

2016 Board Requested Legislation

The following legislative proposals are offered by the Board of Trustees for the State Retirement and Pension System for the Joint Committee on Pensions' consideration for the 2017 legislative session. These legislative proposals are intended to clarify or correct perceived inconsistencies within existing law, and in some instances, correct inconsistencies with federal law. These proposals, if approved by the board, will be presented to the joint committee for its consideration to sponsor as legislation for the 2017 legislative session.

References to the Reformed Contributory Pension Selection

When the Reformed Contributory Pension Benefit (RCPB) was created under Title 23, Subtitle 2, Part IV of the State Personnel and Pensions Article in 2011, reference to this new tier of the Employees' Pension System (EPS) was inadvertently omitted from various sections of this article. Staff has found two provisions addressing eligibility service in Title 23 (§§ 23-306.2(a) and (c)) that should have been amended in 2011 to include reference to the RCPB. Staff is recommending these sections be amended to now include the RCPB.

There is no cost associated with this proposal.

Purchase of Employment as a Legislative Employee

Section 23-307 of the State Personnel and Pensions Article addresses the purchase of service credit by members of the EPS. Specifically, this provision provides that members of the EPS may purchase various types of service, provided the member pays one-half of the employee cost and one-half of the employer cost for the service. One type of service that may be purchased under this section is up to 130 days of employment as an employee of a member of the Maryland Senate or House of Delegates, prior to the individual joining the EPS. However, the provisions of § 23-307 that address purchasing this service provide a different calculation than what is provided for all other eligible service under this section. Moreover, § 23-307 provides different calculations depending on whether the member commenced employment for the General Assembly on or after the start of the EPS, on January 1, 1980. Service purchased prior to January 1, 1980 is set at the amount that the member would have been required to contribute for that period of employment; plus interest compounded annually. For employment on or after January 1, 1980, the cost of service equals the amount that the member would have been required to contribute for that period of employment and the amount that the State would have been required to contribute for the member for that period of employment, plus interest on each piece, compounded annually. Finally, the interest rate for this purchase (regardless of when the employment occurred) is calculated using the same formula that was used beginning in 1984, to determine the amount of interest a member would receive on the member's refunded member contributions after transferring from the Employees' Retirement System (ERS) to the then non-contributory EPS. In an effort to encourage more members to transfer from the ERS to the EPS, in 1984, the interest rate paid on the member's contributions was changed from 4%, compounded annually, to the average annual realized rate of return on the System's investment portfolio for the five years preceding the transfer. This rate is referred to as the "transfer interest rate" and is

the rate that is currently applied to the cost of service for employment as an employee of the General Assembly prior to joining the EPS. All other purchases under § 23-307, and throughout the State Personnel and Pensions Article for that matter, are calculated using either 4% or 5% interest, compounded annually.

Staff has researched this provision and cannot determine any member of the EPS in the past 10 years who has requested to purchase pre-membership employment with the General Assembly. Additionally, in 2004, all new legislative employees were required to join the EPS as a condition of employment. This was changed to provide these individuals with optional membership beginning in 2015, however, the option to join the EPS is now irrevocable and must be made at the commencement of employment. Therefore, since 2004, legislative employees commencing employment on or after July 1, 2004, will not have any service that could be purchased under § 23-307.

While staff recognizes that it is unlikely that any legislative employee will come forward in the future seeking to purchase up to 130 days of employment prior to joining the EPS, it is still possible. Therefore, in the event this would happen, staff would recommend amending the purchase provisions for this specific type of employment as follows:

- (1) for employment before January 1, 1980, the amount that the member would have been required to contribute for that period of employment, plus 5% interest, compounded annually; and
- (2) for employment on or after January 1, 1980, one-half of the employee cost and one-half of the employer cost for the service.

Staff recognizes that if § 23-307 is amended, as recommended, it would result in purchases of service at a lower cost than is currently provided for in statute. That being said, staff also believes that due to the fact that there has not been a request to purchase this type of employment in the last 10 years, coupled with the small period of time that can be purchased under the provision in question, the cost to the System would be de minimus.

Independent Medical Evaluations – Small Procurements

Independent medical evaluations are required through the Agency's regulations to be performed on ever disability applicant applying for a line of duty disability and at the discretion of the medical board for applicants applying for non-line of duty disability applicants. In order to stay under the small procurement cap, the Agency currently can pay only up to \$25,000 each year to each doctor that performs independent medical evaluations. This amount can be reached quickly through examinations and testifying before the Office of Administrative Hearings and any other appeals that may occur. Once the \$25,000 cap is reached, the Agency is placed in the position of either finding additional doctors willing to do independent medical evaluations or seek increases in funding through the regular procurement process, on a case by case basis. To avoid the seeking out additional doctors to perform the independent medical evaluations and the administrative burden and time delay incurred through navigating the State's regular

procurement process, staff is recommending expanding the System's procurement exemption in the State Finance and Procurement Article to include an exemption for the services of physicians related to the medical board. These services would include independent medical examinations and any resulting testimony that would be required of the physicians.

Membership Elections - Prohibited

Recent Internal Revenue Rulings have alerted staff and legal counsel to issues regarding provisions within the State Personnel and Pensions Article that allow certain individuals the election to join various plans within the System throughout the employment careers of these individuals. Generally, these rulings address impermissible cash or deferred arrangements and limit the circumstances under which one-time irrevocable elections are permissible. Based on a review of these rulings, and on advice of tax counsel for the System, staff is recommending changes to several provisions in both the Optional Retirement Program (ORP) and the EPS that are currently in conflict with these rulings.

Optional Retirement Program

Presently, individuals employed as faculty or professional employees of the University of Maryland, Morgan State University, St. Mary's College, the Maryland Higher Education Commission or any community college have the option to join either the Teachers' Pension System (TPS) or the ORP within their first year of employment with one of these employing institutions. If no election is made within the first year of employment, the individual is enrolled in the TPS. This election is allowed even if the individual is currently, or previously has been, a member of another plan in the System. If the member accepts new employment with an employing institution, that individual has the option to join the ORP or the TPS. (In instances where the individual is already a member of the TPS, the election to move to the ORP or stay in the TPS is presented.)

Based on a review of the recent Internal Revenue Rulings, tax counsel has advised that current and former employees of the State or a participating governmental unit (PGU) who at some point in their careers have been members of one of the several systems, may no longer be offered an election to join the ORP. In addition, tax counsel has also advised that new employees, with no previous membership in one of the several systems may only be offered an election to join the ORP or the TPS at the commencement of employment. In other words, individuals joining the System for the first time may no longer have a year to elect either membership in the ORP or the TPS. Accordingly, staff is recommending changes to Title 30 of the State Personnel and Pensions Article that would reflect the advice of the System's tax counsel.

Optional Membership in Other State Systems

Tax counsel has also found provisions that provide for optional membership in the EPS that it is recommending be amended to comply with recent Internal Revenue Rulings. Specifically, § 23-209 allows the board the discretion to make membership optional for members

in the TPS whose compensation is paid only partly by the State or whose employment is temporary or on other than a yearly basis. In addition, § 24-203 provides that the Secretary of State Police has the option to join either the State Police Retirement System (SPRS) or the EPS. Because the IRS is now only permitting optional membership at the commencement of employment, staff is recommending § 23-209 be amended, accordingly. Moreover, amendments to § 23-209 would also include language that would prohibit any election if the individual is currently a member of the TPS at the time the individual accepts employment that would qualify under this section. With regard to the Secretary of State Police, to avoid potential issues that would require the Secretary to become a member of the EPS due to earlier membership in that system, staff is recommending amending § 24-203 to remove the election entirely. Accordingly, the Secretary would then be required to become a member of the SPRS.

Finally, the last area of the State Personnel and Pensions Article that tax counsel is recommending be amended concerns elections made by employees of PGUs at the time a new PGU enters the System or an existing PGU withdraws from the System. According to the recent Internal Revenue Rulings, staff has been advised that current employees of an enrolling PGU may no longer be offered the option to join the EPS, Law Enforcement Officers' Pension System (LEOPS) or Correctional Officers' Retirement System (CORS), if at the time the PGU joins the System, it (1) participates in the "pick-up" program of either the EPS, LEOPS, or CORS, and prior to joining the EPS, LEOPS, or CORS had its own plan that participated in a pick-up program; and (2) the employee contribution rates between the State plan and the PGU plan are different. Additionally, this prohibition on elections would also apply if the same criteria were met for a PGU withdrawing from the plan. If the PGU is leaving to start a plan that participates in a pick-up program and has a different contribution rate from the State plan from which it is withdrawing, the employees of the PGU participating in the EPS, LEOPS, or CORS at the time of withdrawal would not be permitted to elect to leave and join the new plan offered by the PGU.

In order to remain in compliance with provisions of the Internal Revenue Code and recent Internal Revenue Rulings, staff is recommending the amendments proposed by tax counsel.

Optional Retirement Program – Annuity Contracts

In conducting its bi-annual review of the investment performance of the ORP, Segal Rogerscasey ("Segal") presented the Investment Division staff with several recommendations relating to the board's ORP agreement with TIAA CREF. Investment Division staff supported these recommendations and Segal and staff presented the recommendations to the Investment Committee during the May, 2016 Investment Committee meeting. Several of these recommendations were predicated on moving from TIAA's current individual annuity contract structure to a product known as the Retirement Choice contract. Segal and staff explained that the Retirement Choice contract has lower fees, allows for greater portability and provides a plan sponsor with greater flexibility in managing a plan's investment options.

Segal explained that "[w]hen TIAA was first retained as an ORP vendor, the only contract available to the State was the Retirement Annuity. These are individually-owned contracts or certificates that are controlled by plan participants. Because the contracts are

controlled by the participants, the board does not have complete flexibility over investment options and the ability to map assets to other funds.” Additionally, the Retirement Annuity structure limits the Board’s ability to implement alternative fee sharing structures. Segal further advised that “as the retirement industry has evolved over time, TIAA has created and made available institutionally owned, group contracts (Retirement Choice contracts) as an alternative to the original individual contracts.” Segal and Investment Division staff recommended moving to the Retirement Choice contract for all future contributions, including rollovers.

In order to implement the recommended Retirement Choice contract, §30-206 of the State Personnel and Pensions Article would need to be amended to allow the board to enter into a group annuity contract to provide benefits to participating employees. Amendments to §30-206 would clarify that an employee’s rights under an annuity contract are nonforfeitable in accordance with IRC § 403(b)(1)(C), but would no longer require that annuity contracts purchased under the program “be issued to and become the property of the participating employees.”

Reduction of Accidental Disability Benefits by the Amount of Related Workers’ Compensation Benefits

Please see Attachment A.

Board of Trustees Budget Authority – Investment Division

Please see Attachment B.

Abolishing Statute Requiring the Reduction of Certain Accidental Disability
Benefits by the Amount of Related Workers' Compensation Benefits

Background:

Maryland law generally prevents a government retiree covered by both workers' compensation and a governmental pension or retirement plan from recovering twice for a single injury. The General Assembly has enacted two intersecting laws to prevent double recovery.

Md. Code Ann., State Personnel & Pension Art. ("SPP"), § 29-118 provides:

(1) Except as otherwise provided in this subsection, this section applies to a retiree and any designated beneficiary.

(2) (i) This section does not apply to:

1. a retiree of a participating governmental unit, or a designated beneficiary of that retiree; or

2. a retiree of the Employees' Pension System or the Employees' Retirement System who receives a disability retirement benefit as a former employee of a county board of education or the Board of School Commissioners of Baltimore City, or a designated beneficiary of that retiree.

(ii) A retiree described in subparagraph (i) of this paragraph, or a designated beneficiary of that retiree is subject to § 9-610 of the Labor and Employment Article.

(b) Reduction in retirement allowance. --

(1) The Board of Trustees shall reduce an accidental or special disability retirement benefit by any related workers' compensation benefits paid or payable after the effective date of retirement if the workers' compensation benefits:

(i) are paid or payable while a pension is paid or payable; and

(ii) are for an accidental personal injury arising out of and in the course of the retiree's employment by a participating employer.

Under SPP § 29-118, the Board of Trustees (the "Board") must reduce the accidental or special disability retirement benefit of a State retiree or a Teachers' Pension System/Teachers' Retirement System ("TPS/TRS") retiree by any related workers' compensation benefit paid or payable after the effective date of retirement if the two benefits are paid or payable during the same time period.¹

Md. Code Ann., Labor & Employment Art. ("LE"), § 9-610 provides that:

Except for benefits subject to an offset under § 29-118 of the State Personnel and Pensions Article, if a statute, charter, ordinance, resolution, regulation, or policy, regardless of whether part of a pension system, provides a benefit to a covered employee of a governmental unit or a quasi-public corporation..., payment of the benefit by the employer satisfies, to the extent of the payment, the liability of the employer and the Subsequent Injury Fund for payment of similar benefits under this title.

¹ The retirement allowance is not reduced "to be less than the sum of the retiree's annuity and the amount authorized to be deducted for health insurance premiums; or for workers' compensation benefits that are reimbursements for legal fees, medical expenses or other payments made to third parties and not the retiree." SPP § 29-118(b)(2).

Under this statute an employer, such as the State or a participating governmental unit ("PGU"), is required to offset a disability retiree's workers' compensation award payments by the amount of similar pension benefits that are not subject to an offset under § 29-118.

Because the Maryland State Retirement and Pension System ("MSRPS") is not involved in the workers' compensation process, its statutory duty regarding reducing an accidental disability award is often not fully understood by the Commission. Moreover, the Commission, the disability retiree and the attorneys that practice before the Commission, often do not understand the intricate interplay between LE § 9-610 and SPP § 29-118. Therefore, the Commission's awards may not acknowledge or consider the MSRPS's required reduction of certain accidental disability benefits when they grant or approve employer and insurer offsets to workers' compensation awards if an MSRPS accidental disability allowance is also being paid or will be paid.

The complicated statutory scheme for offsets and reductions for workers' compensation and retirement disability awards have resulted in a process that is disjointed, and sometimes inconsistent in its application. Moreover, the Retirement Agency finds that administering and monitoring the mandatory reduction of an accidental benefit in many instances can be unduly burdensome and time-consuming. Highlighted below are some examples of issues that the Retirement Agency has encountered with administering SPP § 29-118:

Issue 1: Retroactive Accidental Disability Awards

When an accidental disability retirement is *retroactively* awarded, the Retirement Agency has found it nearly impossible to recover the related workers' compensation payments if an offset based on LE § 9-610 for the ordinary disability award has been granted to the employer/insurer.

In these cases, the employer or insurer has already been credited an offset, thereby reducing the workers' compensation payments actually received by the disability retiree. Nonetheless, SPP § 29-118 requires the Retirement Agency to reduce the retiree's accidental benefits to recoup the amount of the workers' compensation award. To adhere to SPP § 29-118, the Agency would have to recoup money from the disability retiree that he or she never received, or seek a return of the money the employer/insurer.

For obvious reasons, the Retirement Agency has been reluctant to reduce a retiree's accidental disability retirement in this situation. Moreover, the Agency has been unsuccessful in recouping this money from the employer. Thus far, no employer has agreed to repay money to the disability retiree or the System, or to stop an ongoing offset. The employers' claim that the offset was based on a valid order or settlement signed by the Commission, and that at the time of the award or settlement, the offset was proper. In one case, the Retirement Agency went before the Commission to reopen a case. However, the Commission ruled that the Retirement Agency did not have standing to challenge the award.

Example:

- TPS employee was injured in a workplace accident on Jan. 1
- On Feb. 1, TPS member is granted and accepts an ordinary disability retirement by the Board (\$800/mo. (\$200/week)), but is appealing award for accidental disability.
- On March 1, TPS retiree receives a workers' compensation award of \$200/week for Jan. 1 injury
- Under LE § 9-610, the Commission awards TPS retiree's former employer, a local school board, an offset of \$200/week because of the overlapping ordinary disability award
- On July 1, Board retroactively grants TPS retiree an accidental disability award of \$1200/mo (\$300/week) for Jan. 1 accident

- Under SPP § 29-118, the Agency should recoup the \$200/week workers' compensation award since March 1 (approx. \$1600), and should reduce any overlapping accidental disability award by \$200/week going forward.

Issue 2: Erroneous Commission Awards

The Agency has uncovered at least one instance where the Commission erroneously awarded an offset for an employer/insurer despite the fact that the retiree was granted an accidental retirement benefit subject to a SPP § 29-118 reduction. It is the Agency's position that it must reduce the accidental retirement allowance in accordance with § 29-118, regardless of the Commission's erroneous award. Nonetheless, this could create a hardship for the retiree who must seek to have the Commission amend the award, or take other legal action.

Example:

- TPS employee was injured in a workplace accident on Jan. 1
- On Feb. 1, TPS employee is granted and accepts an accidental disability retirement by the Board (\$1000/mo. (\$250/week))
- On March 1, TPS retiree is awarded workers' compensation (\$200/week) for the Jan. 1 injury
- Under LE § 9-610 the Commission erroneously grants the employer, a local school board, an offset based on the accidental disability award. Because of the offset the TPS retiree is not receiving any money for workers' compensation award.
- Under SPP 29-118, the MSPRS must reduce the accidental disability award by \$200/week based on the related workers' compensation award. Therefore, the TPS retiree is subject to two offsets, resulting in a monthly compensation of \$50/week.

Issue 3: Delayed Notice of a Workers' Compensation Award

A workers' compensation award is often granted after an accidental disability has been awarded. Accidental disability retirees are instructed to notify the Agency if they are subsequently granted a workers' compensation award for the same injury for which they are receiving the accidental disability benefit. Many times, however, the disability retiree does not notify the Agency, and the Agency does not discover the related workers' compensation award until many months or years after the award. Recouping the double payment can lead to an almost total reduction of the retiree's monthly retirement allowance, resulting in claims of real or perceived hardship to the disability retiree.

Example:

- On March 1, EPS state employee is granted and accepts an accidental disability retirement for a Jan. 1 workplace accident for \$1000/month.
- Agency instructs EPS retiree to report any subsequent workers' compensation awards
- July 1 Commission awards EPS retiree a \$20,000 lump sum award
- EPS retiree does not report award to the Agency
- Two years later the Agency learns of lump sum award
- Agency reduces EPS retiree's monthly accidental disability benefit to maximum allowed to recoup the lump sum award, leaving little for retiree to live on.

Proposed Legislative Amendments:

Abolishing SPP § 29-118 and deleting reference to SPP § 29-118 from LE § 9-610

Abolishing SPP § 29-118 would mean the Board would no longer reduce accidental disability awards for related workers' compensation award payments. However, the retiree would not receive both accidental and workers' compensation benefits for the same injury. If SPP § 29-118 were abolished, LE § 9-610 would prevent the disability retiree from being paid for the same injury twice. In fact, LE § 9-610 would prevent the disability retiree from receiving any "similar" workers' compensation benefits. The employer or insurer that pays the workers' compensation award would reduce or "offset" the workers' compensation payments, based on the accidental disability award. In fact, this is the way all ordinary disability allowance offsets are handled now. In the case of State retirees, the State, through its third-party administrator, the Injured Workers' Insurance Fund ("IWIF"), would receive the offset.² In the case of TPS retirees, the respective local school boards would receive the offset. The Agency reports that because the local school boards now share in the costs of teachers' retirements their receipt of the workers' compensation offset is not a windfall to the local school boards.



The following charts demonstrate how the offset is taken when a MSRPS disability retiree receives a similar or related workers' compensation benefit currently and under the proposed amendments:

Offsets under the current law

	TPS/TRS retiree	State retiree	PGU retiree
Ordinary Disability	Employer reduces retiree's workers' compensation award (LE § 9-610)	State (IWIF) reduces retiree's workers' compensation award (LE § 9-610)	Employer reduces retiree's workers' compensation award (LE § 9-610)
Accidental/Special Disability	MSRPS reduces retiree's disability allowance (SPP § 29-118)	MSRPS reduces retiree's disability allowance (SPP § 29-118)	Employer reduces retiree's workers' compensation award (LE § 9-610)

Offsets under proposed amendments

	TPS retiree	State retiree	PGU retiree
Ordinary Disability	Employer reduces retiree's workers' compensation award (LE § 9-610)	State (IWIF) reduces retiree's workers' compensation award (LE § 9-610)	Employer reduces retiree's workers' compensation award (LE § 9-610)
Accidental/Special Disability	Employer reduces retiree's workers' compensation award (LE § 9-610)	State (IWIF) reduces retiree's workers' compensation award (LE § 9-610)	Employer reduces retiree's workers' compensation award (LE § 9-610)

-  =MSRPS offsets under the current law
-  =Offset provisions changed under the proposed legislation

² The State of Maryland's workers' compensation program is self-insured. LE § 10-102(d). IWIF is the third-party administrator of workers' compensation benefits to the State of Maryland. *Id.*

MEMORANDUM

TO: Administrative Committee

FROM: Andrew C. Palmer, CIO

THROUGH: R. Dean Kenderdine, Executive Director

DATE: September 6, 2016

RE: Board of Trustees Budget Authority – Investment Division

Executive Summary:

The MSRPS Investment Division is seeking legislative changes to invest the Board of Trustees of the Maryland State Retirement and Pension System with budgeting authority for the Investment Division. Specifically, the Board would have the authority to set compensation levels for staff, create and eliminate positions and approve investment-related expenditures to preserve and enhance the value of the System's assets. This recommendation is intended to alleviate the resource constraints faced by the division in attracting and retaining qualified personnel, creating additional positions, and providing other investment-related resources in a timely and responsive manner. These suggestions come after a review by the CIO found that the System's assets are at risk under the current process and the System is challenged to reduce fees through internal management and more broadly, meet the investment objectives of the System requires with the current level of budgetary flexibility.

Within existing statute, the CIO and the Board have authority to incur investment-related expenses, but excludes the work of the investment division from the definition of investment management expenses, which has been interpreted as fees paid to external managers. This legislative change would recognize the work of the investment division as investment management.

These requests stem from the CIO's assessment that:

1. The current level of staffing could put the System's ability to achieve its return objective at risk.
2. The compensation structure of staff contributes to turnover and poor alignment of interests between staff and the plan, which exacerbates the risk to the plan from low levels of staffing.
3. The level and compensation of staff are an impediment to internal management initiatives that are contemplated to lower System costs and improve the potential of achieving the System's return objectives.

4. The System's intention to create an internal investment capability and improve the System's potential to achieve its investment objectives requires more flexibility in obtaining investment management-related products and services.

Background:

Having joined the MSRPS Investment Division as CIO in July 2015, I have had the opportunity to review and analyze the division's staffing level and operations. I have found that the sophistication, size and complexity of the investment portfolio have outpaced the staffing levels. From the end of 2005 to the present, the plan has grown from 7 investment strategies and 50 accounts to 18 strategies and 380 investment accounts by 2016. During that same time, fund assets have grown from \$33.7 billion to \$46.2 billion, while Investments Staff has grown from 15 to 23.

During the past year, we have been examining our structure to identify opportunities to streamline processes and improve productivity and efficiency through software tools. Currently, we are evaluating client relationship management software to enhance our process to source, diligence and monitor the managers we engage. Another area of focus is the potential use of internal management to reduce the number of managers employed and the related fees. Internal management could also add value through tactical positioning of the portfolio based on perceived market opportunities.

While more accounts and a larger asset base may suggest that more staffing is appropriate, they do not provide guidance on the appropriate level of staffing. In 2015, the New York City Comptroller's Office contracted with the Funston Group to perform an operational review of the five pension systems and the investment office that supports them. The study is available on the Comptroller's website and provides some guideposts for staffing. A second, more limited study was performed for the New York Common Retirement Fund and is available on the state comptroller's website.

The reports suggest that the peer median number of investment staff with respect to asset size is .6 FTE/\$1 billion. At 16 investment staff and \$46 billion in assets, the MSRPS Investment Division has .35 FTE/\$1 billion. The peer median investment staff for the System would be 27 full-time employees.

Funston further provided suggestions on the appropriate level of staffing per asset class. They found significant business risk in asset classes that were managed by only one person. The risks result from the lack of coverage depth, the lack of institutional continuity, periods of reduced oversight and opportunity cost from a reduced scope of inquiry into better investment alternatives. Currently, MSRA has six asset classes that are each managed by one person: fixed income, credit, absolute return, real estate, commodities and natural resources. In fact, four people are responsible for these six asset classes as well as the risk management function.

Lastly, Funston recommends a robust human resources function to reduce the risk of turnover. The elements they recommend are:

- Recruit superior investment talent
- Create strong onboarding practices
- Implement a robust training program
- Provide opportunity for career advancement

At present, MSRA does not have a robust human resources function. While the agency is able to recruit qualified individuals to work at the System, the compensation structure and lack of career advancement opportunities available in the division have limited the System to individuals who self-select into the agency because of geographic preference or the opportunity to rapidly gain experience that will be valuable to a subsequent employer.

The opportunity for career advancement within the Investment Division is limited due to the lack of hierarchy. Currently, there are two position levels, Senior Investment Analyst and Managing Directors. Barring turnover at the Managing Director level, analysts have no opportunity for advancement in position or salary, regardless of how their skills, experience or responsibilities expand. Managing Directors and the Deputy Chief Investment Officer have been offered some salary opportunity through the 2012 legislation that placed them in the Executive Salary Plan, but many of them are near the top of that pay scale. One recent Managing Director departure cited the pay cap as the primary reason for leaving.

Training and onboarding practices are weak given the limited overlap in asset classes to provide training to new employees.

In the New York City study, Funston noted that the poor compensation structure added to the risk of the System stemming from personnel issues. However, New York City was able to bypass this issue, highlighted in the study, because the Comptroller had already implemented a plan to improve compensation. For the New York Common Fund study, Funston found that:

“...While the fund is currently well-managed, compared to most peers, it remains severely understaffed for its scale and complexity, with underdeveloped risk analysis and management capabilities and an over-reliance on outsourced investment management and support functions. In addition, independent compensation benchmarking indicates that PICM” (Division of Pension Investment and Cash Management) “staff compensation levels are in the bottom quartile for similar public pension funds. There is justifiable concern that current staff will leave if compensation is not increased, and it is likely that PICM will struggle to recruit needed new staff and stem turnover at current compensation levels.”

The System’s ability to attract and retain qualified personnel will depend on its ability to change the compensation structure within the division. Using publicly available data on compensation for state plans of similar size and structure, MSRA found that staff was in the bottom quartile of pay for most positions. This data compares MSRA salaries for 2015 against peer salaries from 2012 to 2015.

		2015		PUBLIC			
		MSRA	MSRA	DATA			
Position	Title	Number	Mean Salary	Low Q	Median	Upper Q	Average
Executive Director	Executive Director	1	150.5		249.5	0	249.5
CIO	CIO	1	330	244	295	324	287
Deputy CIO	Deputy CIO	1	143.1	173	253	309	245
Team Leader Traditional Products	Managing Director	1	123.4	171	183	233	203
Team Leader Alternative Products	Managing Director	2	130.2	171	183	233	203
Senior Manager Ext	NA	6	100	118	141	168	141
Senior PM Fixed Income	Senior Analyst	0	0				
Senior Analyst Ext	Senior Analyst	2	94.3	100	110	126	111
Senior Compliance	Senior Compliance	1	90.7	n/a	n/a	n/a	n/a
Total/Average Investment Staff		13	108.2	122.6	143.7	174.5	147.8

The Peer group is highlighted in green in the table below and represents funds of similar size but only modest or no internal management.

Name	Total U.S. DB assets	% OF ASSETS MGD INTERNALLY
California Public Employees' Retirement System	\$283,879	67%
California State Teachers' Retirement System*	\$181,294	38%
New York State Common Retirement Fund	\$173,541	57%
State Board of Administration of Florida	\$139,231	43%
Teacher Retirement System of Texas	\$125,327	36%
New York State Teachers' Retirement System	\$101,828	63%
State of Wisconsin Investment Board*	\$90,926	NA
North Carolina Retirement Systems	\$85,511	26%
Ohio Public Employees Retirement System	\$85,256	35%
New Jersey Division of Investment	\$73,008	71%
Washington State Investment Board	\$71,133	22%
Teachers Retirement System of Georgia	\$62,529	100%
Retirement Systems of Alabama	\$32,185	100%
Tennessee Consolidated Retirement System	\$41,164	74%
Public Employees' Retirement Association of Colorado	\$42,042	73%
State Teachers' Retirement System of Ohio	\$68,676	70%
Employees Retirement System of Texas	\$25,101	62%
State of Michigan Retirement Systems	\$59,407	37%
Virginia Retirement System	\$65,375	36%
Pennsylvania Public School Employees' Retirement System	\$47,569	31%
Arizona State Retirement System	\$33,680	26%
Oregon Public Employees Retirement Fund	\$68,122	10%
Illinois Municipal Retirement Fund	\$33,429	1%
Teachers' Retirement System of the State of Illinois	\$43,450	0%
Minnesota State Board of Investment	\$60,125	0%
Massachusetts Pension Reserves Investment Management Board*	\$58,840	0%
Connecticut Retirement Plans & Trust Funds	\$28,093	0%
South Carolina Public Employee Benefit Authority	\$27,699	0%
Iowa Public Employees' Retirement System	\$27,190	0%
Utah State Retirement Systems	\$26,723	0%
Public School and Education Employee Retirement Systems of Missouri	\$36,741	0%
Public Employees' Retirement System of Nevada	\$32,991	0%
Commonwealth of Pennsylvania State Employees' Retirement System	\$25,922	0%
Texas Municipal Retirement System*	\$24,010	0%
Maryland State Retirement & Pension System	\$43,691	0%

In addition to the staffing issues, we have identified additional resource issues that present challenges to the division under the existing budget process. The System's requirement for additional services and products changes from year to year as the asset allocation changes and markets evolve. In addition, staff's ability to engage in any level of internal management will require more flexibility in budgeting and timing than is afforded in the present process. The changing regulatory landscape is an additional driver of the need for responsiveness in the budgeting process.

Legislative Solution:

The staffing levels of the Investment Division present two areas of concern: systemic risk of understaffing and insufficient resources to develop an internal management function. The legislature has recognized the compensation issues facing the System and has made a number of changes that have provided the MSRPS Board salary-setting authority for the CIO, and with limitations, the Deputy CIO and Managing Directors. This authority has been effective in

improving the System's ability to attract and retain senior staff, but has proven to be of temporary effectiveness as industry compensation has continued to expand. In addition, the compensation for the remainder of staff has become increasingly uncompetitive, and has been a significant impediment in attracting and retaining qualified staff.

Existing statute provides that investment management expenses are excluded from the state's budgeting process and are considered an expense of the fund. The work of the Investment Division has been interpreted to be an administrative expense and has been included in the State's annual budgeting process. In fact, the investment division performs the services of a fund-of-funds manager for the entirety of the System's assets. Its primary function is to preserve and enhance the value of the System's assets through advising the Board on asset allocation, making recommendations to the CIO on manager selection and termination, and monitoring the System's managers for compliance. All of these are investment management functions. In addition, to the extent the System manages assets internally, it will be directly supplying investment management services.

Expanding the Board's authority to encompass all of the resource needs of the Investment Division, both personnel and services, and redefining investment management expenses to include the expenses of the Investment Division will provide the needed flexibility to meet the System's needs and provide effective control of the expenses. In addition to the Board's oversight of these expenses, existing statute places a cap on investment management service costs incurred in public markets. MSRA expenses could be included in this maximum, providing an additional level of control.