

MAINE STATE LEGISLATURE

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HAND DELIVERED

March 1, 2011

Senator Richard W. Rosen, Senate Chair
Representative Patrick S.A. Flood, House Chair
Members, Joint Standing Committee on Appropriations and Financial Affairs
5 State House Station
Augusta, ME 04333-0005

Dear Senator Rosen, Representative Flood and Members of the Appropriations Committee:

Please accept the Maine Public Employees Retirement System (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, 2010.

INVESTMENTS

The System's fiscal year ending value of assets reflects the market volatility of the past two years. 2010 calendar year returns were 12.2%, placing MainePERS in the top half of a public fund universe¹ during the economic recovery. During the two-year period ending December 31, 2010, the fund was up 36.6%, with an ending market value of \$10.3 billion.

¹ BNY Mellon Performance & Risk Analytics, LLC public pension fund universe. As of 12/31/10 the universe included 106 pension funds with aggregate assets of \$939.6 billion.

Fiscal Year Ending	Fund	Return
June 30, 2008	\$10.5B	-3.1%
June 30, 2009	\$ 8.3B	-18.8%
June 30, 2010	\$ 8.9B	11.1%

The three-year, five-year, 10-year, and 30-year periods ending on June 30, 2010 annualized returns based on market value are -4.4%, 1.6%, 2.4%, and 9.4%, respectively.

The 2008 through 2010 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 in FY 2010 and so far in FY 2011.

MainePERS' long-term average investment return target is 7.75%. The System carefully balances the need for return with the expected risk associated with its investments to achieve this long-term average target. Our well diversified portfolio of investments is consistent with this long-term investment target. 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 avoiding hasty reactions. We remain committed to our disciplined, long-term strategy.

MainePERS currently has a target asset allocation of 55% in stocks, 25% in bonds, and 20% in alternatives.

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 which can share in this 20% allocation to capture sound investment strategies that do not fall into one of the other alternative categories.

MainePERS will conduct an asset/liability study and an asset allocation study in 2011 to review these strategic allocations.

MainePERS Asset Allocation



Investment performance affects employer contribution rates because investment earnings are a significant part of the total fund. The impacts of the economic downturn increased the FY 2012-2013 rates submitted to the State in July, 2010.

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 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 December 31, 2010 was \$112.6 million reflecting a 12-month increase of approximately 14.0%.

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 2010 from \$3.995 billion at June 30, 2009 to \$4.304 billion at June 30, 2010. The primary reason for the increase in the UAL was the 2008 downturn and resulting market performance. The investment return on an actuarial basis was 1.26% during FY 2010, an increase from the FY 2009 actuarial return of -2.17% but still 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 2010 from 67.6% to 65.9%. Ten years ago, the funding ratio was 73.0%. The severe decline in investments, as discussed above, will also negatively affect future funded status.²

Funding Status of the Legislative Retirement Program

The Legislative Program is funded at 142.2% as of June 30, 2010 primarily because few legislators qualify for a retirement benefit under the terms of the program. No employer contribution is currently required because of the overfunded status of the program. The funding status of this program will be reduced by the decline in investments in a manner similar to the State Employee and Teacher Retirement Program, although it is highly likely to remain overfunded.

² 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.

Funding Status of the Judicial Retirement Program

Investment returns resulting from the 2008 market downturn are the primary reason for the reduction in the Judicial Program funding status from 95.9% on June 30, 2009 to 89.7% at June 30, 2010.

Funding Status of Consolidated Plan for Participating Local Districts

The Consolidated Plan consisted of 275 participating local districts at June 30, 2010. For the second year in a row, the funding level was below 100% at 92.9% at June 30, 2010. This funding level decline is due primarily to the impact of the 2008 market downturn on 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 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 rate increase was implemented for FY 2011.

OPERATIONS

Changes in Board Membership

Catherine Sullivan and Richard Metivier were re-confirmed as Trustees by the Legislature in 2010. In 2011, Bruce Poliquin, State Treasurer, assumed the duties of Trustee *ex officio*.

Qualified Plan Status

MainePERS administers individually designed defined benefit and defined contribution plans that qualify for favorable federal tax treatment under Section 401(a) of the Internal Revenue Code. 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.

Nearly all public pension systems are submitting their plans for determination letters at Internal Revenue Service request. MainePERS received the favorable determination letters earlier than most other pensions systems in part due to responsive legislative action to bring state law into compliance in PL 2009, c. 474.

Audit

The independent audit of the MainePERS financial statements for the year ended June 30, 2010 resulted in an unqualified opinion. An unqualified opinion means that the financial statements present fairly, in all material respects, the fiduciary net assets of the System as of June 30, 2010, in conformity with generally accepted accounting principles.

Awards and Certifications

GFOA Certification - In 2010, the System submitted its FY 2009 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 sixth 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 2010 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2010, for the third 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 continued efforts in 2010 to expand and improve services to members and retirees by:

- Working with employers to arrange for 15,000 State, Teacher and PLD employees with optional MainePERS membership to exercise a one-time election to join, remain or withdraw from membership. Previously, State law allowed employees multiple opportunities to join and re-join the System, but IRS code does not permit this practice.
- Responding to significantly increased calls from members and retirees looking for information about the security of their benefit as a result of news reports about public pensions in Maine and nationally.
- Conducting 294 group presentations for members and introducing quarterly retiree feedback forums.

- Meeting several times with the Participating Local District Advisory Committee during the year to receive members' advice on revisions to the rules for the PLD retirement program, changes to the employer contribution rates and implementing the new accidental death benefit for professional firefighters.
- Completing the retirement process for almost 800 teacher recipients, the highest number in any single year.
- Working 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.

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. Participants who terminate their employment have always had the option to continue life insurance coverage by converting to an individual whole policy. In 2010, the System added a portability option allowing participants to continue group coverage through a group life plan offered by Aetna.

Employer Services

Each month 624 teacher, participating local district and state employers submit payroll reporting information to MainePERS providing earnings, contributions and employment information on approximately 54,000 employees. This information creates the foundation for a future retirement benefit.

MainePERS works closely with employers to support accurate and timely reporting of information and contributions. System staff provide employers with training, consultation and documents to assist in their reporting.

During 2010, the System conducted 19 employer training sessions statewide in preparation for conversion to the new automated system. More than 600 employers provided test files in preparation for on-line submission of payroll reports. The State of Maine, the largest reporting employer, has worked closely with System staff to assure that State payroll files will process correctly in the new system.

MainePERS actively solicits feedback and guidance from an Employer Reporting Work Group comprised of teacher and participating local district providers. Regular meetings with the Office of the State Controller help assure balanced

consideration of reporting needs and system capability. The System's website includes a section specifically for Employers. The *Employer Update*, an electronic update focused on employer specific matters, goes to all reporting employers six times each year.

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%. Trustees did not adjust retiree benefits in 2010 for the second consecutive year. Two factors contributed to this result. First, in 2009, the CPI-U was negative (-1.4%) for the first June 30th since the inception of cost-of-living adjustments, facing Maine retirees with a potential reduction in retirement benefits. The law was amended during the First Session of the 124th Legislature 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. Second, the law was further amended during the Second Session of the 124th 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. While the CPI was positive (1.1%) in 2010, it was not sufficient to offset the prior negative year, resulting in another 0% COLA in 2010. Future COLAs will require additional adjustment to fully recover the 2009 negative CPI impact.

Disability Program

The System has continued to review and improve its processes for both disability applicants and recipients including the following initiatives:

- Redesigning the disability application into a simplified three-page rather than multi-page document resulting in a more user-friendly application process that increases personal contact with MainePERS staff.
- Reporting disability decisions to members with explanations about the outcome prior to issuing a written decision.
- Re-writing correspondence with disability applicants and recipients to increase usefulness and understanding.
- Improving alignment of Medical Board specialties with applicant medical conditions through the recruitment of two new physicians.
- Redesigning medical review process materials to make the process more understandable for disability applicants.
- Redesigning Annual Statement of Compensation process written materials to provide greater clarity for recipients reporting earnings.

These initiatives resulting from Chapter 322 have been favorably received by both applicants and disability recipients.

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

Information Technology

Significant technology initiatives were undertaken in 2010, including:

- Perimeter connectivity upgrades providing a more direct path to the core of the internet in the greater Boston area.
- Building to building wireless providing a stable platform for communication between MainePERS physical locations.
- Core network upgrade with advanced Cisco switching gear design to enhance firewall, intrusion detection, and internal wireless security infrastructure.
- Successful network perimeter security audit.
- Virtualization of MainePERS servers with critical agency data replicated in real time to disaster recovery site server.

Each of these initiatives increases MainePERS ability to provide a secure operating environment for its business operations in addition to significantly reducing recovery time for business processes in the event of a disaster.

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 three new employers in MaineSTART during 2010, bringing the total number of participating PLD employers to 42, with a total of 704 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 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.

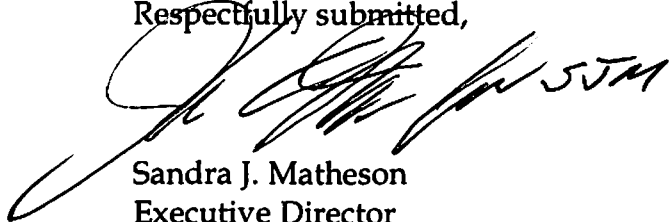
The FY 2011 Board-approved budget of \$10,648,499 was less than FY 2009 and FY 2010. We continuously review costs for efficiency reductions.

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,

A handwritten signature in black ink, appearing to read 'SJM', is written over the typed name and title of Sandra J. Matheson.

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
Rachel Tremblay, Office of Fiscal and Program Review

NEW RETIREES Calendar Year 2010 5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	424
Teacher	830
Legislative	0
Judicial	3
Participating Local District	320
Total	1577

NEW ACTIVE MEMBERS Calendar Year 2010 5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	873
Teacher	1255
Legislative	32
Judicial	2
Participating Local District	1414
Total	3576

DISABILITY RETIREMENT and APPEALS Calendar Year 2010 5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2010	176	
Applicants awarded disability retirement at applications stage	123	70%
Applicants awarded disability retirement following submission of additional information ¹	15	9%
Net number of applicants for disability retirement who appealed decisions that denied disability retirement	20	
DISABILITY APPEALS		
Number of appeals filed in 2010 (Note: Includes some 2009 denials)	52	
Number of carryover appeals	11	
Total active appeals	63	
Number of appeals completed in 2010	20	
Number of applicants granted disability following appeal	9	45%

¹ The Appeals Working Group rewrote Chapter 702, the System's appeal rule, to eliminate an intermediate step in the System's initial eligibility determination process and to expand the scope of appeal proceedings. The new rule was adopted by the MainePERS Board of Trustees and implemented in March 2010.

**BUDGET STATUS OF ADMINISTRATIVE
OPERATIONS AND FUNCTIONS
Fiscal Year 2011**

5 M.R.S.A. § 17103(E)

	FY11 Budget	07/01/2010- 12/31/2010 Actual	01/01/2011- 06/30/2011 Expected	Projected Surplus /(Deficit) ¹
Personal Services	6,718,075	3,011,252	3,566,111	140,712
Professional Services	582,450	377,729	366,597	(161,876)
Communications	648,560	242,257	324,281	82,022
Computer Support and System Development ²	617,007	0	617,007	0
Office Rent	498,180	248,512	249,090	578
Computer Maintenance and Supplies	631,164	211,497	315,582	104,085
Depreciation	270,420	117,350	135,210	17,860
Professional Development	105,385	21,917	52,693	30,775
Medical Board, Records and Exams	194,500	103,881	113,750	(23,131)
Miscellaneous Operating Expenses	382,758	117,263	191,385	74,110
Total Administrative Expenses	10,648,499	4,451,658	5,931,706	265,135

¹The Projected Surplus at December 31, 2010 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 associated with ongoing work on behalf of the Legislature on Plan Funding issues.

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.

SUMMARY OF ADMINISTRATIVE EXPENSES	
Fiscal Year 2010	
5 M.R.S.A. § 17103(D)	
Personal Services	6,544,056
Professional Services	895,462
Communications	434,727
Computer Support and System Development	443,350
Office Rent	528,952
Computer Maintenance and Supplies	298,099
Depreciation	214,764
Professional Development	35,731
Medical Board, Records and Exams	37,145
Miscellaneous Operating Expenses	439,096
Total Administrative Expenses ¹	9,871,382

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

CONTRIBUTIONS AND RETIREE PAYMENTS
Fiscal Year 2010

5 M.R.S.A. § 17103(I)

Plan Status	Employee Contributions	Employer Contributions	Total Payments to Retirees
State ¹	38,165,230	122,913,627	233,143,302
Teacher	87,652,401	205,517,153	332,760,111
Judicial	530,521	961,083	2,799,764
Legislative	129,308	n/a ²	304,334
Participating Local Districts	32,485,294	12,607,712	104,922,589
Total	158,962,754	341,999,575	673,930,100

¹State Plan totals include contributions to the Governors' Plan.

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