



STATE RETIREMENT AGENCY
120 East Baltimore Street
Baltimore, MD 21202-6700

MARYLAND
STATE RETIREMENT
and PENSION SYSTEM

410-625-5555 • 1-800-492-5909
TTY Users: call via Maryland Relay
sra.maryland.gov

Maryland State Retirement Agency
Fiscal Year 2025 Operating Budget
Response to Department of Legislative Services Analysis

Testimony by
Martin Noven, Executive Director
Maryland State Retirement Agency

Senate Budget and Taxation Committee
Chair Guy Guzzone
February 13, 2024

House Appropriations Committee
Chair Ben Barnes
February 16, 2024

Good afternoon, Chairman and members of the committee. As the Executive Director of the State Retirement Agency (Agency), 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 2025.

The Agency 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 over 420,000 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 3.14% on assets in fiscal year 2023. After the payment of benefits, the market value of invested assets increased by approximately \$573 million, from \$64.6 billion on June 30, 2022, to \$65.2 billion on June 30, 2023, resulting in a funded ratio of 75.3% (74.73%, excluding participating governmental units) as of June 30, 2023, compared to 77.2% (76.6%, excluding participating governmental units) at the end of fiscal year 2022.

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Net Returns as of June 30, 2023

	1 year	3 year	5 year	10 year
Total Plan	3.14%	8.23%	6.93%	7.04%
Policy Benchmark	2.20%	7.07%	6.28%	6.50%

According to preliminary performance reports as of December 31, 2023, the System's total investment portfolio returned 3.40%, net of all fees and expenses, on investments for fiscal year-to-date, exceeding the policy benchmark of 3.25% by 15 basis points, or 0.15%. The market value of assets as of December 31, 2023, was approximately \$66.4 billion.

The System's investment performance during fiscal year 2023 is summarized in the following exhibit:

	FY2023 SRPS Performance	FY 2023 Benchmark Performance	SRPS Allocation June 30, 2023
Public Equity	13.8%		30.2%
Custom Benchmark		13.8%	
U.S. Equity	19.2%		12.3%
Russell 3000		19.0%	
International Equity	16.7%		7.3%
MSCI World ex U.S.		17.4%	
Emerging Markets Equity	3.1%		7.1%
MSCI Emerging Markets		1.8%	
Global Equity	15.1%		3.5%
MSCI AC World Index		16.5%	
Private Equity	0.3%		21.8%
Custom State Street PE		-2.9%	
Rate Sensitive	-3.7%		17.2%
Custom Benchmark		-3.5%	
BBG U.S. Gov't Long Index		-6.8%	
BBG Securitized		-1.5%	
BBG Corporate		1.6%	
BC U.S. TIPS Index		-1.3%	

Credit/Debt Strategies	6.0%		8.7%
Custom Benchmark		9.0%	
BBG High Yield		9.1%	
S&P LSTA Leveraged Loan		10.7%	
BBG EM Hard Currency Sov		7.7%	
BBG EM USD Corporate		4.2%	
Real Assets	-3.4%		15.4%
Custom Benchmark		-6.7%	
Absolute Return	-1.4%		5.9%
Custom Benchmark		1.4%	
Multi-Asset	-1.6%		0.4%
Custom Benchmark		2.20%	
Cash	5.3%		0.4%
Custom Benchmark		3.8%	
TOTAL FUND	3.1%	2.2%	100%

The **public equity portfolio** returned 13.8%, compared with a return of 13.8% 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 19.2%, exceeding the return of the Russell 3000 Index by 28 basis points. The international equity portfolio returned 16.7% compared to 17.4% for its benchmark, the Morgan Stanley Capital International (MSCI) World ex-U.S. Index. The emerging markets equity program returned 3.1% outperforming the 1.8% 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 15.1%, underperforming its benchmark, the MSCI All-County World Index, by 1.4%.

The **rate sensitive portfolio** returned -3.7%, compared to -3.5% 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 6.0% compared to 9.0% for its blended benchmark. The portfolio has a blended benchmark of 89% U.S. (80% BC U.S. Corporate High Yield Index, 20% S&P LSTA Leveraged Loan Index), and 11% non-U.S. (50% Bloomberg/Barclays Emerging Markets Hard Currency Sovereign Index and 50% Bloomberg/Barclays Emerging Markets U.S. Dollar Aggregate Corporate Index).

The **real assets portfolio** returned -3.4%, compared to -6.7% for its blended benchmark, which consists of approximately 67% real estate (NCREIF ODCE Index + 40 basis points) and 33% natural resources and infrastructure (20% S&P Global Natural Resources Index and 80% Dow Jones-Brookfield Infrastructure Index).

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

The **private equity portfolio** returned 0.3%, compared to the -2.9% 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 2023, the program returned 10.3%, underperforming its custom benchmark return of 10.9%. Since inception, the Terra Maria program has achieved an annualized return of 4.8%, compared to 4.6% 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. As of June 30, 2023, nine internal portfolios valued at \$12.8 billion had been established: U.S. TIPS, U.S. Long Government Bonds, Russell 1000 large-cap U.S. equity, investment-grade corporate bonds, U.S. small cap equity, U.S. securitized bonds, International large-cap equity, International equity value factor strategy and public equity infrastructure. Staff is currently in the development process to implement additional internal portfolios, including enhanced cash and currency hedging. Staff also expects to gradually increase the level of active management within the existing passive portfolios.

Business Operations

The Business Operations Office continues to support the Agency's efforts with improvements and enhancements to the Agency's business processes by building on the success of MPAS+ Project. In the past year we have successfully rolled out several new applications and enhancements to existing applications including Manual Benefit Payment, Daily Paid Check Payment, SRA Document Upload and Member Document Storage (MDS) Version 2.

Other initiatives that are currently in development 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. As well, we are working with the State Treasures Office and M&T Bank to implement Account Validation Service (AVS) to further improve our recently re-engineered direct deposit process. 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.

One initiative that was planned and included in the scope of work for the MPAS+ project was **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. The RFP for this service is nearing its conclusion. Tentatively this RFP will be reviewed by the Board of Public Works on March 13, 2024.

During the next fiscal year, Business Operations will expand the Education and Training division by three employees. These positions will be funded by shifting the Pre-Retirement Seminars provided by the Community College of Baltimore County at a cost of roughly \$300,000 a year. This will provide greater flexibility and allow the Agency to adapt to the changing climate of virtual meetings, changes in retirement law, and changes in our business processes.

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 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 FY25 operating budget, funds are requested to:

- Replace the Agency's mission critical firewall solutions that have reached end-of-life support and near capacity levels respectively.
- Replace the Agency's mission critical database server solution that have reached near capacity performance and storage levels.
- Maintain existing systems development professional services, meet mission critical computer hardware maintenance commitments and improve the Agency's security posture.
- Establish an SRA-Software Engineer Manager position.

Most of the technology changes since fiscal year 2019 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 selection phase and is moving through the final approval and 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 and to maintain existing service levels to our participants, employers and staff, an upgraded database and storage solution has been requested.

Cybersecurity is an Agency priority. Information Systems is in a state of continuous improvement as it dedicates resources to the monitoring and response to potential threat events. Having the tools and staff resources to achieve this objective is a pre-requisite for success against an evolving threat. The Agency's existing firewalls are a first line of defense in maintaining its security posture. An End-of-Life (unsupported) date of August 2025 is scheduled for our existing primary firewalls. In preparation for this event, resources are being requested to replace the existing firewall solution.

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 was successfully implemented for fiscal year 2024 in partnership with the Department of Budget and Management's Division of Classification and Salary. The goal to assist in the recruitment of qualified staff as well as ensure that current staff are sufficiently compensated in a competitive job marketplace is being realized. Current recruitments are positive. In anticipation of an expanded systems development team, and an increasing complex service platform, the Agency is requesting an additional position to guide both internal and contractual resources in the addressing new service development, technical debt, cybersecurity best practices and maintenance of existing services.

During the upcoming year, an upgrade to the Agency's backup and recovery will be completed 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 has seen the implementation of a "trading desk" for Investment Division. Information Systems continues to support that implementation

Benefits Administration

Active membership increased from 194,210 at the end of fiscal year 2022 to 198,647 at the end of fiscal year 2023. We continue to see steady and consistent increases in the number of annuitants. At the end of fiscal year 2023, the number of retirees and beneficiaries receiving benefits increased 1.4% to 174,609 compared to 172,235 in the previous fiscal year. Over a ten-year period, the total number of annuitants has grown slightly more than 22% from 142,887 at the end of fiscal year 2014 to 174,609 at the end of fiscal year 2023. As of December, our current number of retirees and beneficiaries receiving monthly allowances is more than 177,077, because of new retirements since July 1, 2023.

To improve and enhance the services we provide to our members, we are seeking to restructure our member services team under a new Member Services Administrator. Doing so would allow us to better serve the more than 420,000 members of the retirement system while managing the turnover in Retirement Administration. A standalone division focused on modernizing how we serve our members could do so more effectively and efficiently. We are requesting the resources required to hire an experienced member services professional to restructure the call center, counselors, and correspondence functions. Specifically, the Administrator of Member Services would be expected to improve call center scripts, explore alternative ways to provide members the information they are seeking, proactively engage our members, and improve staff morale. The position would work closely with a new Director of Communications to better educate our members.