

MAINE STATE LEGISLATURE

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HAND DELIVERED

February 28, 2014

Senator Dawn Hill, Senate Chair
Representative Margaret R. Rotundo, House Chair
Members, Joint Standing Committee on Appropriations and Financial Affairs
5 State House Station
Augusta, ME 04333-0005

Dear Senator Hill, Representative Rotundo and Members of the Appropriations Committee:

Please accept the Maine Public Employees Retirement System's (MainePERS) annual report to the Joint Committee on Appropriations and Financial Affairs. This report is prepared in response to 5 M.R.S.A. § 17103, sub-§11 requiring the MainePERS Board of Trustees to submit a written report about the Maine Public Employees Retirement System to the appropriate legislative committee each year by March 1. The System's Comprehensive Annual Financial Report (CAFR), copies of which were previously provided to the Committee, and which is available at www.maineopers.org, provides detailed information that supplements this report.

We are pleased to provide this information based on operations through June 30, 2013.

INVESTMENTS

The ending market value of the System's defined benefit plans for the fiscal year 2013 was \$11.3 billion. The net position of the trust fund increased strongly, as net investment and other income for the fiscal year significantly exceeded payments to retirees. The investment return for fiscal year 2013 was 11.1%, which compares favorably to the 7.25% actuarially assumed investment rate of return for the System.

Because the System's investment strategy has changed little from year to year, these results were determined almost entirely by behavior of the capital markets. For the fiscal year ended June 2013, strong gains in domestic and foreign stock markets more than offset declines in fixed income markets.

Fiscal Year Ending	Fund Value	Investment Return*
June 30, 2011	\$10.8B	22.4%
June 30, 2012	\$10.5B	.6%
June 30, 2013	\$11.3B	11.1%

*Refers to performance of the investments, not the change in Fund Value

The annualized returns, net of management fees, for the three-year, five-year, 10-year, and 30-year periods ending on June 30, 2013 based on market value were 11.0%, 4.3%, 6.9%, and 8.7%, respectively.

Negative returns for the fiscal years ended June 30, 2008 and 2009, which impacted the System's five-year return, were the result of declines in domestic and foreign stock markets, partially offset by gains in the domestic bond market.

In 2012, the System changed its target allocation to 20% domestic publicly traded stocks, 20% international publicly traded stocks, 25% fixed income investments, and 35% to alternative investments.

The System's allocation to alternative investments targets 10% in infrastructure, 10% in private equity, 10% in real estate, and 5% in hard assets, which may include agriculture, timber, and commodities. At June 30, 2013, alternative investments comprised approximately 10% of the System's portfolio on an invested basis. In addition, the Board of Trustees has approved a 0% to 10% allocation to an "Other" category that seeks sound investment strategies that do not fall into one of the other asset categories. While the Board has approved the new Asset Allocation targets, it will take several years to fully implement and fund the alternatives allocation.

Investment performance affects employer contribution rates because investment earnings are a significant contributor to the total fund. Because most of the System's benefit payments are not due for several decades into the future, the System has concluded it is prudent in achieving strong long-term investment performance to maintain a substantial portion of its assets in publicly traded equities and private equity and other return-seeking investments. For the past ten years, the

MainePERS Target Asset Allocation



System has invested between 60% and 70% of its assets in equities. Over sufficiently long periods, equities have been shown to outperform bonds. The System expects this relationship to hold in the future. All of the assets of the System's retirement plans and other funds continue to be in portfolios managed by professional investment management firms. These managers act as fiduciaries and invest the assets assigned to them in accordance with the System's investment policies and the individual agreements between MainePERS and the investment managers.

The 123rd Legislature created an Investment Trust with a \$100 million initial contribution for the purpose of investing funds set aside by the State of Maine to cover Other Post-Employment Benefits (OPEB) liabilities for State retiree health insurance benefits. The Trustees of MainePERS were named Trustees for this Investment Trust and have the responsibility for investing these funds. The market value for the OPEB assets at June 30, 2013 was \$162.0 million, reflecting a 12-month increase of \$20.5 million. The fund gained \$18.7 million from investment activity and an additional \$1.8 million was contributed by the State of Maine.

PROGRAM FUNDING

Funding Status of the State Employee and Teacher Retirement Program

The unfunded actuarial liability (UAL) of the State Employee and Teacher Retirement Program decreased in FY 2013 from \$2.673 billion at June 30, 2012 to \$2.653 billion at June 30, 2013. While investment returns on a market value basis were 11.1% as stated earlier, the return on an actuarial value of asset basis was 6.76% for FY 2013, an increase from the FY 2012 actuarial return of 4.77%. This is because the actuarial value, upon which contributions are calculated, continue to absorb the 2008-09 market losses through the end of FY13. This actuarial return is therefore lower than the actuarial investment return assumption of 7.25%. (See the Investments section for market returns.) The actuarial funded status of the State Employee and Teacher Retirement Program, or the ratio of plan assets to plan liabilities, increased in FY 2013 from 76.9% to 77.6%. Ten years ago, the funding ratio was 67.4%.

Funding Status of the Legislative Retirement Program

The Legislative Program is funded at 142.2% as of June 30, 2013, primarily because few legislators qualify for a retirement benefit under the terms of the program even though contributions were made on their behalf at one point in time. No employer contribution is currently required because of the resulting overfunded status of the program.

Funding Status of the Judicial Retirement Program

The funding status of the Judicial Program decreased from 107.3% at June 30, 2012 to 97.5% at June 30, 2013. As with the funding of other programs, this is at least in part because of the continued absorption of the 2008-09 market losses through the end of FY13.

Funding Status of Consolidated Plan for Participating Local Districts

The Consolidated Plan consisted of 286 participating local districts at December 31, 2013. The funding level of the plan decreased slightly from 86.9% at June 30, 2012 to 86.6% at June 30, 2013. Since the inception of this plan, employer rates have remained stable and low. To partially address the decline in plan funding, employer rates have been incrementally increasing since FY 2011 and are scheduled to return to their original level of 8% aggregate by 2015. To further maintain the strong fiscal condition of this plan, the Participating Local District Advisory Committee that continuously monitors the Consolidated Plan recommended modernization of benefit provisions, and legislation was submitted to the 126th Legislature to accomplish that result. PL 2013, c. 391, the public law that enacted these benefit provision changes, was effective October 9, 2013.

OPERATIONS

Changes in Board Membership

On June 7, 2013, the Senate confirmed Shirrin Blaisdell as a Trustee. Ms. Blaisdell serves in the seat of a retiree receiving a MainePERS benefit, replacing George Burgoyne, who had served as a Trustee since 2007.

Legislative

As in prior years' reports, MainePERS is not reporting information as set forth in the requirement of 5 M.R.S.A. §17103, sub-§11, paragraph C. This requirement refers to a law pertaining to divestment from South Africa that has since been repealed. We therefore recommend that the report requirement found in paragraph C likewise be repealed. Absent another legislative vehicle through which to make this change, MainePERS will include this recommendation in a future System omnibus bill.

The 2012-2013 biennial budget established a working group to design a new retirement plan for State employees and teachers hired after June 30, 2015. Beginning in September 2011 and continuing throughout 2012, staff of the System as well as its actuaries and pension counsel supported the working group in

developing a “New Pension Plan” design that responded to the legislative directive. In March 2012, a full report, “New Pension Plan Design and Implementation Plan,” was submitted to the Appropriations Committee. Additional legislation was enacted during the Second Regular Session of the 125th Legislature directing the System to develop proposed legislation and an implementation plan to implement the plan described in the March 2012 report. On January 15, 2013, the System submitted the proposed legislation and implementation plan to the Appropriations Committee.

In October, 2013, MainePERS submitted its Program Evaluation Report to the Legislative Committee on Appropriations and Financial Affairs, as required by the Government Evaluation Act.

Qualified Plan Status

In 2010, MainePERS received updated favorable “determination letters” from the Internal Revenue Service stating that all the plans administered by MainePERS continue to qualify for favorable tax treatment under the provisions of the Internal Revenue Code. MainePERS continues to closely monitor tax law changes in order to ensure the pension plans continue to comply with federal law and maintain their qualified status. MainePERS is considered by the IRS to be a “Cycle C” filer, which provides for resubmission of the plans for updated determination letters by January 31, 2014, which has now been completed. MainePERS anticipates receiving updated favorable determinations from the IRS in the near future, which will be valid until January 31, 2019.

Audit

The independent audit of the MainePERS financial statements for the year ended June 30, 2013 resulted in an unqualified opinion. An unqualified opinion means that, in the opinion of the auditor, the financial statements present fairly, in all material respects, the fiduciary net assets of the System as of June 30, 2013, in conformity with generally accepted accounting principles.

Awards and Certifications

GFOA Certification - In 2013, the System submitted its FY 2012 Comprehensive Annual Financial Report (CAFR) to the Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting Program and was awarded the Certificate of Excellence for the ninth consecutive year. In order to be awarded this certificate, a governmental unit must publish an easily readable and efficiently organized CAFR, with contents that meet or exceed rigorous

program standards and satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid only for one year, and the System's FY 2013 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2013, for the sixth consecutive year, the System was awarded the Public Pension Coordinating Council's Recognition Award for Funding. To receive this award, retirement programs must meet professional standards for plan funding as set forth in the Public Pension Standards. The regular flow of required contributions and the up-front funding of new liabilities were listed as factors contributing to the System's receipt of this award.

Member and Retiree Services

More than 90,000 public employees in Maine are members, or retirees, of MainePERS. After two years of higher than usual retirement volumes due to legislative changes and retirement incentives, 2013 application levels reverted to those of prior years. MainePERS approved benefits for 1,691 new retirees in 2013.

To better serve our members, we developed a new informational area on our web site and began promoting it via monthly mailings to members. At the beginning of each member's birth month, the System mails postcards to non-retired members, encouraging them to visit the MainePERS web site for general retirement information and to use the new feature allowing them to make an information request at any time. Members' responses have been very positive. As a result, the overall volume of information requests has increased.

Required specific statistical information about members and retirees can be found in Attachment 1.

Group Life Insurance

More than 49,000 State, Teacher and Participating Local District employees and retirees have Group Life insurance administered by MainePERS. Employers collect participant premiums and submit payments to MainePERS. In 2013, MainePERS approved life insurance claims for 587 participants.

Employer Services

Approximately 530 teacher, participating local district and State employers each month report earnings, contributions and work history information on approximately 53,000 employees. MainePERS relies on this information to

determine a member's eligibility to retire and the amount the member will receive in benefits.

MainePERS works closely with employers to support accurate and timely reporting of employment information and contributions. System staff provides employers with training, consultation and written materials to assist in their reporting. During 2013, the System conducted nine employer training sessions.

MainePERS continues to solicit feedback and guidance from an Employer Reporting Work Group comprised of teacher and participating local district employers. Regular meetings with the Office of the State Controller help to assure balanced consideration of reporting needs and improved system capability. The System's website includes a section specifically for employers. The *Employer Update*, an electronic update focused on employer specific matters, was published six times in 2013.

Records Management

MainePERS continues to make significant improvements in the management of incoming and outgoing documents. All incoming documents are imaged upon receipt and forwarded to the appropriate business unit electronically, allowing better tracking of turnaround time for member and other requests. Out-going correspondence, including e-mail, become part of the member's System record.

Cost-of-Living Adjustment (COLA)

The Board of Trustees is directed by statute to annually adjust the retirement benefits of its eligible retirees by a cost-of-living adjustment equal to the change in the Consumer Price Index for All Urban Consumers (CPI-U) over the 12 months preceding June 30 of each year. The CPI-U at June 30, 2012 was 1.7%. As a result of action taken by the Legislature in 2011 to freeze cost-of-living adjustments to retirees from the State and Teacher Program, the Legislative Program and the Judicial Program for three years, no adjustments in 2012 were made to the benefits of retirees from the State-sponsored defined benefit plans administered by MainePERS. The legislation that froze the COLAs also provided for the payment of a one-time, noncumulative 2012 COLA of up to 3% (based on actual CPI-U) on the first \$20,000 of benefit, payable in 2013, provided there were sufficient State surplus funds. Because the actual funds available were slightly less than the amount required for the full COLA, MainePERS prorated the funds, as directed by the legislation, and paid a 1.67% 2012 COLA payment to eligible retirees in September, 2013. Eligible

retirees from the Participating Local District Retirement Program were granted a regular cost-of-living adjustment in accordance with the 2013 CPI-U of 1.8%.

Disability Program

MainePERS staff continues to work with stakeholders on improving its service to those seeking disability benefits and filing administrative appeals. This work includes:

- Formation of a stakeholders' working group tasked to identify disability program best practices. If appropriate, the working group will develop recommendations for modifications to the program for presentation to the Board of Trustees and to the Legislature.
- Working with employers' Equal Employment Opportunity (EEO) Coordinators and supervisors in an effort to provide a more complete analysis of required job duties. The EEO Coordinators provide a different perspective than that of the immediate supervisor in terms of performance challenges faced by applicants.
- Completion of a review of disability forms and streamlining of reporting forms to make filings easier for applicants.
- Ongoing improvement of communications between staff and disability applicants and benefit recipients.

Required specific statistical information about the disability program can be found in Attachment 2.

Information Technology

MainePERS continues to advance its technological environment with a particular emphasis on security.

- The System formed an Information Technology (IT) Security Council to oversee the System's IT Security policies and the development of technology plans. The Council is comprised of members of the System's IT staff, senior management, and representatives of Sage Data Security, a data security consulting firm, and Systems Engineering, MainePERS' principal technology partner. The goal of the council is to review and create security policies that strengthen the protection of the System's electronic assets and ensure a technology infrastructure that serves the System's business needs.

- MainePERS recently expanded its business continuity and disaster recovery capabilities. In the event that a disaster were to occur that rendered the Augusta office inoperable, the System's Portland facility allows for the continuation of essential business operations.
- MainePERS engaged in a number of initiatives this year designed to harden its technology environment and ensure continuing protection of its data. These efforts included greater authentication for remote access, encryption of laptops, and infrastructure modernization.
- MainePERS implemented around the clock Managed Security services with an external technology partner in order to ensure further protection of the MainePERS computing and data environment.
- MainePERS installed a more robust email archive, search, and recovery system.

DEFINED CONTRIBUTION PLANS

MaineStart

The System continued to promote its defined contribution retirement plans established under sections 401(a), 403(b) and 457(b) of the Internal Revenue Code, collectively referred to as MaineSTART, to its participating local district employers. MaineSTART offers a group of Vanguard funds designed to be low cost and easy to understand. The System enrolled two new employers in MaineSTART in 2013, bringing the total number of participating PLD employers to 60, with a total of approximately 883 participants.

BUDGET

The System's administrative costs and expenses attributable to the State Employee and Teacher Retirement Program, the Legislative Retirement Program, the Judicial Retirement Program and the Participating Local District Retirement Program are directly charged against the assets of the applicable program. The System's budgeted operating expenses are approved by the Board of Trustees prior to the start of each fiscal year and provided to this Committee.


The FY 2014 Board-approved budget is \$11,400,000. We continuously review costs to identify efficiency improvements.

Required specific information about the budget and administrative expenses can be found in Attachments 3 and 4. Required specific information about employee and employer contributions can be found in Attachment 5.

CONCLUSION

Please accept this report on behalf of the Maine Public Employees Retirement System. We welcome questions and are happy to address them as the Committee requests and in the format desired.

Respectfully submitted,



Sandra J. Matheson
Executive Director

SJM/nlp
Attachments

cc: Members, Board of Trustees
John C. Milazzo, General Counsel and Chief Deputy Executive Director
David E. Boulter, Executive Director, Legislative Council
Rachel Tremblay, Office of Fiscal and Program Review

NEW RETIREES	
Calendar Year 2013	
5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	506
Teacher	820
Legislative	14
Judicial	2
Participating Local District	349
Total	1691

NEW ACTIVE MEMBERS	
Calendar Year 2013	
5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	1029
Teacher	1353
Legislative	1
Judicial	0
Participating Local District	977
Total	3360

DISABILITY RETIREMENT and APPEALS Calendar Year 2013		
5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2013¹	164	
Applicants awarded disability retirement at applications stage	74	46%
Applications terminated due to death	0	
Applicants denied at the application stage ²	88	54%
DISABILITY APPEALS		
Number of appeals filed in 2013 (Note: Includes some 2012 denials)	85	
Number of carryover appeals	139	
Total active appeals	130	
Number of appeals completed in 2013	94	62%
Number of applicants granted disability following appeal	16	18%

¹Two applications were withdrawn by members prior to a decision being issued.

²5 M.R.S.A. §17103 (11) (J) (2) and (3) require the System to report on processes that are no longer in effect due to changes in the System's appeal rule, Chapter 702, that expanded the scope of the appeal proceedings in 2010. In lieu of the information originally required under the above sections, the System offers an accounting of the disposition of cases in the application phase.

**BUDGET STATUS OF ADMINISTRATIVE OPERATIONS AND
FUNCTIONS
FY 2013-2014**

5 M.R.S.A. § 17103(E)

	FY14 Budget	07/01/2013- 12/31/2013 Actual	01/01/2014- 06/30/2014 Expected	Projected Surplus /(Deficit)¹
Personal Services	6,499,889	2,843,067	3,284,878	371,944
Professional Services²	1,361,700	557,633	648,036	156,031
Communications	518,590	232,820	259,296	26,474
Computer Support and System Development³	185,000	92,500	92,500	-
Building Operations	412,430	112,602	197,790	102,038
Computer Maintenance and Supplies⁴	1,238,000	618,690	619,000	310
Depreciation	500,000	190,553	250,000	59,447
Professional Development	111,180	26,768	58,340	26,072
Medical Records and Exams	209,500	81,326	104,750	23,424
Miscellaneous Operating Expenses	363,711	152,439	187,778	23,494
Total Administrative Expenses	11,400,000	4,908,398	5,702,368	789,234

¹The Projected Surplus at December 31, 2013 is attributable in part to vacant positions occurring during the fiscal year. Any realized savings at the close of the fiscal year will inure to the trust funds.

²Professional Services include actuarial and legal service fees, as well as hearing officers' services related to disability appeals.

³Computer Support and System Development costs are those costs associated with funding reserves for the new technology system. Reserve funds are transferred at year-end.

⁴Computer Maintenance and Supplies include equipment, supplies and ongoing supports necessary to maintain the new member recordkeeping system which was implemented in October 2011.

SUMMARY OF ADMINISTRATIVE EXPENSES FY13	
5 M.R.S.A. § 17103(D)	
Personal Services	5,804,890
Professional Services	1,911,097
Communications	384,884
Computer Support and System Development	705,818
Office Rent	344,432
Computer Maintenance and Supplies	630,725
Depreciation	358,653
Professional Development	41,492
Medical Records and Exams	29,896
Miscellaneous Operating Expenses	746,862
Total Administrative Expenses¹	10,958,749

¹ Total Administrative Expenses include all expenses of the System. Refer to the CAFR for a breakdown of administrative expenses across plans.

EMPLOYER CONTRIBUTIONS IN 2013			
5 M.R.S.A. § 17103(I)			
Plan Status	Employee Contributions	Employer Contributions ²	Total Payments to Retirees
State ¹	34,835,177	99,836,726	266,396,625
Teacher	86,223,940	163,863,452	403,020,461
Judicial	518,094	841,397	3,282,344
Legislative	194,669	6,507	363,022
Participating Local Districts	31,764,619	27,121,518	123,323,345
Total	153,536,499	291,669,600	796,385,797

¹State Plan totals include Governors.

²Employer Contributions for the State, Teacher, Judicial, and Legislative Plans include contributions to fund the one-time COLA distributed during the year.