

# MAINE STATE LEGISLATURE

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Sandra J. Matheson, Executive Director  
John C. Milazzo, General Counsel and  
Chief Deputy Executive Director

BOARD OF TRUSTEES  
Peter M. Leslie, Chair  
Benedetto Viola, Vice Chair  
Dimitri N. Balatsos  
George A. Burgoyne  
David G. Lemoine, State Treasurer, ex-officio  
Richard T. Melivier  
Catherine R. Sullivan  
Kenneth L. Williams

HAND DELIVERED

March 1, 2010

Senator Troy Dale Jackson, Senate Chair  
Representative John L. Tuttle, Jr., House Chair  
Members, Joint Standing Committee on Labor  
2 State House Station  
Augusta, ME 04333-0002

Dear Senator Jackson, Representative Tuttle and Members of the Labor Committee:

Please accept the Maine Public Employees Retirement System (MainePERS) annual report to the Joint Committee on Labor. We are submitting this report pursuant 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), attached to this letter and available at [www.mainePers.org](http://www.mainePers.org), provides detailed information that supplements this report.

We are pleased to provide this information based on operations through June 30, 2009. More recent updates on investments have been included for your information because of the 2008 economic crisis and the resulting impacts on the financial markets.

**INVESTMENTS**

The System's assets reflect the market volatility of the past two years, placing MainePERS near the median in a public fund universe<sup>1</sup>. 2009 calendar year returns were 21.4%, placing MainePERS in the top third of a public fund universe during the economic recovery.

Fiscal Year Ending	Fund	Return
June 30, 2008	\$10.5B	-3.1%
June 30, 2009	\$ 8.3B	-18.8%
January 31, 2010	\$ 9.2B	12.9%

<sup>1</sup> BNY Mellon Performance & Risk Analytics, LLC public pension fund universe. As of 12/31/09 the universe included 106 pension funds with aggregate assets of \$939.6 billion.

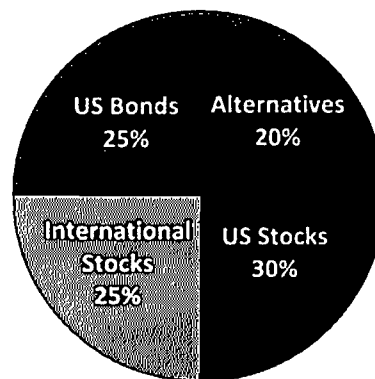
The three-year, five-year, 10-year, and 30-year periods ending on June 30, 2009 annualized returns based on market value are -2.9%, 1.9%, 2.3%, and 9.5%, respectively.

The 2008 and 2009 market environment was unprecedented for pension funds, but not outside of theoretical expectations. The Board of Trustees asset allocation planning in 2008 considered low probability scenarios with losses similar to those experienced in FY 2009 and gains similar to those experienced so far in FY 2010.

MainePERS investment objective is to earn a long-term average return of 7.75%. It is necessary to carefully balance the need for return with the expected risk associated with its investments to achieve this objective. Our well diversified portfolio of investments is consistent with this long-term investment objective. Our investment team and advisors are continuously monitoring our investments and the markets. As a result of recent market turmoil “managing risk” has become an important topic of discussion for most investors, including MainePERS. We are researching potential new ways to manage risk and improve our long-term strategy while exercising caution and to avoid quick fixes or hasty reactions. We remain committed to our disciplined, long-term strategy.

The 20% allocation to Alternatives consists of Real Estate (10%), Private Equity (5%), and Infrastructure (5%). In addition, the Board of Trustees has approved a 0% to 10% allocation to Opportunistic Strategies. Opportunistic Strategies includes a broad range of investment strategies that do not fall into one of these specific categories. Some examples would be commodities, hedge funds, farm land, currencies, and strategies that seek to take advantage of temporary market dislocations.

### MainePERS Asset Allocation



Investment performance affects employer rates because investment earnings are a significant part of the total fund. The impacts of the economic downturn will affect the FY 2012-2013 rates.

The 123<sup>rd</sup> Legislature created an Investment Trust for the purpose of investing funds set aside by the State of Maine to cover Other Post-Employment Benefits (OPEB) liabilities for retiree health insurance benefits for State employees and teachers. The Trustees of MainePERS were named Trustees for this Investment Trust and have the responsibility of investing these funds.

The market value for the OPEB assets at January 31, 2010 was \$95.9 million reflecting a 12-month increase of approximately 28.1%.

## **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 increased in FY 2009 from \$3.036 billion at June 30, 2008 to \$3.995 billion at June 30, 2009. It should be noted that a slight increase had been projected since the establishment of a 28-year amortization schedule for the UAL in 1997. The primary reason for the remaining increase in the UAL was poor market performance. The investment return on an actuarial basis was -2.17% during FY 2009, a decrease from the FY 2008 actuarial return of 5.8% and significantly lower than the actuarial investment return assumption of 7.75%. (See Investments section for market returns.) The actuarial funded status of the State Employee and Teacher Retirement Program, that is, the ratio of plan assets to plan liabilities, decreased in FY 2009 from 74% to 67.6%. Ten years ago, the funding ratio was 69.0%. The severe decline in investments, as discussed above, will also negatively affect future funded status.<sup>2</sup>

### ***Funding Status of the Legislative Retirement Program***

The Legislative Program is overfunded at 158.5% as of June 30, 2009. The overfunding results primarily because few legislators qualify for a retirement benefit under the terms of the program. There currently is no required employer contribution to the program because of the overfunded status of the program. The funded status of this program will be negatively affected by the decline in investments in a manner similar to the State Employee and Teacher Retirement Program.

### ***Funding Status of the Judicial Retirement Program***

Negative investment returns reduced the Judicial Program funding from 105.9% on June 30, 2008 to 95.9% at June 30, 2009.

### ***Funding Status of Consolidated Plan for Participating Local Districts***

The Consolidated Plan consisted of 258 participating local districts at June 30, 2009. For the first time since the plan's inception in 1993, the funding level has dropped below 100% to 98.4% at June 30, 2009. This funding level decline is due to negative investment returns. The Plan's employer rates, which have decreased since inception, have remained stable and low. The funding methodology adopted by the Board in FY 2000 is designed to manage the

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<sup>2</sup> Actuarial basis is calculated by smoothing gains and losses over a 3 year period to moderate sudden impacts of market volatility on rates. Actuarial rates used for rate setting differ from market returns of the fund.

volatility that can be associated with a well-funded retirement plan. As reported last year, actuarial data indicates that, even before accounting for the present market decline, rates will gradually need to increase to more closely match the normal cost of the plan. The first such rate increase will be implemented for FY 2011.

## OPERATIONS

### *Changes in Leadership*

Sandra J. Matheson joined the System on April 1, 2009, as the Executive Director.

- Director of the Washington State Department of Retirement Systems 2005-2009
- Broad-based public pension experience and innovative thinking on design and funding of programs and services
- BA Northwestern University and MBA from Washington State University.

### *Changes in Board Membership*

*Benedetto Viola* and *Kenneth Williams* were re-confirmed as Trustees by the Legislature in 2009. *Dimitri Balatsos* was appointed by the Governor and confirmed as a Trustee in August, 2009. The terms of *Peter Leslie*, also a gubernatorial appointee, and *George Burgoyne*, retiree trustee, expired on December 31, 2009. Both were re-confirmed by the Legislature in February 2010.

### *Qualified Plan Status*

MainePERS administers individually designed defined benefit and defined contribution plans qualified under Section 401(a) of the Internal Revenue Code that qualify for favorable federal tax treatment. The most recent defined benefit plan "determination letter" from the Internal Revenue Service declaring the MainePERS State and Teacher plan qualified under the Tax Code is dated 1973.

In September 2005, the Internal Revenue Service announced that governmental plans like MainePERS, in order to maintain their qualified status and thus continue to receive favorable federal tax treatment, should seek updated determination letters from the IRS demonstrating compliance with federal statutory and regulation changes that have occurred since the date of the last determination letter, 1973. The IRS decided that governmental plans like MainePERS should file for a determination letter by January 31, 2009, which the System did. The filing process and IRS review are very complex and comprehensive.

With the assistance of independent expert tax counsel, MainePERS conducted a comprehensive evaluation of the statutory and regulatory provisions under which it operates and determined that there were some areas where one or more of the plans it administers were not in compliance with current federal law, from either a plan document

perspective or from a plan operation perspective. The System determined that the best course was to enter the IRS' Voluntary Compliance Process ("VCP"), disclose the identified problems, and work with the IRS to take the necessary steps to bring the plans fully into IRS compliance and thereby continue to maintain the plans' qualified status.

On August 20, 2009, MainePERS received favorable determination letters from the IRS confirming the continued qualification and favorable tax treatment of the defined benefit plans administered by the System, subject to correction of the compliance issues self-identified by MainePERS in its January 2009 VCP filings with the IRS. The Compliance Statements that accompanied the determination letters approve the methods of correction proposed in the VCP filings and require MainePERS to verify the adoption of the changes no later than December 31, 2010.

Bringing the plans into compliance requires certain statutory and rule changes on which the System is working with the Legislature and various constituent groups to have completed and implemented by the IRS' deadline of December 31, 2010.

#### *Awards and Certifications*

**GFOA Certification** - In 2009, the System submitted its FY 2008 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 fifth 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 2009 CAFR has been submitted to the GFOA.

**Public Pensions Standards Award** - In 2009, for the second 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 significant factors in this recommendation.

#### *Member and Retiree Services*

The System undertook several initiatives in 2009 to expand services to members and retirees and increase interaction with organizations that represent members and retirees:

- Regional meetings for "early and mid-career" State and Teacher members that include an overview of MainePERS' benefits. These events are in addition to

retirement planning sessions conducted in partnership with MSEA and Office of State Employee Health and Benefits for retirement eligible members. For Participating Local Districts, the System conducts employee meetings at the request of the employer;

- The *Retiree Reminder*, a new publication focused on information of interest to retirees, is mailed periodically during the year;
- Increased amounts of information are now being made available by phone, eliminating the need for members to wait for a written response;
- Revisions to the rules for early retirement and return to employment increased the number of days early retirees can work without jeopardizing their retirement benefit;
- Changes to the System website have made it easier for visitors to find information and offer feedback via the "Contact the Director" link;
- Work continues toward the completion of a system that will automate more pension administration processes with the goal of improving the accuracy and timeliness of services to members and employers. In January 2009, the System began using the monthly benefit payment module of the system. The remaining portions of the system are expected to be in production later in 2010.

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

### ***Group Life Insurance***

More than 45,000 State, Teacher and Participating Local District employees and retirees have Group Life insurance administered by MainePERS. The System implemented a new process for collecting retiree life insurance premiums from Participating Local District employers. The new process, which employers endorsed, is the first phase of a more comprehensive change to premium collection for all participants. The System contacted more than 16,000 members and retirees in an effort to update beneficiary information for both group life insurance and pre-retirement death benefits. The response has been excellent.

### ***Employer Services***

More than 600 employers submit information to the System. During 2009, the System conducted 54 employer training sessions statewide. These sessions introduced employers to upcoming changes that will make it easier for employers to correct reporting errors, and to transact other business with the System, on-line. System staff has coordinated with the State of Maine, as our single largest reporting employer, on ways to improve information exchange. The System's Employer Reporting Work Group meets regularly to advise the System on operational issues that affect employers.

### *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 over the 12 months preceding June 30 of each year in the Consumer Price Index for All Urban Consumers (CPI-U), up to a maximum of 4%. In 2009, the CPI-U was negative for the first June 30th since the inception of cost-of-living adjustments, facing Maine retirees with a potential reduction in retirement benefits. The System worked closely with the Legislature to amend the law so that no reduction in benefits would occur, while at the same time, ensuring no impact on the funding or funding requirements of the retirement plans. L.D. 1595 was introduced in the Second Session of the 124<sup>th</sup> Legislature to address those same concerns in the event of multiple years of a negative Consumer Price Index, or if the Index is not sufficiently positive to offset a prior negative year. Recognizing how important it is for retirees to know what they can plan on for retirement income, the System has in place a communication plan through which we have already published several pieces of information about last year's legislation as well as the proposed legislation. We will continue to provide information to retirees over the course of the next few months, including the progress and status of L.D. 1595. Once the June 30, 2010 Consumer Price Index is released, we will be ready to communicate the specific impact to retirees.

### *Disability Program*

The review of our disability program as discussed in the System's Report on Chapter 322 continues. As we indicated in that report, the review process is in its initial stages and we anticipate that it will take 6 - 9 months to complete. This time frame will permit our analysis to be thorough, planning for change to be complete, and implementation of change to be effective.

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

## **DEFINED CONTRIBUTION PLANS**

### *MaineStart*

The System continued to promote its defined contribution retirement plans as 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 five new employers in MaineSTART during 2009, bringing the total number of participating PLD employers to 42, with a total of 596 participants.



## BUDGET

Since July 1, 2007, the System's administrative costs and expenses attributable to the State Employee and Teacher Retirement Program, the Legislative Retirement Program and the Judicial Retirement Program are directly charged against the assets of the applicable programs rather than collected from the State in addition to the required employer retirement contribution. The System's budgeted operating expenses are approved by the Board of Trustees prior to the start of each fiscal year and this approved budget is provided to this Committee. Last year the report was done by way of this annual report and we have followed the same procedure this year.

For FY 2010, our Board-approved budget was flat funded over FY 2008 and FY 2009 at \$10,958,310. We are reviewing our budget in 2010 for efficiency reductions. Vacant positions no longer needed in reserve will be eliminated upon the successful implementation of our new technology system.

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/pjm  
Attachments

cc: Members, Board of Trustees  
John C. Milazzo, General Counsel and Chief Deputy Executive Director  
David E. Boulter, Executive Director, Legislative Council  
Carolyn Russo, Office of Policy and Legal Analysis

<b>NEW RETIREES</b> Calendar Year 2009  5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	704
Teacher	650
Legislative	13
Judicial	5
Participating Local District	276
<b>Total</b>	<b>1648</b>

<b>NEW ACTIVE MEMBERS</b> Calendar Year 2009  5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	703
Teacher	1007
Legislative	2
Judicial	0
Participating Local District	865
<b>Total</b>	<b>2577</b>

**DISABILITY RETIREMENT and APPEALS**  
**Calendar Year 2009**

5 M.R.S.A. § 17103(J)(1)-(4)

	Count	Percentage
<b>NEW APPLICATIONS</b>		
<b>Disability applications received in 2009</b>	140	
<b>Applicants awarded disability retirement at applications stage</b>	105	75%
<b>Applicants awarded disability retirement following submission of additional information</b>	15	11%
<b>Net number of applicants for disability retirement who appealed decisions that denied disability retirement</b>	44	
<b>DISABILITY APPEALS</b>		
<b>Number of appeals filed in 2009 (Note: Includes some 2008 denials)</b>	26	
<b>Number of carryover appeals</b>	37	
<b>Total active appeals</b>	63	
<b>Number of appeals completed in 2009</b>	44	
<b>Number of applicants granted disability following appeal</b>	24	55%

**BUDGET STATUS OF ADMINISTRATIVE  
OPERATIONS AND FUNCTIONS**  
Fiscal Year 2010

**5 M.R.S.A. § 17103(E)**

	<b>FY10 Budget</b>	<b>07/01/2009- 12/31/2009 Actual</b>	<b>01/01/2010- 06/30/2010 Expected</b>	<b>Projected Surplus /(Deficit)<sup>1</sup></b>
<b>Personal Services</b>	7,313,158	3,071,235	3,650,007	591,916
<b>Professional Services</b>	555,395	321,437	208,437	25,521
<b>Communications</b>	579,865	214,554	370,554	(5,243)
<b>Computer Support and System Development<sup>2</sup></b>	617,007	0	617,007	0
<b>Office Rent</b>	494,790	247,822	247,822	(854)
<b>Computer Maintenance and Supplies</b>	493,660	150,612	286,612	56,436
<b>Depreciation</b>	270,420	108,060	156,060	6,300
<b>Professional Development</b>	124,250	13,445	61,445	49,360
<b>Medical Board, Records and Exams</b>	172,500	86,718	86,718	(936)
<b>Miscellaneous Operating Expenses</b>	337,265	273,378	155,179	(91,292)
<b>Total Administrative Expenses</b>	<b>10,958,310</b>	<b>4,487,261</b>	<b>5,839,841</b>	<b>631,208</b>

<sup>1</sup>The Projected Surplus at December 31, 2009 is attributable primarily to currently vacant positions included in the approved budget. We anticipate that the majority of these positions will remain vacant as we continue to work towards implementation of our new technology system. Any savings resulting from these vacant positions will inure to the trust funds.

<sup>2</sup>Computer Support and System Development costs are those costs associated with funding reserves for the new technology system. Reserve funds are transferred at year-end.

<b>SUMMARY OF ADMINISTRATIVE EXPENSES</b> Fiscal Year 2009  5 M.R.S.A. § 17103(D)	
<b>Personal Services</b>	6,406,456
<b>Professional Services</b>	768,610
<b>Communications</b>	418,932
<b>Computer Support and System Development</b>	620,315
<b>Office Rent</b>	471,184
<b>Computer Maintenance and Supplies</b>	271,210
<b>Depreciation</b>	892,472
<b>Professional Development</b>	50,824
<b>Medical Board, Records and Exams</b>	163,824
<b>Miscellaneous Operating Expenses</b>	414,829
<b>Total Administrative Expenses<sup>1</sup></b>	<b>10,478,656</b>

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

**CONTRIBUTIONS**  
 Fiscal Year 2009

5 M.R.S.A. § 17103(I)

<b>Plan Status</b>	<b>Employee Contributions</b>	<b>Employer Contributions</b>	<b>Total Payments to Retirees</b>
<b>State<sup>1</sup></b>	38,543,191	126,162,787	225,329,285
<b>Teacher</b>	85,466,293	192,806,400	336,062,012
<b>Judicial</b>	508,074	1,267,870	2,611,306
<b>Legislative</b>	179,037	n/a <sup>2</sup>	364,876
<b>Participating Local Districts</b>	29,849,808	11,865,460	103,849,459
<b>Total</b>	<b>154,546,403</b>	<b>332,102,517</b>	<b>668,216,938</b>

<sup>1</sup>State Plan totals include contributions to the Governors' Plan.

<sup>2</sup>No Employer Contributions are currently assessed for the Legislative Plan due to its current overfunded position.