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Maryland State Retirement Agency
Fiscal Year 2021 Operating Budget
Response to Department of Legislative Services Analysis

Testimony by
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Senate Budget and Taxation Committee
Chair Guy Guzzone

House Appropriations Committee
Chair Maggie McIntosh

Good afternoon, Chairs and members of the committees. As the Executive Director of the State Retirement Agency (SRA), it is my pleasure to present and discuss, on behalf of the System's Board of Trustees, the Agency's proposed budget for fiscal year 2022.

The SRA carries out two equally important business functions: the administration of member and retiree benefits, and the management of invested assets. The continued success of these two core processes is of critical importance to the more than 412,000 active, vested and retired State and local participating employees, teachers, police, judges, law enforcement officers, correctional officers and legislators whom we serve.

Investment Management

The Maryland State Retirement and Pension System earned a net investment return on invested assets of 3.57 percent in fiscal year 2020. After the payment of benefits, the market value of invested assets increased by approximately $562 million, from $54.2 billion on June 30, 2019 to $54.8 billion on June 30, 2020, resulting in a funded ratio of 73.6 percent (72.9 percent, excluding participating governmental units) as of June 30, 2020 compared to 72.9 percent (71.5 percent, excluding participating governmental units) at the end of fiscal year 2019. The top-performing asset class for the year was Rate Sensitive, which consists of government and corporate bonds.

Net Returns as of June 30, 2020

	1 year	3 year	5 year	10 year
Total Plan	3.57%	6.01%	5.80%	7.57%
Policy Benchmark	3.14%	5.93%	5.84%	7.17%

According to preliminary performance reports as of December 31, 2020, the System's total investment portfolio returned 16.04 percent, net of all fees and expenses, on investments for fiscal year-to-date, beating the policy benchmark of 14.46 by 158 basis points, or 1.58 percent. The market value of assets as of December 31, 2020 was approximately $62.5 billion.

The System's investment performance during fiscal year 2020 is summarized in the following exhibit:

	FY 2020 SRPS Performance	FY 2020 Benchmark Performance	SRPS Allocation June 30, 2020
Public Equity	2.0%		36.2%
Benchmark		0.4%	
U.S. Equity	5.0%		11.7%
Russell 3000		6.5%	
International Equity	-2.8%		6.7%
MSCI World ex U.S.		-5.4%	
Emerging Markets Equity	-4.7%		10.0%
MSCI Emerging Markets		-3.4%	
Global Equity	10.4%		7.8%
MSCI AC World Index		2.1%	
Private Equity	2.5%		14.2%
Custom State Street PE		-1.9%	
Rate Sensitive	18.1%		18.7%
Benchmark		17.2%	
BC U.S. Gov't Long Index		25.1%	
BC U.S. TIPS Index		8.7%	
Credit/Debt Strategies	-0.4%		9.3%
Benchmark		-0.1%	
BC High Yield		0.0%	
S&P LSTA Leveraged Loan		-2.0%	
JP Morgan GBI EM GD		-2.8%	
JP Morgan EMBI GD		0.5%	
JP Morgan CEMBI Broad		4.6 %	
Real Assets	-5.4%		11.8%
Benchmark		-2.3%	
Absolute Return	-2.5%		7.8%
Benchmark		0.6%	

	FY 2020 SRPS Performance	FY 2020 Benchmark Performance	SRPS Allocation June 30, 2020
Multi-Asset	2.9%		1.5%
Benchmark		3.1%	
Cash	1.5%		0.5%
Benchmark		1.6%	
TOTAL FUND	**3.6**	**3.1%**	**100%**

The **public equity portfolio** returned 2.0 percent, compared with a return of 0.4 percent for its blended benchmark. The program has four components: U.S Equity, International Developed Equity, Emerging Markets Equity and Global Equity.

The **U.S. public equity portfolio** returned 5.0 percent, trailing the return of the Russell 3000 Index by 150 basis points. The international equity portfolio returned -2.8 percent compared to -5.4 percent for its benchmark, the Morgan Stanley Capital International (MSCI) World ex-U.S. Index. The emerging markets equity program returned -4.7 percent, trailing the -3.4 percent for its benchmark, the MSCI Emerging Markets Index, a broad measure of stock performance in emerging markets. The global equity portfolio achieved a return of 10.4%, outperforming its benchmark, the MSCI All-County World Index, by 8.27%

The **rate sensitive portfolio** returned 18.1 percent, compared to 17.2 percent for its blended benchmark: 53 percent Barclays US Government Long Bond Index, 13 percent Barclays US Investment Grade Corporate Index, 13 percent Barclays US Securitized Index, and 21 percent Barclays US TIPS Index.

The **credit/debt strategies portfolio** returned -0.4 percent compared to -0.1 percent for its blended benchmark. The portfolio has a blended benchmark of 78 percent U.S. (80 percent BC U.S. Corporate High Yield Index, 20 percent S&P LSTA Leveraged Loan Index), and 22 percent Non-U.S. (50 percent Bloomberg/Barclays Emerging Markets Local Government Index -30 basis points, 25 percent Bloomberg/Barclays Emerging Markets Hard Currency Sovereign Index, 25 percent Bloomberg/Barclays Emerging Markets U.S. Dollar Aggregate Corporate Index).

The **real assets portfolio** returned -5.4 percent, compared to -2.3 percent for its blended benchmark, which consists of 71 percent real estate (85 percent NCREIF ODCE Index, 15 percent FTSE EPRA/NAREIT Index) and 29 percent natural resources and infrastructure (60 percent S&P Global Natural Resources Index and 60 percent Dow Jones-Brookfield Infrastructure Index.

The **absolute return portfolio** returned -2.5 percent, trailing the 0.6 percent return of its benchmark, which is the Hedge Funds Research, Inc. (HFRI) Fund of Funds Conservative Index plus 1 percent.

The **private equity portfolio** returned 2.5 percent, compared to the -1.9 percent return of its benchmark, the State Street Private Equity Index (one quarter lag). The program is expected to produce returns in excess of the public equity markets.

The System's **Terra Maria** program is comprised of smaller investment management firms—including many that are minority and/or women owned—focusing primarily on equity and fixed income investments. For fiscal year 2020, the program returned -2.3 percent, underperforming its benchmark of -2.1% While annualized performance for the five years ending June 30, 2020 has been negative relative to its benchmark, the return since inception has added value. Since inception, the Terra Maria program has achieved an annualized return of 4.7 percent, compared to 4.3 percent for the benchmark. It should be noted that the Terra Maria program was restructured in the second half of fiscal year 2017, and since the restructuring was completed, performance has improved.

The Investment Division regularly solicits input on investment opportunities and best practices from several sources. The System's investment consultants are broadly utilized across the total portfolio in assisting staff in sourcing new investment ideas that improve the risk/return efficiency of the fund. Consultants are also helpful in providing insight into new trends and ideas among other public pension funds. The System also belongs to several trade associations, and participates in selected investment conferences, that are useful in establishing peer contacts and gaining market insight. By attending conferences that focus on emerging managers, the System can meet, and provide access to, promising smaller managers that might not be identified in the normal search process. Existing and prospective investment managers are also a valuable source of information in terms of market trends and investment opportunities.

Chapter 728 of the Acts of 2018 grants the Board of Trustees broader authority in its management and oversight of the investment of System assets. The law authorizes the Board to set and approve the budget for the personnel and operational expenses of the Investment Division. The Board is now able to determine and create the type and number of investment positions necessary for carrying out the functions of the Investment Division and set the compensation for these positions.

The Board began applying the new compensation criteria in March 2019, and again in March 2020, with salary adjustments for most Investment Division staff that moved compensation closer to industry peers. With a new, more competitive salary structure, the Investment Division has been able to hire several experienced investment professionals, some of whom will focus on the Board's initiative to begin managing System assets in-house. The System would not have been able to recruit these individuals under the prior pay scale, which was not competitive relative to industry peers.

The transition to internal management will result in significant fees savings to the System, net of the additional expenses to develop the program. The initial internal portfolio was funded on July 1, 2019 and invests in U.S. Treasury Inflation Protection bonds. As of December 31, 2020, the size of this account was $2.5 billion. On March 1, 2020, the second mandate was funded to invest in long-duration nominal Treasury bonds. As of December 31, 2020, the market value of this portfolio was $1.2 billion. The initial equity strategy was funded on October 1, 2020, with a market value of $577 million as of December 31, 2020. It is expected that several new internal mandates will be funded over the next year as staff demonstrates continued skill and experience in the implementation of internal management. To assist in the internal trading function, the Investment Division implemented a new order management system to facilitate a more automated and efficient trade settlement process.

Chapter 728 also provides the Board with the authority to determine the qualifications, salary levels and performance incentives for Investment Division staff, subject to certain restrictions. For example, increases in compensation may not exceed 10 percent in any fiscal year. In addition, the Board may not grant any increases in compensation in a fiscal year in which state employees are subject to a furlough.

Chapter 728 also requires the Board to adopt objective criteria for setting the qualifications and compensation of positions within the Investment Division, as well as awarding financial incentives. In developing these objective criteria, the Board was required to form an Objective Criteria Committee. The role of the Objective Criteria Committee was to work with a third-party compensation consultant to recommend objective compensation criteria to the Board.

In April 2019, the Board also approved an incentive compensation program for investment-focused staff. This program is designed to reward staff for investment performance that exceeds policy benchmark targets and the System's actuarial assumed rate of return. In compliance with the statute, the Board approved maximum annual incentive compensation up to 33% of base salary for select positions within the Investment Division. While Investment staff earned incentive compensation based on fiscal year 2020 performance, the payment of these incentives was deferred pending greater clarity regarding the fiscal position of the State and employee furloughs.

Business Process Re-Engineering and Organizational Transition

Starting in January 2018, the Agency formally commenced the third phase of its Maryland Pension Administration System (MPAS) strategy, or "MPAS-3" – a multi-year initiative to re-engineer the retirement administration's business function operations. MPAS-3, now known as MPAS+, is a Major IT Development Project (MITDP) as directed by the General Assembly, under Department of Information Technology (DoIT) oversight. MPAS+ is divided into three phases: 1) Design Phase 2) Foundation (Preparation/Procurement) Phase and 3) Execute, Build and Implement Phase.

Design Phase – The Phase 1 activities involved project design which included comprehensive and deep planning to address each project element: processes, technology and organization, and to define the entire project approach at a level of procurement and implementation activities for the next phase. The outcome of this phase was a complete and detailed road map on how the Business Processes will be re-engineered, what technologies are needed and what organizational changes are needed. This phase was completed in July 2018.

Foundation (Preparation/Procurement) Phase – The Phase 2 activities involved procurement and implementation of any absent technologies necessary to support the project and achieve increased functionality, improved communications and greater member/retiree and employer access to their data. This phase was completed in January 2020.

In addition to building the IT Infrastructure, four critical solutions were implemented:

1. Workflow & Customer Relations Management (CRM) – Microsoft Dynamics 365 provides the CRM software that works as a customizable, flexible solution designed to suit an organization's business requirements. Dynamics 365 can be a stand-alone application that meets the needs of a specific line of business, or its multiple CRM tools can work together as a powerful integrated solution.
2. Scanning & Intelligent Character Recognition (ICR) Services – ABBYY, a software solution provider, offers a variety of low-cost document scanning, document management, forms processing and ICR applications in one place. The software automatically scans many documents at once and organizes them using keywords in the text, barcodes or key indexing. It scans files to hard drives, or integrates with document management systems, and business applications.

3. Document Management System – The Agency built in-house a document management system, called Member Document Storage (MDS), to store all documents of customers. This software is integrated with scanning and CRM software solutions.
4. Registration and Authentication services – SRA used the multi-factor authentication services offered by SecureAuth to implement additional layers of identity security to ensure protected access to the participant portal, ***mySRPS***.

Benefiting from the above accomplishments, significant progress has been achieved over the last 12 months –

1. ***mySRPS*,** the secure participant portal, was launched in February 2020. This application will allow participants to view their account information, print asset and income verification letters, view and print Personal Statement of Benefits and 1099R tax documents. Retirees can also change their address information and tax withholdings online and in real time. For active members, the benefit estimate wizard is the most exciting feature. This feature allows members to estimate their monthly retirement benefits at any time and as often as they like.
    a. Registration to ***mySRPS*** requires a secure unique registration code issued by SRA. The registration codes were sent to roughly 365,000 participants (202,000 active members and 163,000 retirees) which completes the ***mySRPS*** rollout to all active members and retirees. Currently, about 93,000 members and retirees registered (25%). It should be noted that the initial registration in the first year of launch of similar portals is typically around 10% to 15% with other retirement and pension systems in the country.
    b. Few of the notable statistics include ***mySRPS*** members creating more than 50,000 benefit estimates online, and more than 2,000 retirees changing tax withholdings online.
    c. Adhering to ***mySRPS*** users' feedback, SRA rolled out a new feature, View/Change Beneficiary Information" to active members in September 2020. Since then, more than 4,000 online requests were completed by ***mySRPS*** users to change their beneficiary information.

2. **Business Process Re-engineering (BPR)**, the final phase of the MPAS+ project was started in January 2020. The Phase 3 activities involve the building and implementation of the re-engineered Agency's business processes within the Administration and Finance divisions. Each Agency business process is evaluated and reengineered seeking optimal and fully integrated solutions that will incorporate a more robust workflow, integrated document management services, increased functionality, improved relationships & communications with participants, employers, and strategic partners. This new approach will be more automated Straight Through Processes (STP), replacing existing paper-based processing and eliminating staff intervention to the maximum extent. Work began on re-engineering of three major business processes – 1) Benefit Estimates Process, 2) Payments Processes – Payments received by SRA and Payments made by SRA, and 3) Employer Processes.

    a. Benefit Estimate Process was used the first and forerunner BPR to build the required infrastructure, frameworks (Template framework & Process framework) for Straight Through Processes (STP) such that it can be replicated for re-engineering of other business processes. The re-engineered Benefit Estimate Process was successfully built and implemented in November 2020.
    b. Traverse Financial Software provides economical and modular solutions for Business Accounting and Enterprise Resource Planning. Traverse can be implemented easily

because it integrates with most existing databases and offers the option of either web-based or on-premise deployment. SRA currently uses General Ledger module of this software. Now, it is adding Accounts Receivable, Payroll and Banking modules, and activating Accounts Payable module to support the BPR efforts. These modules will automate SRA's Payment business processes and make them straight through and more efficient, which are currently manual for most part. These modules will also replace the existing antiquated "Create-A-Check" software used for making SRA payments.

c. Employer processes will be re-engineered and incorporated into a new self-service portal for employers. This portal will provide employers a new online way to interact with SRA securely and efficiently. Employers will submit payroll data and adjustments through this portal which creates invoices and allows employers to pay online. Employers will view and upload documents. They also will securely send and receive messages with SRA, and view employer news articles created and shared by SRA using this new portal.

Over the past several months, we were and still are in very uncertain and challenging times, which no one might have anticipated or planned for. It hasn't been easy, but we have prevailed. Dedicated teamwork by all its members have made it possible to achieve so many milestones in these unprecedented and difficult times.

Information Systems

The Agency's data and voice technology platforms continue to operate reliably with virtually no production downtime. Most Agency IT staff are State employees; however, daily operations continue to be supported by two consulting and technical services systems development supplemental staffing task order contracts. Those two contracts also provide programmer and business analyst support for MPAS+, The Agency requests approval of the Information Systems operating budget submission. In addition to the requested FY21 operating budget, funds are requested to continue progress being made on MPAS+, scheduled to be completed in FY22.

Most of the technology changes since FY19 have been driven by the Business Process Re-Engineering project discussed in the prior section. The "behind-the-scenes" infrastructure associated with each new business function and each new point of integration represents considerable effort to ensure technical efficacy and appropriate IT security enhancements and refinements addressing both on-premise and cloud-based technologies (a "hybrid" environment).

The Agency recently issued an RFP for identity proofing software-as-a-service, to further enhance ***mySRPS*** and facilitate higher-risk transactions with plan participants (anticipated implementation in late calendar year 2021). This procurement is currently in the proposal evaluation stage.

Implementation of ***mySRPS*** is a marked improvement in service delivery to members and has been accordingly received, as noted above. This service also represents a sophisticated and complicated technology achievement, requiring complicated server and database configurations, and a significant amount of linking software to securely, reliably, and efficiently integrate a workflow that must cross seamlessly among various high-availability platforms, protected by newly-implemented application firewalls, using enhanced data and log file storage, all fully backed up between the Agency's primary computing site and the disaster recovery site in Annapolis.

During most of the past year, as with all of State government, the Agency has adapted to the pandemic, implementing work-from-home scenarios that were already in place for business disruptions. Essentially, the provisions that the Agency had previously implemented and tested for continuity of operations, planned for an outage of short duration, have now been in constant use for more than ten months. Because of the Agency's and Information Systems' advance planning, though, when March 2020 forced an increase in remote operations, the Agency already had Call Center equipment for Member Services and remote access licenses/capabilities for most Agency personnel. While further equipment was required for people whose home configurations were inadequate for full-time work, causing some delays in service delivery, overall Agency functions continued unabated.

During the past year, the Agency moved to fill several newly created positions in the Information Systems Division, including positions in Network Operations, Database Management, and Information Security. The addition of these positions proved immediately valuable to the Agency. For example, the Agency has used SolarWinds software for network management for several years. When SolarWinds was compromised in 2020, the Agency was able to immediately respond, even before directives came from the State, shutting off the errant software, performing scans of network activity going back to January 2020, and installing vendor "hot fixes" promptly. In addition, the Agency has effectively absorbed and managed the significant technology associated with MPAS+, along with being able to support remote operations.

During the upcoming year, the Agency anticipates integration of the Agency's telephone system with the CRM, along with improved interchange with participating employers through a new release of a (consolidated) secure employer portal referenced in the previous section. In addition, process improvements will be instituted in financial processes supporting Agency operations, including payments to/from employers and issuance of physical checks for refunds and other purposes. Last, as mentioned, it is expected that identity proofing for ***mySRPS*** will be implemented in the coming year.

The Investment Division continues its progress towards internal portfolio management. The Information Systems Division supports this progress with commensurately capable workstation platforms, improved connections to external resources, integration with Internet-based investments management platforms, and a reliable computing environment that is in the process of being segregated from the Agency's other network components to improve performance and security. That segregation is expected to be complete once the Investment Division personnel consolidates in the same space on the Agency's 12th floor area. The Agency will also be establishing a "trading desk" for Investment Division actions, pending the ability to return to full on-site functionality following pandemic restrictions, and information Systems will support that implementation.

Benefits Administration

Active membership increased slightly from 193,458 in fiscal year 2019 to 195,851 in fiscal year 2020. We also continue to see steady and consistent increases in the number of annuitants. At the end of fiscal year 2019, the number of retirees and beneficiaries receiving benefits increased slightly more than 1.6 percent to 167,644 compared to 164,892 in the previous fiscal year. Over a ten-year period, the total number of annuitants has grown slightly more than 31 percent from 127,171 in fiscal year 2011 to 167,644 in fiscal year 2020. Our current number of retirees and beneficiaries receiving monthly allowances is more than 170,000, as a result of new retirements since July 1, 2020.

As in previous fiscal years, the Benefits Administration Division has continued to experience a significant number of vacancies in most units. Recruitment challenges require constant re-allocation of staff within the production areas of the Division to ensure timely completion of critical tasks and to minimize delays and backlogs in less critical duties. Hiring and retaining qualified staff has remained a challenge for most units of the Division throughout the fiscal year.

Overall, the Member Services Unit's Call Center was not able to meet our performance measures for fiscal year 2020. This trend has continued into fiscal year 2021. The improvement of the Call Center's performance is a top priority for the Benefits Administration Division and will remain so until performance has significantly improved, and we are once again meeting the performance goals.

However, the Call Center, and all of Member Services, has been open for business throughout the state of emergency created by the COVID-19 pandemic. On the first day of the state of emergency, the Call Center's disaster recovery plan was activated – there was no disruption in service. We deployed ten laptops so that retirement benefits specialists were able to continue to answer phone calls while teleworking. Since that time, the Agency has acquired and deployed additional laptops to expand tele-work capabilities in Member Services. In total Member Services has answered more than 85,000 phone calls since the beginning of the state of emergency.

In addition to focusing on staffing and training improvements, we will also be working on several other initiatives to improve the performance of the Call Center. The goals of these initiatives will be to reduce the number of incoming calls, reduce the amount of time each call takes to resolve, and reduce the number of occurrences where a caller needs to call the Call Center more than one time. We will also be closely monitoring the effect of the roll out of ***mySRPS*** on the Call Center's performance. The Agency's Call Center performance measures for fiscal year 2020 are summarized below:

Performance Measure	**Performance Goal**	**FY2020 Performance Average**
Call Abandonment	Not to exceed 7.50%	18.45%
Average Wait Time	Not to Exceed 135 seconds	344 seconds

2011 Benefit Reform Scorecard

Reforms enacted by the Maryland General Assembly in 2011 and in subsequent years continue to show positive results for the System and, in fact, continue to exceed earlier projections (see chart below). The System is on track to be 80% funded by 2026; 85% funded by 2030; and 100% funded by 2039.

Projected June 30, 2020 Results on June 30, 2010 Valuation

	Before Reforms	**After Reforms**	**Actual Results 2019 Valuation**
FY 2021 Contribution Rates No Reinvestment (% of Pay)			
ECS (State)	23.46%	19.44%	20.50%
TCS	22.30%	18.43%	14.67%
All State Plans	23.85%	19.86%	17.50%
June 30, 2019 Funded Ratio No Reinvestment			
All State Plans	69.0%	68.9%	70.4%

	Before Reforms	After Reforms	Actual Results 2019 Valuation
June 30, 2018 Funded Ratio Reinvestment			
All State Plans	69.0%	73.0%	72.9%

The 2010 valuation was the basis for the original estimates and projections related to potential effects of the 2011 reforms. Certain changes since implementation of reforms affect the comparability of the figures:

1) Systems are now receiving Actuarially Determined Contributions based on 25-year closed amortization of unfunded actuarial accrued liability (UAAL) ending in FY 2039. Elimination of the corridor funding method resulted in a large contribution increase for the Employees' Combined System (ECS). The change was very small for the Teachers' Combined System (TCS).
2) The General Assembly lowered reinvested savings to $75 million from the original $300 million in two steps beginning in FY 2014.
3) Both demographic and economic assumptions have changed since 2010 acting to increase contributions and decrease funded ratios.
4) There was an overall favorable experience since 2010 (except ECS) which decreased actuarial contribution rates and increased funded ratios.

Agency Response to Operating Budget Recommended Action

1. Reduction of Supplemental Retirement Contribution: If this action is taken, it would be the first time that the System will not receive some level of reinvested savings contributions since first adopted as policy with the enactment of the 2011 reforms of the System. The General Assembly's intent with the reinvested savings was to accelerate the progress toward certain levels of funded status than would be achieved through the annual actuarially determined contribution alone. It should be noted that these pension reform savings to the State result from the reforms which increased employee and teacher payroll contributions from 5% to 7% while also reducing the level of benefits to employee when they retire.

   It also should be recognized that not having these contributions go into the System trust fund in FY2021 and FY2022 is projected to result in an increase in actuarially determined contributions for FY23, of approximately $6.4 million. The FY24 contributions then rise to $13.4 million above currently projected contributions. In the following years, the increased contributions will persist by an average $14 to $15 million dollars above currently projected contribution levels until the System reaches 85% funded status in 2031. These projections are based on all current actuarial assumptions being met each year.

2. Narrative Requesting a Report on Investment Division Personnel Budget Information: The Agency concurs.