

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

MINUTES OF MEETING

March 18, 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 Dr. Nancy Grasmick, Arthur N. Caple Jr., Debra Humphries, William D. Brown, Carl D. Lancaster, Major Morris L. Krome, G. Bruce Harrison, and Dr. Ali Alemi, Trustees, and Dean Kenderdine, Acting Secretary to the Board. Agency Staff members also attending were Margaret A. Bury, Retirement Administrator, Deborah Bacharach, Robert Feinstein, Assistant Attorneys General, Carol Boykin, Chief Investment Officer, Rick Harrison, Chief Financial Officer, Howard Pleines, Legislative Director, Thomas Gighotti, Chief Internal Auditor, Gary Scribner, Chief Information Officer, Gwen Mulkey, Executive Associate, Cathy Clevinger, Revenue Administrator.

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| Minutes | 1 | On motion made by Bruce Harrison and seconded by Art Caple, the Minutes of the regular meeting of the Board of Trustees for the State Retirement and Pension System of Maryland, held on February 27, 2003, were unanimously approved with amendments. |
| Milliman USA Presentation | 2 | <p>Mr. Robert Dezube and Mr. William Reimert of Milliman, USA made a presentation for the Board on the principal results of their five year experience study of actuarial assumptions used since 1997. The handout that was provided contained sections on scope, mortality, disability, withdrawal, retirement, salary, investments, and COLAs.</p> <p>After the presentation, there was a question and answer period wherein Board members asked several questions concerning how Milliman arrived at their figures and the inflation assumption. Mr. Harrison pointed to the status of the State Police Retirement system, that it is more than fully funded and that its status is the result of the contribution rate of State Troopers. Mr. Harrison asked the Milliman representatives how they arrived at their more aggressive assumptions. Mr. Harrison added that he understood that EnnisKnupp considers the Milliman methods very aggressive. Mr. Reimert stated that they did share their study with Mr. Roland Davis of EnnisKnupp and that the difference between their two positions is largely attributable to an inflation assumption by EnnisKnupp of 2.6% vs. 3.0% by Milliman.</p> |

Mr Lancaster asked about the underlying facts supporting current salary assumptions. In particular, he wondered why judges' salary increase assumptions were cut in half. Mr Lancaster further asserted that the General Assembly had granted the legislators a 38% salary increase over the next several years, yet the Milliman salary assumptions were 1/3 less than that amount. Milliman explained that they only consider data from the previous five years under review and the trends that data creates. Milliman added that if the Board wished to have other data considered in future five year experience studies, they will certainly honor that request. Of course, any consideration of additional data will effect Milliman's conclusions.

Treasurer Kopp asked if Milliman would make this same presentation to the Joint Pension Committee. Milliman responded that they would be happy to do so.

Mr Harrison wanted clarification as to how they came up with the different rates for the State Police and LEOP's when they both belong to the same union and collective bargaining group. Milliman stated that it is a problem to separate the two groups since LEOP's is a relatively new system. Mr Harrison felt it was more realistic to put the two systems together. Treasurer Kopp stated that a special effort was made seven years ago on behalf of the State Police with regard to salaries. Mr Harrison asked what the impact would be of changing the current assumption and combining State Police and LEOP's. Milliman replied that this would require further analysis and they would have to respond at a later date.

Mr Lancaster asked Milliman to do an expanded calculation to include a proposed investment return assumption rate of 7.25% and what its impact would be not only for next year, but for several years into the future. Milliman stated that they did not have an answer but would be happy to get back to the Board with a response. Major Krome wanted to know why there was such a huge change when you're only talking about a quarter percent interest. Milliman stated that it is a rule of thumb, changing the interest rate by 1/4%, which generally results in about a 5% increase in liabilities.

Mr Caple described the three main goals of the system, 1) to payoff unfunded liability, 2) to keep the system sound, and 3) to keep employer costs relatively level. Major Krome stated that the decisions made by the Board of Trustees in the past have kept the employer rate low and if it had not been for their good decisions in this regard, rates may have been as high as 20%, to which Milliman agreed. In fact, the rates were about 14.3% in Fiscal Year 1990 and are now down from that level by about 50%.

Mr Caple then inquired about Milliman's assessment of the recent Wilshire study which found the Maryland system to be 78% funded. This conflicts with Milliman's conclusion that the Maryland system is 94% funded. Milliman explained that the Wilshire study is flawed in that it compared states' funding levels using different fiscal year data. For example, Maryland was evaluated on the basis of its June 30, 2002 data, whereas Virginia was evaluated on their 1999 Fiscal Year data. Second, the Wilshire study determines the funding status of current assets against our long-term obligations without taking into account future contributions and investment returns. Milliman and all actuarial assumptions account for those other variables.

Being that the Milliman USA representatives did not have all the information with them to answer questions to the satisfaction of some Board members, the Milliman handout was collected and no action will be considered until June.

Investment Committee 3
Report and Recommendations

Mr Arthur Caple, Chairman of the Investment Committee, reported on the meeting held on March 14, 2003. Mr Caple reviewed the actions taken at the March 14, 2003 Investment Committee meeting, including the following items:

- a. TCW made a presentation in light of the fact that they are on the Watch List. Staff will follow up by preparing charts showing the cyclical nature of TCW's performance and asset value. No action required.
- b. EnnisKnupp reviewed the way in which they will assist the Investment Operations Manual Subcommittee and Staff in completing the revisions to the Investment Operations Manual. This is scheduled to be complete by September 2003. EnnisKnupp stated that the Subcommittee has already completed the revisions of the Operations Manual that were most needed, and most of the remainder should be able to be finalized with modest revisions.
- c. Staff requested input on a proxy issue prior to completing the updated version of the proxy policy since proxy season is under way. The Committee voted to uphold its policy of opposing re-pricing of stock options, and it included options for non-executive employees in this decision. At present, the policy only applies to executive stock options. On a motion by Mr Caple, which was seconded by Major Krome, the Board voted unanimously to follow the Investment Committee's recommendation on this matter.
- d. The Committee approved the open minutes from its January and February meetings. It also approved the closed minutes from its November, December, January and February meetings. The following minutes were approved as amended: November closed, December closed, and February open and closed.

c The Committee was appraised of a letter written by Mr Riven to the co-chairs of the JPC. The topic was the impact of the transition on the fee cap. Staff believes that Mr Riven's comments could be misinterpreted, and they will draft a letter of response to the co-chairs of the JPC. I will be glad to explain the impact if misinterpreted in the event any Trustee wants further explanation.

Executive
Committee Report

4 No report presented

Acting Executive
Director's Report

5 Mr Kenderdine reported that Trustee David Rakes submitted his resignation from the Board and shared a copy of Mr Rakes' letter of resignation, dated March 12, 2003.

The next item Mr Kenderdine presented was a plan for the implementation of a new Strategic Information System. It is intended that this document will give all Trustees a "road map" which will guide this implementation as well as ensure adequate internal controls over the project. Mr Kenderdine distributed a draft letter from himself to Senator Kasemeyer and Delegate James concerning the agencies' fee cap. This letter was prompted by a letter from Matt Riven to the Joint Pension Committee which had the potential of being misinterpreted. As a result of the agency increasing its externally managed indexed assets and decreasing its external actively managed assets, there is a decline in fee costs of approximately 2.8 million dollars per year. Mr Riven's apparent intent was to show that the asset reallocation has resulted in more room under the 30 basis point fee cap and enables the agency to hire more managers with high fees. Mr Kenderdine's letter stresses the fact that the agency is committed to controlling fees and managing its assets in the most cost effective manner.

Mr Kenderdine discussed SB 340, Senator Hogan's bill to create a "Maryland Technology Investment Program". While the Board has not taken a position on this bill, Ms Boykin and Mr Feinstein have written a memo outlining their concerns should this measure pass the General Assembly. Mr Kenderdine has written to Senator Hogan and shared a copy of this memo. The letter also restates the agencies' interest in working with the Legislature on the entire matter of private equity investments.

Mr Kenderdine reported on the status of SB 721, the legislation submitted by Senator Kasemeyer and intended to reform the Board of Trustees. The bill has been amended so as to restore the election of Trustees who represent State employees, Teachers and State Police. A second amendment eliminates the current three public members of the Investment Committee and replaces them with the three new gubernatorially appointed Trustees. (These three new Trustees take the place of the Superintendent of Schools, the Superintendent of State Police, and one State Police representative, all of whom would be eliminated from the Board by this bill.) A third amendment creates a benefits commission to be composed of one State Senator, one Delegate and five individuals.

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appointed by the governor. In addition to assessing retirement benefits, this Commission is also charged with evaluating the level of health benefits. This will prove extremely difficult given the multitude of employers participating in the system and their many different health insurance programs.

Major Krome spoke to the matter of SB 721. He thanked Mr. Lancaster for his support of the Maryland State Police during Mr. Lancaster's testimony before the Senate. Major Krome indicated several questions remained as to how this law, if enacted, would be implemented. For example, if it is necessary for one State Police representative to step down, which Trustee will it be and who decides? Major Krome challenged the rationale behind the elimination of one State Police Trustee stating that the issue of disparity in employee group representation had never been an issue before. Major Krome restated his point that he and Corporal Harrison have represented the interests of all members and retirees with honesty and integrity. Major Krome expressed his disappointment that no one has defended the right of the State Police to have two representatives on the Board. Major Krome expressed concern that this bill would shift the balance of power on the Board in favor of the governor and, thereby, its independence. Major Krome concluded by asking for support of the State Police, particularly from the Comptroller and the Treasurer.

Chairman Schaefer acknowledged that he had not taken a position on this bill and stated that he would discuss the matter further with the Treasurer.

Treasurer Kopp expressed her concern that the Investment Committee would lose the benefit of its three public members, adding that Mr. Shaner and Mr. Schaefer and other previous public members have brought great value to the Investment Committee's deliberations. The Treasurer recommended that the legislators who are pushing this initiative be advised of the talent that the agency will lose if Mr. Shaner and Mr. Schaefer are forced to step down. Treasurer Kopp also expressed reservations about the new governor appointees being able to manage the workload of the Board plus the Investment Committee.

Mr. Lancaster stated that he is not opposed to everything in the bill, but that the bill is flawed and with these additional amendments feels it is moving in the wrong direction. The bill is encumbered with a lot of things that are not well thought out. Mr. Lancaster recommends that it would be best for this bill to be tabled for the time being while the Board's current initiatives to improve asset management and agency performance are given time. Chairman Schaefer reminded the Board of the events that prompted the legislature to act. The events surrounding Nathan Chapman is what has been driving this effort. The legislature is in a position of having to show their constituents that they have done something in response to publicity the agency has received over the last year. He reminded the Board that the agency has done a lot of good but that it has not been communicated well enough to the legislature. Mr. Harrison concurred that this bill would throw the balance of power into the governor's office.

Mr Tydings expressed his concern that the three public members of the Investment Committee represent the "institutional memory" of the Board and are of great value because they remember what was done, why and how. Treasurer Kopp also acknowledged that the legislature needs to show they have done something and reminded the Board that the legislature represents Maryland's taxpayers who have serious concerns about the State Retirement Agency as reflected in media reports. Mr Brown agreed that greater effort needs to be put forth to set the record straight with the General Assembly.

Audit Committee Report

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No report presented

Committee and Sub-Committee Reports and Recommendations

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Treasurer Kopp stated that due to the resignation of David Rakes from the Board of Trustees, a replacement will have to be named.

Mr Harrison had no news to report on behalf of the Benefits Improvement Committee.

2003 Proposed Legislation

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Mr Pleines offered to answer questions regarding any other legislation pending before the General Assembly. The Trustees had no questions.

Medical Board Report

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On a motion by Dr. Alemu and seconded by Mr. Caple, the Board accepted the Medical Board reports in connection with applications of members for ordinary, accidental and special retirement allowances.

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.

On a motion made by Mr. Caple and seconded by Mr. Brown, the Board voted unanimously to meet in Executive Session, to consider the following matters: deliberations regarding the appointment of a public member to the Investment Committee, obtain legal advice and consultation regarding pending or potential litigation, the investment of public funds, personnel matters, the exercise of an executive function and the discussion of a confidential report. **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.**

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EXECUTIVE SESSION

The Board met in Executive Session at 11:45 a.m. in the Boardroom of the SunTrust Building at 120 East Baltimore Street to discuss pending or potential litigation, to obtain legal advice. All Board members present at the beginning of the meeting were present in Executive Session. The Board adjourned its Executive Session at 12:30 p.m. and returned to regular session to complete the agenda.

REGULAR SESSION

On a motion made by Dr. Alemi and seconded by Mr. Brown, the Board voted to ratify all actions taken during Executive Session.

On a motion made by Dr. Alemi and seconded by Mr. Caple, the Board voted unanimously to approve the February 27, 2003, Executive Session Minutes.

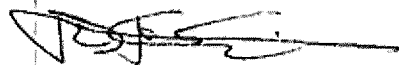
Other Business

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Adjournment

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There being no further business, the meeting adjourned at 1:10 p.m.



Dean Kenderdine
Acting Executive Director