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Maryland State Retirement Agency
Fiscal Year 2024 Operating Budget
Response to Department of Legislative Services Analysis

Testimony by
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Senate Budget and Taxation Committee
Chair Guy Guzzone
February 7, 2023

House Appropriations Committee
Chair Ben Barnes
February 10, 2023

Good afternoon, Chairman 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 2024.

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 nearly 414,000 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 -2.97 percent on assets in fiscal year 2022. After the payment of benefits, the market value of invested assets decreased by approximately $3.3 billion, from $67.9 billion on June 30, 2021, to $64.6 billion on June 30, 2022, resulting in a funded ratio of 77.2 percent (76.6 percent, excluding participating governmental units) as of June 30, 2022, compared to 76.9 percent (76.2 percent, excluding participating governmental units) at the end of fiscal year 2021.

Net Returns as of June 30, 2022

	1 year	3 year	5 year	10 year
Total Plan	-2.97%	8.38%	7.93%	7.79%
Policy Benchmark	-3.48%	7.40%	7.38%	7.14%

According to preliminary performance reports as of December 31, 2022, the System's total investment portfolio returned -1.21 percent, net of all fees and expenses, on investments for fiscal year-to-date, exceeding the policy benchmark of -1.46 percent by 25 basis points, or 0.25 percent. The market value of assets as of December 31, 2022, was approximately $62.9 billion.

The System's investment performance during fiscal year 2022 is summarized in the following exhibit:

	FY2022 SRPS Performance	FY 2022 Benchmark Performance	SRPS Allocation June 30, 2022
Public Equity	-19.4%		28.5%
Custom Benchmark		-18.1%	
U.S. Equity	-13.3%		10.7%
Russell 3000		-13.9%	
International Equity	-18.0%		6.5%
MSCI World ex U.S.		-16.8%	
Emerging Markets Equity	-25.6%		7.9%
MSCI Emerging Markets		-25.3%	
Global Equity	-24.8%		3.4%
MSCI AC World Index		-15.8%	
Private Equity	24.5%		21.5%
Custom State Street PE		24.0%	
Rate Sensitive	-15.3%		17.6%
Custom Benchmark		-13.7%	
BBG U.S. Gov't Long Index		-18.4%	
BBG Securitized		-9.0%	
BBG Corporate		-14.2%	
BC U.S. TIPS Index		-5.7%	
Credit/Debt Strategies	-4.5%		7.9%
Custom Benchmark		-12.6%	
BBG High Yield		-12.8%	
S&P LSTA Leveraged Loan		-2.8%	
BBG EM Hard Currency Sov		-22.7%	
BBG EM USD Corporate		-19.3%	
Real Assets	25.7%		15.2%
Custom Benchmark		19.9%	
Absolute Return	1.4%		7.6%
Custom Benchmark		3.0%	

	FY2022 SRPS Performance	FY 2022 Benchmark Performance	SRPS Allocation June 30, 2022
Multi-Asset	-19.0%		0.4%
Custom Benchmark		-3.5%	
Cash	0.3%		1.3%
Custom Benchmark		0.2%	
TOTAL FUND	**-3.0%**	**-3.5%**	**100%**

The **public equity portfolio** returned -19.4 percent, compared with a return of -18.1 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 -13.3 percent, exceeding the return of the Russell 3000 Index by 55 basis points. The international equity portfolio returned -18.0 percent compared to -16.8 percent for its benchmark, the Morgan Stanley Capital International (MSCI) World ex-U.S. Index. The emerging markets equity program returned -25.6 percent, slightly trailing the -25.3 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 -24.8 percent, underperforming its benchmark, the MSCI All-County World Index, by 9.1 percent.

The **rate sensitive portfolio** returned -15.3 percent, compared to -13.7 percent for its blended benchmark comprised of the Barclays US Government Long Bond Index, Barclays US Investment Grade Corporate Index, Barclays US Securitized Index, and Barclays US TIPS Index.

The **credit/debt strategies portfolio** returned -4.5 percent compared to -12.6 percent for its blended benchmark. The portfolio has a blended benchmark of 87 percent U.S. (80 percent BC U.S. Corporate High Yield Index, 20 percent S&P LSTA Leveraged Loan Index), and 13 percent non-U.S. (50 percent Bloomberg/Barclays Emerging Markets Hard Currency Sovereign Index and 50 percent Bloomberg/Barclays Emerging Markets U.S. Dollar Aggregate Corporate Index).

The **real assets portfolio** returned 25.7 percent, compared to 19.9 percent for its blended benchmark, which consists of approximately 72 percent real estate (NCREIF ODCE Index + 40 basis points) and 28 percent natural resources and infrastructure (60 percent S&P Global Natural Resources Index and 40 percent Dow Jones-Brookfield Infrastructure Index).

The **absolute return portfolio** returned 1.4 percent, trailing the 3.0 percent return of its benchmark, which consists of event-driven, global macro and relative value strategies.

The **private equity portfolio** returned 24.5 percent, compared to the 24.0 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 2022, the program returned -19.2 percent, underperforming its custom benchmark return of -17.2 percent. Since inception, the Terra Maria program has achieved an annualized return of 4.5 percent, compared to 4.2 percent for the benchmark.

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, 2022, the value of this account was $2.7 billion. On March 1, 2020, the second mandate was funded to invest in long-duration nominal Treasury bonds. As of December 31, 2022, the market value of this portfolio was $2.3 billion. The initial equity strategy was funded on October 1, 2020, with a market value of $2.8 billion as of December 31, 2022. Three new internal mandates were 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, 2022, were $596.3 million, $361.6 million and $505.6 million, respectively. The most recent internal account was incepted on December 1, 2022, to manage global public infrastructure securities. As of December 31, 2022, the market value of this account was $385 million. It is expected that new internal mandates will be established as staff demonstrates continued skill and experience in the implementation of internal management.

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+, was 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 June 2018, the foundation phase was completed in June 2020, and final phase was completed in June 2022.

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, Agency rolled out a new feature to active members and retirees in FY 2021: View/Change Beneficiary Information. Recently in November 2022, Agency added another feature for retirees – Setup or Change Direct Deposit Instructions.

Business Process Re-engineering (BPR) – The Phase 3 activities involved the building and implementation of the re-engineered Agency's business processes within the Administration and Finance divisions. Each Agency business process was 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 and 3) Employer Processes were completed and launched.

The MPAS+ project officially ended June 30th, 2022, and transitioned into maintenance, operations and enhancements of MPAS+ initiatives. Agency intends to further improve and enhance the Agency's business processes by building on the success of MPAS+ Project. Agency planned several such initiatives for next few fiscal years.

One such initiative that is planned and included in the scope of work is ***mySRPS*** Identity Proofing. This service will upgrade the Agency's current multifactor authorization (MFA). This service will require a government ID match where the participant takes a picture of their government ID and a selfie. The software-as-a-service will validate that the government ID is valid and that the picture on the government ID matches the selfie. The service will also provide an alternate method which will include a knowledge-based quiz. This higher standard of identify proofing is required for allowing participants to complete sensitive transactions, such as withdrawals of member contributions and processing of retirement applications through ***mySRPS*** and improve the overall security of the application.

Other initiatives that are planned include automation of withdrawal of member contributions, automation of member's payroll data adjustments and payments submitted by State and PGU employers and automation of member enrollments and designation of beneficiaries. These automated business processes will provide better customer service to the members, retirees and participants of the system, improve the efficiency and the quality of the work done by Agency staff and eventually lead to cost savings to Agency.

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 ongoing MPAS+ process improvements that are designed to deliver more efficient services to our participating members and employers. The Agency requests approval of the Information Systems operating budget submission. In addition to the requested FY24 operating budget, funds are requested to replace the Agency's mission critical backup and recovery solution that has reached near capacity levels and to improve its cybersecurity posture. In addition, a salary adjustment has been approved to address staff retention and recruiting challenges.

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. This procurement has completed the evaluation phase is currently in the initial award 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.

As a result of the MPAS+ project's focus on the digital automation transformation of a paper centric business model, the Agency has experienced a significant increase in data storage and retention requirements. Additional storage needs have also been a result of the Agency's strategy to bring the investments portfolio management in-house. Data driven investment decision making requiring significant data consumption has contributed to the support needs. To ensure continuity of operations in the event a data storage failure, a more efficient backup and recovery solution has been requested. As a value-added enhancement, the Agency is requesting additional hardware and software resources to mitigate its risk of data loss due to malicious cybersecurity attacks, by establishing a quarantined offline managed storage environment. Since purchasing the current solution, the Agency has seen a significant rise in public sector ransomware occurrences. Each has had a major impact on the services it can provide to its constituency. By implementing this solution, the Agency will be further fulfilling its data stewardship responsibilities by enhancing our participants and investments data protection.

During most of the past year, as with all of State government, the Agency continues to adapt to the post-pandemic working model, supporting, and improving work-from-home and video-conferencing scenarios. 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 continued unabated.

Retaining and recruiting highly skilled information technology professionals to support this ever-evolving architecture is a priority for the Agency. An Annual Salary Review has been approved to assist in the recruitment of qualified staff as well as ensure that current staff are sufficiently compensated in a competitive job marketplace. The Information Systems Division feels that an Annual Salary Review is an appropriate strategy to successfully meet its planned objectives, including a competitive salary structure, accurate position descriptions and career paths based on technical skills and expertise.

During the upcoming year, an upgrade to the Agency's telephone system is being explored, with the goal of improving work-from-home services and providing the Agency's Member Call Center staff with additional tools to improve its participant's service. 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 see the implementation of a "trading desk" for Investment Division actions, pending the ability to return to full on-site functionality following occupancy approvals. Information Systems will support that implementation.

Benefits Administration

Active membership decreased slightly from 194,311 at the end of fiscal year 2021 to 194,210 at the end of fiscal year 2022. We continue to see steady and consistent increases in the number of annuitants. At the end of fiscal year 2022, the number of retirees and beneficiaries receiving benefits increased 1.7 percent to 172,235 compared to 169,368 in the previous fiscal year. Over a ten-year period, the total number of annuitants has grown slightly less than 25 percent from 137,925 at the end of fiscal year 2013 to 172,235 at the end of fiscal year 2022. As of December, our current number of retirees and beneficiaries receiving monthly allowances is more than 175,515, because of new retirements since July 1, 2022.

The Agency remains focused on improving the customer experience provided by its Member Services Unit and in particular its Call Center. The Agency has shifted three permanent positions and one contractual position from other units within Benefits Administration to the Member Services Unit and is requesting four new permanent positions in the fiscal year 2024 budget request to further enhance staffing resources in the Member Services Unit. With these additional resources, the Agency anticipates that it will not only be able to meet its managing for results goals but also to more proactively counsel and educate participants on value and importance of their pension benefits.

The Agency's Call Center performance measures for fiscal year 2022 are summarized below:

Performance Measure	Performance Goal	FY2022 Performance Average
Call Abandonment	Not to exceed 7.50%	15.36%
Average Wait Time	Not to Exceed 135 seconds	384 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, 2022, Results
Based on June 30, 2010, Valuation

	Before Reforms	After Reforms	Actual Results 2022 Valuation
FY 2024 Contribution Rates No Reinvestment (% of Pay)			
ECS (State)	24.70%	20.29%	21.13%
TCS	22.47%	18.46%	14.86%
All State Plans	24.37%	20.15%	17.88%
June 30, 2022, Funded Ratio No Reinvestment			
All State Plans	72.6%	72.4%	72.4%
June 30, 2022, Funded Ratio Reinvestment			
All State Plans	72.6%	77.3%	76.6%