

# MAINE STATE LEGISLATURE

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HAND DELIVERED

March 1, 2012

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.mainebers.org](http://www.mainebers.org), provides detailed information that supplements this report.

We are pleased to provide this information based on operations through June 30, 2011.

## INVESTMENTS

The System's ending market value of assets for fiscal year 2011 was \$10.8 billion. This value reflects the continued rebound from the credit crisis that significantly reduced MainePERS assets during fiscal years 2008 and 2009. The investment return for the fiscal year 2011 was 22.4%, placing MainePERS well ahead of the system's actuarially assumed investment return and in the top third of a public fund peer universe.<sup>1</sup> During the first six months of fiscal year 2012 (July 1, 2011 to December 31, 2011), the system's assets experienced an investment loss of 4.7%, consistent with market conditions. During the two-year period ending December 31, 2011, the fund was up 12.6%, with an ending market value of \$10.1 billion.

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<sup>1</sup> BNY Mellon Performance & Risk Analytics, LLC public pension fund universe.

Fiscal Year Ending	Fund	Return
June 30, 2009	\$ 8.3B	-18.8%
June 30, 2010	\$ 8.9B	11.1%
June 30, 2011	\$10.8B	22.4%

The three-year, five-year, 10-year, and 30-year periods ending on June 30, 2011 annualized returns based on market value are 3.4%, 4.4%, 5.4%, and 9.4%, respectively.

The 2008 through 2010 market environment was unprecedented for pension funds, but not outside of MainePERS' 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.

MainePERS' long-term average investment return target is 7.25%. The System balances the need for return with the expected risk associated with its investments to achieve this long-term average target. Our diversified portfolio of investments is consistent with this long-term investment target. Our investment team and advisors are continuously monitoring our investments and the financial markets. During the next several quarters, MainePERS Investment Team, advisors and Trustees will be studying our investment objective, the most basic component of our investment policy statement. During this study, we will assess the System's interest for returns in excess of the risk free rate and articulate investment outcomes that are unacceptable to the collective stakeholders. A primary outcome of this study will be an updated asset allocation and risk management framework.

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

The 20% allocation to Alternatives is approximately divided to 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 capture sound investment strategies that do not fall into one of the other alternative categories.

As previously stated, MainePERS will work with its advisors during the remainder of 2012 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 2008 credit crisis and economic downturn increased the FY 2012-2013 rates submitted to the State in July, 2010.

The 123<sup>rd</sup> 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, 2011 was \$125.9 million reflecting a 12-month increase of \$13.3 million. For the 2011 calendar year, the fund lost approximately 0.5% from investment activity, but had a net increase due to a contribution to the fund of \$14,411,368.

## **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 2011 from \$4.304 billion at June 30, 2010 to \$2.545 billion at June 30, 2011. The decrease in the UAL results primarily from changes to the benefit structure, as adopted by the Legislature in 2011, and changes in the actuarial assumptions, as adopted by the Board upon recommendation by the System's actuary after the completion of an experience study of the plan in early 2011. The investment return on an actuarial basis was 6.89% during FY 2011, an increase from the FY 2010 actuarial return of 1.26% but still slightly 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 2011 from 65.9% to 77.4%. Ten years ago, the funding ratio was 72.9%.

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

The Legislative Program is funded at 157.9% as of June 30, 2011, 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. Changes to the plan design, along with positive returns in fiscal year 2011, contributed to the increased level of overfunding in this program.

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

The funding status of the Judicial Program increased from 89.7% at June 30, 2010 to 103.0% at June 30, 2011. Changes to the plan design, along with positive returns in fiscal year 2011, contributed to an increase in the funding ratio.

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

The Consolidated Plan consisted of 296 participating local districts at June 30, 2011. The funding level of the plan decreased from 92.9% at June 30, 2010 to 90.4% at June 30, 2011. Since the inception of this plan, employer rates have remained stable and low. As previously reported, actuarial data indicates that the employer rates for this plan will gradually need to increase to more closely match the normal cost of the plan. Incremental rate increases were implemented starting in FY 2011.

## **OPERATIONS**

### ***Changes in Board Membership***

In 2011, Bruce Poliquin, State Treasurer, assumed the duties of Trustee *ex officio*.

On February 22, 2012, the Senate confirmed Brian Noyes as a Trustee. Mr. Noyes will serve as a gubernatorial appointee, replacing Dimitri Balatsos, who has served as a Trustee since August 2009.

### ***Legislative***

During 2011, the System undertook several significant studies at the direction of the Legislature. In April 2011, a comprehensive look at the design of the State Employee and Teacher Retirement Program, as well as the impacts of design changes, was presented to the Appropriations Committee in the form of the *Report on Pension Costs to the Legislature of the State of Maine*. Throughout the First Regular Session of the 125<sup>th</sup> Legislature, the System provided technical support to the Administration and Legislature as plan design changes were considered and ultimately implemented. The 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, 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. The full report on that work will be presented to the Appropriations Committee during the Second Regular Session of the 125<sup>th</sup> Legislature.

### ***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 in 2013.

### ***Audit***

The independent audit of the MainePERS financial statements for the year ended June 30, 2011 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, 2011, in conformity with generally accepted accounting principles.

### ***Awards and Certifications***

**GFOA Certification** - In 2011, the System submitted its FY 2010 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 seventh 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 2011 CAFR has been submitted to the GFOA.

**Public Pensions Standards Award** - In 2011, for the fourth 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***

More than 90,000 public employees in Maine are members, or retirees, of MainePERS. This year, because of changes enacted during the last legislative session, and a retirement incentive offered to State employees, the System experienced a significant increase in retirement applications and other inquiries. In order to manage the much higher volume of requests, MainePERS expanded the information available on its website and increased the number of pre-retirement educational sessions to accommodate requests from potential retirees. MainePERS approved benefits for 2293 new retirees in 2011.

To better serve our members, we focused our primary efforts on providing preliminary benefit payments so new retirees could begin receiving benefits without delay. Our practice is to provide 90% of a member's estimated retirement benefit until we have received all of their final payroll information from the employer. Once finalized, we begin paying the full benefit and make the retiree whole with a lump sum adjustment retroactive to the date of retirement. Under normal circumstances, benefits are finalized

anywhere from three to five months after a person retires. The 2011 increase in retirements temporarily increased benefit finalization to seven to nine months after a person retires.

Late in 2011, MainePERS implemented new pension benefit administration software, culminating a five year planning, design, testing and training process. This new software, used by a number of other public pension funds, will allow staff to respond to member requests more quickly as they become fully familiar with all aspects of the software.

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. Employers collect participant premiums and submit payments to MainePERS. In 2011, MainePERS approved life insurance claims for 560 participants.

MainePERS recently implemented a new system that bills employers directly for premiums due, allowing more accurate and timely accounting of program funds.

### ***Employer Services***

Each month 624 teacher, participating local district and State employers report earnings, contributions and work history information on approximately 54,000 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 2011, the System conducted 29 employer training sessions statewide in preparation for conversion to a new, web-based reporting system. The Maine Community College System provided facilities for many of these sessions. More than 100 employers, including the State of Maine, assisted in testing the new reporting system prior to implementation in October, 2011. The State of Maine, the largest reporting employer, has continued to work closely with System staff to assure State payroll data processes correctly in the new system.

MainePERS continues to solicit 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 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 ten times in 2011.

### ***Records Management***

MainePERS made significant improvements in the management of incoming and outgoing documents. All incoming documents are now 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, 2011 was 3.6%. As a result of action taken by the Legislature in 2011 to freeze cost-of-living adjustments for three years, no adjustments were made to the benefits of retirees from the State-sponsored defined benefit plans administered by MainePERS. Recovery of the negative 2009 CPI was however completed. Eligible retirees from the Participating Local District Retirement Program were granted a cost-of-living adjustment of 3.2%. The cost-of-living adjustment granted was less than the CPI-U because a final adjustment of .4% was required to complete the recovery of the negative CPI in 2009.

### ***Disability Program***

The System continues in its initiative to improve its processes for applicants and disability recipients through a variety of steps outlined below:

- Ongoing efforts that increase personal contact with applicants and MainePERS staff through process discussion with applicants upon receipt of new applications and by increased communications with applicants prior to issuing a written decision.
- Updating and re-writing correspondence sent to disability applicants and recipients to increase clarity about a decision or process.
- Continued alignment of Medical Board physician specialties with applicant medical conditions through the recruitment of new physicians.
- Redesigning and simplifying medical review materials intended to make the process more understandable for disability recipients.



- Updating Annual Statement of Compensation written materials to provide greater clarity to recipients about the statutory requirements of reporting earnings.

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

### ***Information Technology***

Significant technology initiatives were undertaken in 2011, including:

- Two Disaster Recovery and Business Continuity tests were conducted in 2011 to evaluate the effectiveness of procedural documents that would be used in the event of an emergency.
- A hot site was established for the System's disaster recovery servers with replication of the primary servers. The location provides redundancy for electrical service, data communications, server cooling capacity, and fire suppression systems as well as onsite generators.
- A technology company was engaged to conduct network penetration testing, a wireless assessment, a Configuration and Vulnerability Assessment, and an overall security risk assessment of information technology resources.
- MainePERS has transitioned to a virtual infrastructure to support the new pension benefit administration software. This improves performance and provides for streamlined backup, recovery and administrative procedures.
- Data and voice infrastructure has been upgraded to accommodate the additional data traffic resulting from the new pension software. The new infrastructure includes additional capacity for voice as well as improved access to the disaster recovery site.

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 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 13 new employers in MaineSTART in 2011, bringing the total number of participating PLD employers to 57, with a total of 788 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 with 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.

The FY 2012 Board-approved budget of \$10,423,659 was less than FY 2010 and FY 2009. 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,



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 2011	
5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	823
Teacher	1098
Legislative	14
Judicial	2
Participating Local District	356
Total	2293

NEW ACTIVE MEMBERS Calendar Year 2011	
5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	667
Teacher	1274
Legislative	3
Judicial	2
Participating Local District	901
Total	2847

<b>DISABILITY RETIREMENT and APPEALS</b> <b>Calendar Year 2011</b>  <b>5 M.R.S.A. § 17103(J)(1)-(4)</b>		
	Count	Percentage
<b>NEW APPLICATIONS</b>		
Disability applications processed and acted upon in 2011	234	
Applicants awarded disability retirement at applications stage	116	50%
Applications terminated due to death	2	
Applicants denied at the application stage <sup>1</sup>	116	50%
<b>DISABILITY APPEALS</b>		
Number of appeals filed in 2011 (Note: Includes some 2010 denials)	103	
Number of carryover appeals	15	
Total active appeals	118	
Number of appeals completed in 2011	34	29%
Number of applicants granted disability following appeal	8	24%

<sup>1</sup> 5 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 2011-2012

### 5 M.R.S.A. § 17103(E)

	FY12 Budget	07/01/2011- 12/31/2011 Actual	01/01/2012- 06/30/2012 Expected	Projected Surplus /(Deficit) <sup>1</sup>
Personal Services	6,343,749	2,816,064	3,367,477	160,208
Professional Services <sup>2</sup>	817,450	404,186	408,725	4,539
Communications	602,420	246,445	348,460	7,515
Computer Support and System Development <sup>3</sup>	617,007	0	617,007	0
Office Rent	495,456	249,058	247,728	(1,330)
Computer Maintenance and Supplies <sup>4</sup>	560,300	310,779	280,151	(30,630)
Depreciation	300,000	172,668	150,000	(22,668)
Professional Development	102,435	44,730	51,218	6,487
Medical Records and Exams	231,000	93,239	115,500	22,261
Miscellaneous Operating Expenses	353,849	156,678	172,026	25,145
<b>Total Administrative Expenses</b>	<b>10,423,659</b>	<b>4,493,847</b>	<b>5,758,285</b>	<b>171,527</b>

<sup>1</sup>The Projected Surplus at December 31, 2011 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.

<sup>2</sup>Professional Services include actuarial and legal service fees associated with ongoing work on behalf of the Legislature on Plan Funding issues.

<sup>3</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.

<sup>4</sup>Computer Maintenance and Supplies include equipment, supplies and supports necessary to prepare for go-live with the new member recordkeeping system that occurred during the quarter.



SUMMARY OF ADMINISTRATIVE EXPENSES FY11	
5 M.R.S.A. § 17103(D)	
Personal Services	6,353,278
Professional Services	1,401,687
Communications	376,213
Computer Support and System Development	348,282
Office Rent	579,698
Computer Maintenance and Supplies	379,517
Depreciation	275,262
Professional Development	41,054
Medical Records and Exams	35,781
Miscellaneous Operating Expenses	313,483
Total Administrative Expenses <sup>1</sup>	10,104,255

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

## EMPLOYER CONTRIBUTIONS IN 2011

### 5 M.R.S.A. § 17103(I)

Plan Status	Employee Contributions	Employer Contributions	Total Payments to Retirees
State <sup>1</sup>	37,208,229	120,716,191	241,616,109
Teacher	87,149,535	212,725,550	353,267,000
Judicial	518,138	987,261	3,034,219
Legislative	182,065	n/a <sup>2</sup>	348,990
Participating Local Districts	35,147,556	17,761,859	115,094,047
<b>Total</b>	<b>160,205,523</b>	<b>352,190,861</b>	<b>713,360,465</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.