirement System, Earl P. Copenhaver, Morris E. Jones, and William F. Simmons, Law Enforcement Officers Pension System.

Mr. Brown stated that the Retirement Agency was following the law that establishes specific requirements for participation in DROP. He noted that agreeing to the requests would violate the law. Therefore he asked the Committee to uphold his denial for a hearing.

Major Krome suggested that the Committee approve the denial of the four requests for hearings and give Mr. Vaughn approval to deny all similar cases received in the future.

Mr. Feinstein stated that it would be important to still present the evidence and denial letter for each future request for appeal since it is highly likely that these members will be involved in a class action suit against the Retirement Agency.

Mr. Brown reported that the Executive Committee recommends to the Board approve Mr. Vaughn's denial of a hearing for Kenneth L. Thrasher, Earl P. Copenhaver, Morris E. Jones, and William F. Simmons. On motion made by Mr. Brown and duly seconded, the Board voted unanimously to deny hearing for Kenneth L. Thrasher, Earl P. Copenhaver, Morris E. Jones, and William F. Simmons.

Mr. Brown asked Mr. Gary Scribner to address the Board to give the monthly Strategic System update.

Mr. Gary Scribner informed the Board. Since May of this year, Syscom states that it has completed an estimated 95% of the Strategic System's software coding.

The Agency and Syscom have expressed divergent views on the depth, breadth and documentation of testing. However, documentation standards have been established and accepted. Test coverage is still an issue. Both the Agency and Syscom did an in depth study of one testing scenario for enrollment, it was determined that between 140-150

test items were required for this test area

The Agency has determined that it is prudent to test all business process logic and rules, which includes compliance with all necessary laws and regulations including specific Pension articles in the Statute and COMAR. In addition, Agency-necessary business practice, in many cases, must be tested. Testing accomplishes two missions in doing so. Testing determines that business processes correctly specified do indeed work as designed, and identifies discrepancies in specifications and actual program logic which has resulted in an errantly designed process.

The RFP for the system contains approximately 3700 separate requirements, many of which must be cross-referenced to a testing plan to ensure the system's compliance with the requirement.

Syscom presented, on September 5, 2001, a draft plan for a new deliverable titled "Comprehensive Integration Testing", dubbed CIT. As defined by Syscom, this proposed deliverable would consist of approximately 6000 test cases, to be planned, executed and documented at a cost of approximately \$8 million. The Steering Committee is not in agreement with this proposal. The Steering Committee believes that a substantial number of tests that Syscom intends to include in this new CIT deliverable would have been included in a properly designed WDM integration test plan, and/or System test plan. The Steering Committee also believes that 4-5 fold increase in cost per test over what was incurred for prior testing efforts is excessive, even with the industry-standard test documentation standards demanded by the Agency. In addition, the Steering Committee understands that the business rule and process testing requirements would have required the level of coverage intended for Syscom's original System test phase, since there was minimal testing of this type in testing deliverables submitted to date.

Syscom indicated that their System test plan would include approximately 2900 test cases, the Steering Committee believes there must be duplication or overlap of these 2900 with the 6,000 CIT test cases that are being estimated.

Based on this discrepancy and difference of opinion over test coverage, Syscom has agreed to develop, with Agency participation, a testing risk assessment which will form a foundation for effective test coverage strategy. The risk assessment will lead to an exercise in risk mitigation i.e. how to mitigate or reduce the impact of not testing certain test cases.

The timeframe estimate submitted by Syscom for completion (to plan, build, execute, document and report) of the CIT tests only is November 2002. After completion of this new phase, Syscom must complete other elements of testing in a System test phase such as cradle to grave

testing, payroll parallel "run" testing, performance and capacity testing, etc. In addition, the Agency must complete whatever User Acceptance Tests it deems are necessary based on the results received during CIT/System testing.

Based on these facts, the Steering Committee anticipates that data conversion and scrubbing will be conducted after FY2003 is completed (July 2003), with a go-live period of September-October 2003.

The positives of the situation are the Steering Committee firmly believes that Syscom is dedicated to getting the project done, Syscom has many business reasons to do so, and certain components of the System have successfully been completed such as the imaging system.

The Board accepted Mr Brown's report.

Audit Committee  
Report

7 Mr. William D. Brown, Chairman of the Audit Committee, reported on the Committee's meeting held on July 20, 2001. Exhibit D

Mr. Brown reported that Ms. Carol Boykin, Chief Investment Officer, had recently responded to the Internal Audit Division's draft reports in these three areas. Upon incorporating the Investment Division's responses, final reports would be issued.

Mr. Brown stated that Internal Audit Division had completed three additional PGU reviews: the City of Takoma Park, the City of New Carrollton, and the Caroline County Board of Education. Several minor errors were noted at each location.

Mr. Brown noted that during the committee meeting Dr. Alemi asked if corrective measures were taken when errors were discovered. Mr. Gigliotti answered that, before an audit is completed, agreement is usually reached with the audit regarding any exceptions noted and the necessary corrective actions.

Mr. Brown informed the Board that Internal Audit Division was planning to perform a review of the Agency's Strategic System. The first part of that review would be an assessment of Syscom's unit test plan and test results. It was anticipated that the review would clarify some of the Agency's concerns about the adequacy and completeness of Syscom's unit testing, and also provide documentation of any deficiencies noted.

Mr. Brown stated that Brown & Company is required to maintain a 20% performance bond throughout their contract. Their surety, Amwest Surety Insurance Company of Nebraska, was declared insolvent, upon notification of termination of their bond, Brown & Company applied for a new bond with Hartford Insurance.

Mr Brown also noted that Mr Bruce Harrison asked about determining the financial viability of a surety who provides a performance bond required by a State contract

Mr Brown informed the Board that Mr Gighotti noted that he had sent a letter to each of the local education agencies notifying them of the upcoming audits, and had also sent them updated guidelines for determining the eligibility of employer retirement contributions for state reimbursement Lindsey & Salita had completed five audits to-date, and had also developed a schedule to complete all of the required audits during the 10-month contract period

Mr Brown informed the Board that the next Audit Committee meeting is scheduled for Thursday, September 20, 2001, immediately following the meeting of the Board of Trustees

The Board accepted Mr Brown's report

Medical Board Reports

8

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

Exhibit E

Supplemental Board

9

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

Exhibit F

Other Business

10

The Board in an attempt to resolve the conflict over awarding disability claimants accidental disability despite their pre-existing conditions, which some board members contend are within the expected health conditions of the aging population, directed staff to conduct a survey regarding how other States handle the issue of Ordinary and Accidental disability, to try to determine whether the current law is too restrictive. The results of the survey are to be presented to the Executive Committee

There being no further business, on motion made and duly seconded,  
the Board adjourned at 12 30 p m

Respectfully submitted,

Peter Vaughn, Secretary