

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

MINUTES OF MEETING

January 21, 2003

The Board of Trustees for the State Retirement and Pension System of Maryland met in the Boardroom of the SunTrust Building 120 East Baltimore Street, Baltimore, Maryland, at 9:30 a.m. There were present Chairman William Donald Schaefer, Vice Chairman Nancy K. Kopp, Secretary James DiPaula, Dr. Nancy Grasmick (arrived 10:15 a.m.), Arthur N. Caple, Jr., Debra Humphries, William D. Brown, Carl D. Lancaster, Colonel Edward Norris, Major Morris L. Krome, G. Bruce Harrison, and Dr. Ali Alemu, Trustees, and Margaret A. Bury, Retirement Administrator. Agency Staff members also attending were Deborah Bacharach, Robert Feinstein, and Carla Katzenberg. Assistant Attorneys General, Carol Boykin, Chief Investment Officer, Rick Harrison, Chief Financial Officer, Howard Pleines, Legislative Director, Sherlyn Matesky, Deputy Legislative Director, Thomas Gighotti, Chief Internal Auditor, Gary Scribner, Chief Information Officer, and Gwen Mulkey, Executive Associate.

Also present were Mary Jo Neville, Maryland State Teachers Association, F. Richard Crowther, Maryland Classified Employees Association, Anne Gawthrop, Department of Legislative Services, Robert Dezube, of Millman USA, Irvin Sebree, Lucille Moore, and Dean Kenderdine, Office of the Comptroller.

Prior to considering agenda items, Chairman Schaefer stated that the Board intended to move quickly in the hiring of a new Executive Director. Chairman Schaefer further stated that Ms. Bury would be responsible for any decisions or actions that the Executive Director would normally handle until a candidate for that position is selected. Chairman Schaefer then welcomed two new members to the Board, Secretary DiPaula and Colonel Norris. Chairman Schaefer ended his opening remarks by noting that there is a new administration and that the Board wants to work with the new Governor to aid in his success.

Vice-Chairman Kopp informed the Board that Chairman Schaefer asked her to convene a small group of Trustees consisting of Dr. Grasmick, Mr. Harrison, Mr. Brown, and herself, to monitor the progress of the search for a new Executive Director. Vice-Chairman Kopp stated that a job description had been developed which included goals for the next six to nine months. Finally, Vice-Chairman Kopp stated that the Board would conduct an aggressive search with the goal of selecting a new Executive Director by the end of February.

On an unrelated matter, Mr. Caple inquired as to who creates the Agency newsletter. Ms. Bury answered her staff. The Board suggested that Mr. Coale be involved in the publishing of the newsletter.

Minutes

1 On motion made by Mr. Caple and seconded by Dr. Alemu, the Minutes of the regular meeting of the Board of Trustees for the State Retirement and Pension System of Maryland, held on December 17, 2002, were unanimously approved

Irvin Sebree

2 The Board considered the report of the Administrative Law Judge in connection with the claim of Irvin Sebree, for accidental disability benefits. The report included a report by the Medical Board and all related documentation submitted by parties to the Administrative Law Judge are presented.

A Union representative addressed the Board on behalf of Mr. Sebree, presenting Mr. Sebree's opposition to 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. Following discussion, the Board deferred further consideration to Executive Session.

Michael Carter

3 The Board considered the report of the Administrative Law Judge in connection with the claim of Michael Carter, for accidental disability benefits. The report included a report by the Medical Board and all related documentation submitted by parties to the Administrative Law Judge are presented.

Mr. Carter's case was heard on the record. Ms. Carla Katzenberg, attorney for the Agency, addressed the Board and argued that the Board should adopt the Administrative Law Judge's recommendations. Following discussion, the Board deferred further consideration to Executive Session.

Lucille Moore

4 The Board considered the report of the Medical Board in connection with the claim of Lucille Moore for accidental disability benefits. The Medical Board report included a report by the Administrative Law Judge and related medical documentation. The Medical Board, based on the evidence submitted, did not find any objective evidence to substantiate Ms. Moore's claim for disability retirement and cannot find that Ms. Moore is disabled from further performance of duty. Ms. Moore appealed the Medical Board's decision.

Ms. Moore appeared before the Board and presented her arguments opposing positions of the Agency and the Medical Board. Ms. Carla Katzenberg, 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.

Investment Committee 5
Report and
Recommendations

Mr. Arthur Caple, Chairman of the Investment Committee, reported on the meeting held on January 10, 2003.

Ms. Bacharach and Mr. Feinstein summarized their October 29, 2002 memo titled, "Manager Searches." Ms. Humphries referred the issue of next steps back to the Minority Subcommittee.

The Investment Committee reviewed EnnisKnupp's framework for evaluating investment managers. This includes a modification of the Watch List process. Changes focus on making this process more systematic. Managers will be ranked in each of the following 4 categories: performance, organization, perceived skill, and other. The rankings will be color-coded. A manager will be placed on the watch list if they receive a "red" in one of the 4 categories or if they do not score "green" in any category. Termination will be considered if a manager receives a score of "red" in 2 or more categories and/or a manager has been on the watch list for more than 12 months with the same concern. EnnisKnupp's watch list report will be sent under a confidential envelope as part of the monthly Investment Committee mailing. Staff will supplement EnnisKnupp's report with another report, which shows additional pertinent information and opinions on the managers. Staff will also produce a monthly report, showing peer results for managers. Treasurer Kopp expressed interest in confidentiality for the EnnisKnupp manager evaluations. She noted that this framework is a helpful tool, and she advised against over-simplification.

The Investment Committee approved renewal of the System's securities lending contract with State Street for a one-year period. Mr. Caple moved that the Board adopt this renewal. The motion was seconded by Mr. Harrison, and it passed unanimously.

The Committee received feedback from EnnisKnupp regarding the use of fund of funds. EnnisKnupp said that fund of funds are not necessary to carry out the objectives of the pension plan. However, they prefer to continue to use fund of funds in the event that the System chooses to continue to invest in private equity and/or emerging managers. EnnisKnupp stressed that their opinion was predicated upon a legal opinion supporting the use of fund of funds in Maryland.

Mr. Caple reviewed the System's history with the use of fund of funds. He noted that fund of funds managers had been used as gatekeepers for the System's minority manager program. He said that fund of funds managers had been employed out of a recognition that staff did not have adequate resources to oversee the minority manager program, since there were many emerging managers in this program.

Comptroller Schaefer stressed that the Board's number one objective for investing is to make money

Mr Brown reported on the Executive Committee held on January 7, 2003

Attachment A

Mr Brown reported that the expenses for November 2002, reflect the anticipated cost of the fiduciary audit contract for \$256,000. He noted that the contract with Cortex has not been finalized. It is possible that meetings originally scheduled to take place in our offices can be conducted by telephone. If that occurs, the cost of the contract should be reduced.

Mr Brown noted that the Retirement Agency had received a request from St Mary's County library to participate in the System's Pickup program. Mr Brown stated that the library had obtained a favorable letter ruling from the Internal Revenue Service and is working with Agency staff to begin the pickup of employee contributions. The Board is required to approve the library's participation as the final step in the process.

The Executive Committee recommends to the Board of Trustees that it approve the participation of the St Mary's County Library in the System's Employer Pickup Program. On motion made by Mr Brown and seconded by Major Krome, the Board voted unanimously to approve the participation of the St Mary's County Library in the System's Employer Pickup Program.

Mr Brown informed the Board that Dr Morton Rapoport, CEO of the University of Maryland Medical System (UMMS), initiated the discussions of funding issues pertaining to the withdrawal liability owed by UMMS. The Maryland General Assembly created UMMS in 1984 when it privatized the University Hospital.

Employees hired after July 1, 1984 are employees of the private corporation. Employees hired prior to this date remained State employees for purposes of salary, fringe benefits and pension. This created two personnel systems, with the State employees generally receiving greater salaries and benefits than the UMMS employees.

Between 1984 and 1989, the difficulties, and costs, of operating two personnel systems continued to grow. In 1989, the State agreed to an incentive program (VIP-Voluntary Incentive Program) to encourage State employees to leave the State personnel system and become covered by the UMMS personnel system. Employees who accepted this program became UMMS employees relating to salary and most benefits. They were permitted to retain their membership in the State Employees' Retirement and Pension System.

From 1984 until 1991, UMMS received funding from the State to cover the so-called 'pension gap'. This funding was phased out between 1992 and 1996 because of the State's own budgetary problems.

In 2001, UMMS hired Buck Consultants to analyze UMMS's pension liabilities. Buck found that UMMS had over funded its pension costs primarily due to a high assumption on salary growth. UMMS then approached Treasurer Richard Dixon on the possible reduction of future UMMS pension costs. The Treasurer sought advice from legislative leaders (Senator Hoffman and Delegate Rawlings) who in turn requested the Department of Legislative Services (DLS) to review and report its findings to the General Assembly.

Staff from DLS prepared an independent analysis of UMMS's request. The conclusion reached is that some form of relief is warranted based on the State's initial commitment to fund the "pension gap".

The Executive Committee asked Ms. Bury to have Milliman USA review the Buck report to determine if our actuary concurs with Buck's findings. He asked that this review be completed immediately so that Milliman and staff could report back to the Executive Committee as quickly as possible.

Mr. Brown indicated to the Board that it is imperative for a decision to be made on extending the existing actuarial contract with Milliman USA or initiating an RFP for a new contract. He noted that the Trustees had received a memorandum from Ms. Bacharach on several options available. Ms. Bacharach had concluded that the Board could extend the current contract for a year, rebid the contract now, or rebid the contract while retaining the right to extend the existing contract. Mr. Brown indicated that while possible, the third option appeared impractical.

Mr. Brown informed the Board that the Executive Committee agreed to recommend that the existing actuarial contract with Milliman USA be extended for one-year under the terms of the existing contract. Mr. Brown made a motion seconded by Dr. Alem to extend the one-year contract with Milliman USA under the terms of the existing contract. Prior to completing the vote, the Board held a discussion on the motion.

Ms. Humphries asked why the Board should extend the current contract with Milliman USA when many of the employees at Milliman who worked on SRA's account are no longer employed with the company.

Ms. Bury stated that not everyone at Milliman who was working on the SRA account left the firm. Mr. Robert Dezube worked on the account, and that in actuality Mr. Gene Kalwarski had not worked directly on SRA's account in recent years. Ms. Bury further stated that the Milliman contract always had two one-year renewal clauses.

Dr. Alemi stated that Milliman USA, like many large firms, want to limit liabilities. Dr. Alemi further stated that if the contract is renewed there should be no liability limits. Dr. Alemi also expressed concern over Mr. Kalwarski's litigation against Milliman USA. Dr. Alemi stated that the contract should be renewed for one year to see what happens.

Mr. Brown restated the motion to extend the one-year contract with Milliman USA under the terms of the existing contract.

Mr. Lancaster amended the original motion to add a RFP at the end of the one-year period to re-bid the actuarial contract.

The Board questioned if an amendment was necessary since the amendment could limit the Board's options at the end of the year.

Mr. Lancaster withdrew his amendment.

On a motion made by Mr. Brown and seconded by Dr. Alemi the Board voted to extend the one-year contract with Milliman USA under the terms of the existing contract with a vote of 11 to 1. Chairman Schaefer, Vice Chairman Kopp, Secretary DiPaula, Dr. Grasmuck, Colonel Norris, Dr. Alemi, Ms. Humphries, and Messrs. Caple, Brown, Harrison, and Mr. Lancaster registered yeas. Major Krome registered a nay vote.

The Board deferred discussion of the Strategic System to Executive Session.

The Board accepted Mr. Brown's report.

Retirement 7
Administrator's
Report

Ms. Bury reported that retirees will receive a 1.583 Cost of Living Adjustment effective July 1, 2003. Attachment B.

Ms. Bury then gave the Board an EFT update. She stated that in 1994 the Board adopted a policy of mandatory direct deposit. In the policy, the Board provided for a waiver of the mandatory deposit based on hardship that would be approved by the Executive Director. Ms. Bury believed that because of recent problems at the post office, it is time to extend mandatory direct deposit to all retirees. After discussion, the Board agreed to refer the matter to the Executive Committee.

Ms. Bury asked Mr. Feinstein to review the revised draft of the Board's proposed securities class action litigation policy statement. Mr. Feinstein noted that after the Board's Fall 2002 retreat, the Board had directed staff and the Office of the Attorney General to put together a comprehensive statement setting forth proposed policies regarding securities class action litigation. The policy, which had been distributed to the Board in October, 2002 and redistributed with revisions in November, 2002, offers a three-part program for dealing with securities class action litigation. First, initial identification by a "claims monitor" of all new securities class action

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litigation affecting the System. Second, a more in depth assessment by a "claim evaluator" of those claims where the System's damages are estimated to exceed \$10 million. Third, more active participation by the System in class action litigation, where warranted. Mr Feinstein noted that the policy contemplates that the services of claims monitor, claim evaluator and securities litigation counsel will be provided by third parties selected through the procurement process. Mr Feinstein also reviewed for the Board the estimated costs which would be incurred if this policy were to be adopted and implemented. After discussion, on a motion made by Mr Brown and seconded by Dr Alemi the Board voted unanimously to adopt the class action litigation policy statement.

Vice Chairman Kopp asked Ms Bury to have Mr Coale prepare an article on the new class action litigation policy.

The Board accepted Ms Bury's report.

Committee and
Sub-Committee Reports
and Recommendations

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Vice Chairman Kopp stated that Joe Coale is working hard to improve communications.

Mr Harrison stated that on behalf of the Benefits Improvement Committee, he wrote a letter to Governor Ehrlich regarding the level of benefits provided and is awaiting a response to his letter. Attachment C

Medical Board
Reports

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On a motion by Mr Brown and seconded by Mr Caple, the Board accepted the reports of the Medical Board in connection with applications of members for ordinary, accidental, and special retirement allowances. Major Krome voted no on Mr Shaw and Mr Poist. Attachment D

Supplemental Medical
Reports

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On a motion by Mr Lancaster and seconded by Mr Brown, the Board accepted the supplemental reports of the Medical Board in connection with applications of members for ordinary, accidental and special retirement allowances. Attachment E

On a motion made by Mr Brown and seconded by Major Krome, the Board voted unanimously to meet in Executive Session, to consider the following matters: deliberations regarding the disability appeals, obtain legal advice and discussion with staff and counsel regarding potential litigation. State Govt Article, Section 10-503(a)(1) authorizes the Board to meet in closed session to exercise a quasi-judicial function. Section 10-508(a)(7) authorizes the Board to meet in closed session to obtain legal advice, and Section 10-508(a)(8) authorizes the Board to meet in closed session to consult with staff or other individuals about pending or potential litigation.

EXECUTIVE SESSION

The Board met in Executive Session at 1:00 p.m. in the Boardroom of the SunTrust Building at 120 East Baltimore Street to consider the appeals of Irvin Sebree, Michael Carter and Lucille Moore, and to discuss pending or potential litigation, to obtain legal advice. All of the persons present at the beginning of the meeting were present in Executive Session except the following: Mary Jo Neville, Maryland State Teachers Association, F. Richard Crowther, Maryland Classified Employees Association, Anne Gawthrop, Department of Legislative Services, Robert Dezube, of Milliman USA, Irvin Sebree, Lucille Moore. The Board adjourned its Executive Session at 2:07 p.m. and returned to regular session to complete the agenda.

REGULAR SESSION

On a motion made by Dr. Alemi and seconded by Major Krome the board voted to ratify all actions taken during Executive Session.

Irvin Sebree

The Board considered the record of Irvin Sebree. Following a discussion, Dr. Alemi made the motion, to reject the Administrative Law Judge's decision and grant Mr. Sebree accidental disability benefits. There being no second, the motion failed. On a motion made by Mr. Harrison and seconded by Mr. Brown, the Board voted to adopt the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law and deny Mr. Sebree's request for accidental disability with a vote of 11 to 1. Chairman Schaefer, Vice Chairman Kopp, Secretary DiPaula, Dr. Grasmick, Colonel Norris and Major Krome, Ms. Humphries, and Messrs. Caple, Brown, Harrison, and Mr. Lancaster registered yea votes. Dr. Alemi registered a nay vote.

Michael Carter

The Board considered the record of Michael Carter. Following a discussion, on a motion made by Mr. Brown and seconded by Mr. Harrison, the Board voted unanimously to accept the Administrative Law Judge's Proposed Findings of Fact and Conclusions of Law and deny Mr. Carter's request for accidental disability retirement benefits.

Lucille Moore

The Board considered the record of Lucille Moore. Following a discussion, on a motion made by Ms. Humphries and seconded by Mr. Brown, the Board voted unanimously to remand the case of Lucille Moore to the Medical Board for further consideration.

On a motion made by Dr. Alemi and seconded by Mr. Brown, the Board voted unanimously to approve the December 17, 2002, Executive Session Minutes.

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- Other Business 11 Chairman Schaefer appointed Secretary DiPaula and Colonel Norris to the Executive Committee
- Adjournment 12 There being no further business, the meeting adjourned at 2 20 p m

Margaret A Bury
Retirement Administrator