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Maryland State Retirement Agency
Fiscal Year 2023 Operating Budget
Response to Department of Legislative Services Analysis

Testimony by
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Senate Budget and Taxation Committee
Chair Guy Guzzone
February 8, 2022

House Appropriations Committee
Chair Maggie McIntosh
February 18, 2022

Good afternoon, Chairs and members of the committee. 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 2023.

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 411,000 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 (System) earned a net investment return of 26.7% on assets in fiscal year 2021. After the payment of benefits, the market value of invested assets increased by approximately $13.1 billion, from $54.8 billion on June 30, 2020, to $67.9 billion on June 30, 2021, resulting in a funded ratio of 76.9% (76.2%, excluding participating governmental units) as of June 30, 2021, compared to 73.6% (72.9%, excluding participating governmental units) at the end of fiscal year 2020.

Net Returns as of June 30, 2021

	1 year	3 year	5 year	10 year
Total Plan	26.69%	11.78	10.68%	8.15%
Policy Benchmark	24.43%	11.19%	10.20%	7.55%

According to preliminary performance reports as of December 31, 2021, the System's total investment portfolio returned 5.27%, net of all fees and expenses, on investments for fiscal year-to-date, trailing the policy benchmark of 5.69% by 42 basis points, or 0.42%. The market value of assets as of December 31, 2021, was approximately $70.6 billion.

The System's investment performance during fiscal year 2021 is summarized in the following exhibit:

	FY2021 SRPS Performance	FY 2021 Benchmark Performance	SRPS Allocation June 30, 2021
Public Equity	44.5%		35.6%
Custom Benchmark		40.5%	
U.S. Equity	43.4%		12.4%
Russell 3000		44.2%	
International Equity	37.2%		7.1%
MSCI World ex U.S.		33.6%	
Emerging Markets Equity	48.4%		9.9%
MSCI Emerging Markets		40.9%	
Global Equity	47.3%		6.2%
MSCI AC World Index		39.3%	
Private Equity	51.9%		17.1%
Custom State Street PE		53.1%	
Rate Sensitive	-2.5%		15.9%
Custom Benchmark		-3.9%	
BBG U.S. Gov't Long Index		-10.4%	
BBG Securitized		-0.2%	
BBG Corporate		3.3%	
BC U.S. TIPS Index		6.5%	
Credit/Debt Strategies	14.4%		9.2%
Custom Benchmark		12.8%	
BBG High Yield		15.4%	
S&P LSTA Leveraged Loan		11.7%	
BBG EM Local Currency		6.1%	
BBG EM Hard Currency Sov		6.7%	
BBG EM USD Corporate		8.0%	

	FY2021 SRPS Performance	FY 2021 Benchmark Performance	SRPS Allocation June 30, 2021
Real Assets	14.8%		11.2%
Custom Benchmark		16.3%	
Absolute Return	15.5%		8.7%
Custom Benchmark		16.2%	
Multi-Asset	24.1%		1.0%
Custom Benchmark		24.4%	
Cash	0.1%		1.3%
Custom Benchmark		0.1%	
TOTAL FUND	**26.7%**	**24.4%**	**100%**

The **public equity portfolio** returned 44.5%, compared with a return of 40.5% 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 43.4%, trailing the return of the Russell 3000 Index by 82 basis points. The international equity portfolio returned 37.2% compared to 33.6% for its benchmark, the Morgan Stanley Capital International (MSCI) World ex-U.S. Index. The emerging markets equity program returned 48.4%, exceeding the 40.9% 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 47.3%, outperforming its benchmark, the MSCI All-County World Index, 8.1%.

The **rate sensitive portfolio** returned -2.5%, compared to -3.9% for its blended benchmark: 53% Barclays US Government Long Bond Index, 13% Barclays US Investment Grade Corporate Index, 13% Barclays US Securitized Index, and 21% Barclays US TIPS Index.

The **credit/debt strategies portfolio** returned 14.4% compared to 12.8% for its blended benchmark. The portfolio has a blended benchmark of 78% U.S. (80% BC U.S. Corporate High Yield Index, 20% S&P LSTA Leveraged Loan Index), and 22% non-U.S. (50% Bloomberg/Barclays Emerging Markets Local Government Index -30 basis points, 25% Bloomberg/Barclays Emerging Markets Hard Currency Sovereign Index, 25% Bloomberg/Barclays Emerging Markets U.S. Dollar Aggregate Corporate Index).

The **real assets portfolio** returned 14.8%, compared to 16.3% for its blended benchmark, which consists of 71% real estate (NCREIF ODCE Index + 40 basis points) and 29% natural resources and infrastructure (60% S&P Global Natural Resources Index and 40% Dow Jones-Brookfield Infrastructure Index.

The **absolute return portfolio** returned 15.5%, trailing the 16.2% return of its benchmark, which is the Hedge Funds Research, Inc. (HFRI) Fund of Funds Conservative Index plus 1%.

The **private equity portfolio** returned 51.9%, compared to the 53.1% 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 2021, the program returned 32.1%, outperforming its custom benchmark return of 30.3%. Since inception, the Terra Maria program has achieved an annualized return of 6.4%, compared to 5.9% 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 transition to internal management will result in significant fee 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, 2021, the value of this account was $2.9 billion. On March 1, 2020, the second mandate was funded to invest in long-duration nominal Treasury bonds. As of December 31, 2021, the market value of this portfolio was $1.7 billion. The initial equity strategy was funded on October 1, 2020, with a market value of $3.4 billion as of December 31, 2021. Three new internal mandates have been established in fiscal year 2022: an investment-grade corporate bond strategy incepted on July 1, 2021, a small cap U.S. equity portfolio and a securitized bond account, both started October 1, 2021. The market value of these new accounts as of December 31, 2021 were $536.4 million, $430.7 million and $237.8 million, respectively. It is expected that new internal mandates will be established as staff demonstrates continued skill and experience in the implementation of internal management. To assist in the internal trading function, the Investment Division has implemented a new order management system to facilitate a more automated and efficient trade settlement process.

Business Process Re-Engineering and Organizational Transition

Beginning 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. The design phase was completed in 2018 and the foundation phase was completed two years later.

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***.

As a result of these accomplishments, significant progress was achieved in FY 2020 to launch the secure participant portal, ***mySRPS***. Launched in February 2020, this application allows 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. Responding to ***mySRPS*** users' feedback, SRA rolled out a new feature to active members in FY 2021: View/Change Beneficiary Information.

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. Re-engineering of business processes related to three (3) major business areas: 1.) Benefit Estimates Process, 2.) Payments Processes – Payments received by SRA and Payments made by SRA, and 3.) Employer Processes were completed and launched in FY 2021 and FY 2022.

a. Service Benefit Estimate Process was used as the first and forerunner BPR to build the required infrastructure and 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. Certain Employer processes were re-engineered and incorporated into a new self-service portal for employers which can only be accessed through Multi Factor Authentication. This portal provides employers a new online way to interact with SRA securely and efficiently by sending and receiving messages. Employers can submit payroll data and adjustments. The portal automatically creates the invoices and allows the employers to pay those invoices online. Employers can send and receive messages with SRA securely, view and upload documents, and view employer news articles created and shared by SRA using this new portal.
c. Traverse Financial Software provides economical and modular solutions for Business Accounting and Enterprise Resource Planning and can be implemented easily because it integrates with most existing databases and offers the option of either web-based or on-premises deployment. SRA added and launched new Traverse modules, Accounts Receivable, Accounts Payable, Payroll and Banking modules and integrated these modules with General Ledger module to support the BPR efforts.
    i. Work done in Traverse allowed SRA to automate the Agency's Payment business processes and make them straight through and more efficient, which were manual for most part. Traverse would eventually replace the existing antiquated "Create-A-Check" software used for making SRA payments.

d. Work on re-engineering of the Daily Payments business processes began in January 2021. Business features of Cancellations and Replacements of Retirement Benefit Payments were re-engineered using Microsoft Dynamics 365 CRM, Traverse Financials and Daily Payments applications. The version 1 of the Daily Payments was launched in November 2021. The re-engineered, automated process allows the business users to cancel an earlier rejected payment and issue the replacement as a check payment in less than 24 hours. Work is currently in progress to issue the replacements through Electronic Fund Transfers (EFT).
    i. Re-engineering of another Daily Payments business process, "Withdrawal of Member Contributions" after member leaves active employment and don't have enough service to vest will start in February 2022.
e. Work on Form Automation initiative began in June 2021. This initiative will automate the processing of the various Forms submitted by participants and received through mail, fax, or email, minimizing, or eliminating, in cases, the human touch. As part of this initiative, business processes related to Federal Tax Withholding and State Tax Withholding forms are automated and ready for launch in February 2022.
    i. Work to automate the next Form processing and re-engineer the business process associated with it, "Direct Deposit — Electronic Funds Transfer Sign-Up Form" will begin shortly.

Information Systems

The Agency's data and voice technology platforms continue to operate reliably with virtually no unscheduled 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.

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-premises and cloud-based technologies (a "hybrid" environment).

The Agency issued an RFP for identity proofing software-as-a-service, to further enhance ***mySRPS*** and facilitate higher-risk transactions with plan participants (anticipated implementation mid calendar year 2022). This procurement is currently in the proposal evaluation stage.

Implementation of ***mySRPS*** and Employer Portal are marked improvements in service delivery to members and employers. Both have been accordingly received, as noted above. These services 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 secure 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 continues to adapt to the pandemic supporting and improving 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 twenty-two 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 continues to be required for people whose home configurations were inadequate for full-time work, causing some delays in service delivery, overall Agency functions continue unabated.

During the past year, the Agency moved to fill several newly created positions in the Information Systems Division, including positions in Network Operations, Systems Development, and Information Security. The addition of these positions proved immediately valuable to the Agency. For example, the Agency has successfully implemented an improved database security solution requiring additional implementation and management resources. The Agency has undergone multiple security assessments over the past year as well. Having the additional resources to satisfy these requests while maintaining continuity of operations, has allowed us to deliver safe and stable services to our customers. In addition, the Agency has effectively absorbed and managed the significant technology associated with MPAS+, along with being able to support remote operations. Most recently, Information Systems experienced transitions in senior leadership brought on by retirement and recruitments.

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 phased release of a (consolidated) secure employer portal referenced in the previous section. In addition, process improvements will continue to 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 decreased slightly from 195,851 at the end of fiscal year 2020 to 194,311 at the end of fiscal year 2021. We continue to see steady and consistent increases in the number of annuitants. At the end of fiscal year 2021, the number of retirees and beneficiaries receiving benefits increased slightly more than 1.0% to 169,368 compared to 167,644 in the previous fiscal year. Over a ten-year period, the total number of annuitants has grown slightly more than 27% from 132,493 at the end of fiscal year 2012 to 169,368 at the end of fiscal year 2022. Our current number of retirees and beneficiaries receiving monthly allowances is more than 172,000, because of new retirements since July 1, 2021.

Throughout the COVID 19 pandemic the Agency has continued to perform all its duties as related to benefits administration. Most critically, members wishing to retire have been retired, the monthly benefits payable to retirees and beneficiaries have been paid on time, and when our members and retirees have contacted the Agency for assistance, we have been here to assist them.

The Agency continues to focus on improving the customer experience provided by its Member Services Unit and in particular its Call Center. While the managing-for-results goals for call abandonment rate and average call wait time were not met for the past fiscal year, the call abandonment rate improved (decreased) by 2% between fiscal years 2020 and 2021. During the first six months of the current fiscal year, that trend has continued and accelerated with the call abandonment rate being 11.45%.

The Agency's Call Center performance measures for fiscal year 2021 are summarized below:

Performance Measure	Performance Goal	FY2021 Performance Average
Call Abandonment	Not to exceed 7.50%	16.43%
Average Wait Time	Not to Exceed 135 seconds	369 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, 2021 Results on June 30, 2010 Valuation

	Before Reforms	After Reforms	Actual Results 2021 Valuation
FY 2023Contribution Rates No Reinvestment (% of Pay)			
ECS (State)	24.13%	19.92%	20.68%
TCS	22.39%	18.45%	14.65%
All State Plans	24.13%	20.03%	17.55%
June 30, 2021 Funded Ratio No Reinvestment			
All State Plans	70.7%	70.5%	72.7%
June 30, 2021 Funded Ratio Reinvestment			
All State Plans	70.7%	75.1%	76.2%