

MAINE STATE LEGISLATURE

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HAND DELIVERED

March 1, 2013

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 (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, 2012.

INVESTMENTS

The System's ending market value of assets for fiscal year 2012 was \$10.5 billion. MainePERS continues to experience negative cash flow of \$300 to \$350 million per year because it is a mature plan where payments to retirees exceed income during the year. The investment return for fiscal year 2012 was 0.6%. While this is below the System's actuarially assumed investment return, it was reflective of national retirement fund averages. Additionally, the System has a long-term outlook and does not make strategy changes based upon short-term results. During the first six months of fiscal year 2013 (July 1, 2012 to December 31, 2012), the System's assets experienced an investment gain of 6.8%, consistent with market conditions.

During the three-year period ending December 31, 2012, the fund was up 8.3%, with an ending market value of \$11.0 billion.

Fiscal Year Ending	Fund	Return
June 30, 2010	\$ 8.9B	11.1%
June 30, 2011	\$10.8B	22.4%
June 30, 2012	\$10.5B	.6%

The three-year, five-year, 10-year, and 30-year periods ending on June 30, 2012 annualized returns based on market value are 11.0%, 1.5%, 6.3%, and 9.7%, 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 assumption is 7.25%. The System balances the need for return with the expected risk associated with its investments to achieve these long-term objectives. Our diversified portfolio of investments is consistent with these long-term investment objectives. Our investment team and advisors are continuously monitoring our investments and the financial markets. Over the past two years, the MainePERS Investment Team, advisors, and Trustees have studied the investment objective, the most basic component of the System's investment policy statement. Upon completion of this study, the Trustees changed the asset allocation to reflect the System's desire to minimize contribution rate volatility, reduce the likelihood of permanent capital impairment, and to grow the assets of the trust. The new MainePERS target asset allocation is 40% in stocks, 25% in bonds, and 35% in alternatives.

The 35% allocation to Alternatives is comprised of Real Estate (10%), Private Equity (10%), and Infrastructure (10%), and Hard Assets (5%). In addition, the Board of Trustees has approved a 0% to 10% allocation to Other. Other seeks sound investment strategies that do not fall into one of the other asset categories.

MainePERS Target Asset Allocation



Investment performance affects employer contribution rates because investment earnings are a significant part of the total fund. The continuing impacts of the 2008 credit crisis and 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, 2012 was \$149.6 million, reflecting a 12-month increase of \$23.7 million. For the 2012 calendar year, the fund gained 13.5% from investment activity and another \$6 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 increased in FY 2012 from \$2.545 billion at June 30, 2011 to \$2.673 billion at June 30, 2012. The increase in the UAL results primarily from the recognition of prior year investment losses. The investment return on an actuarial basis was 4.77% for FY 2012, a decrease from the FY 2011 actuarial return of 6.89%. This return is 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, decreased in FY 2012 from 77.4% to 76.9%. Ten years ago, the funding ratio was 69.4%.

Funding Status of the Legislative Retirement Program

The Legislative Program is funded at 149.3% as of June 30, 2012, 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.

Funding Status of the Judicial Retirement Program

The funding status of the Judicial Program increased from 103.0% at June 30, 2011 to 107.3% at June 30, 2012.

Funding Status of Consolidated Plan for Participating Local Districts

The Consolidated Plan consisted of 282 participating local districts at December 31, 2012. The funding level of the plan decreased from 90.4% at June 30, 2011 to 86.9% at June 30,

2012. 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% by 2015. To further maintain the strong fiscal condition of this plan, the Participating Local District Advisory Committee that continuously monitors the Consolidated Plan has recommended modernization of benefit provisions, and legislation was submitted to the 126th Legislature to accomplish that result.

OPERATIONS

Changes in Board Membership

In 2013, Neria Douglass became State Treasurer and assumed the duties of Trustee *ex officio*.

Legislative

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 and legislation has been submitted to the First Regular Session of the 126th Legislature for consideration. The implementation plan will be submitted in March, 2013.

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. Federal law was recently amended to permit Cycle C governmental plan filers to make an

election to file no later than January 31, 2016. MainePERS is currently consulting with pension counsel to determine whether to make the election.

Audit

The independent audit of the MainePERS financial statements for the year ended June 30, 2012 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, 2012, in conformity with generally accepted accounting principles.

Awards and Certifications

GFOA Certification - In 2012, the System submitted its FY 2011 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 eighth 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 2012 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2012, for the fifth 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. Last fiscal year, because of changes enacted during a prior legislative session, and a retirement incentive offered to State employees, the System experienced a significant increase in retirement applications and other inquiries in 2011. This fiscal year, because of changes to school funding enacted during the current legislative session coupled with retirement incentives offered to teachers by some school districts, the System continued to experience a significant increase in retirement applications and other inquiries. In order to manage the much higher volume of requests, MainePERS continued to expand the information available on its website and again increased the number of pre-retirement

educational sessions to accommodate requests from potential retirees. MainePERS approved benefits for 1796 new retirees in 2012.

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 at least 90% of a member's estimated retirement benefit until we have received all of their final payroll information from the employer. Our new benefit software described below now enables us to provide a preliminary benefit closer to 100% of a member's estimated retirement benefit. 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 and 2012 increases 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 our staff to respond to member requests more quickly as they become fully familiar with all aspects of the software. In January of this year, the System successfully issued Form 1099s to retirees using the new pension benefit administration software.

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 2012, MainePERS approved life insurance claims for 499 participants.

MainePERS implemented a system in 2011 that bills employers directly for premiums due, allowing more accurate and timely accounting of program funds.

Employer Services

Each month 621 teacher, participating local district and State employers report earnings, contributions and work history information on approximately 56,000 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 2012, the System conducted 15 employer training sessions.

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 eight times in 2012.

Records Management

MainePERS continues to make 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 to retirees from the State and Teacher Program, the Legislative Program and the Judicial Program for three years, no adjustments in 2011 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 2011 COLA of 3% on the first \$20,000 of benefit, payable in 2012, provided there were sufficient State surplus funds. Because there were sufficient funds for the full COLA, MainePERS made the 2011 COLA payments in September, 2012. Eligible retirees from the Participating Local District Retirement Program were granted a regular cost-of-living adjustment in accordance with the 2012 CPI-U of 1.7%.

Disability Program

The Disability Program continues to evolve as staff assesses potential improvements in processes that aid both applicants and disability recipients. Examples of this initiative include:

- Continuing to increase personal contact with disability applicants with MainePERS staff facilitating discussions about the application process and its stages.
- Preceding written decisions with a phone call to the applicant to explain the decision and what the next step is in the process.
- Creating and deploying an information video on the MainePERS website that provides an overview of key details about the disability program.
- Streamlining the disability application, resulting in a two page application with accompanying medical release forms.
- Reviewing medical conditions that form the basis of the majority of applications and assuring alignment of Medical Board physician specialties and certification by recruiting physicians within those specialties.
- Redesigning the process of review for continuing eligibility of disability benefits to align with the application process for ease of disability recipients.
- Reviewing and updating the materials sent to disability recipients for submitting their Annual Statements of Compensation.

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

Information Technology

Significant technology initiatives were undertaken in 2012, including:

- MainePERS business continuity and disaster recovery program initiatives continue to evolve as business needs and technology dictate.
- The Line of Business application that allows MainePERS to maintain all of its employer, member, and retiree data, as well as process retiree payroll, underwent a disaster recovery test in 2012. The test simulated the complete loss of all services in Augusta, which allowed IT personnel to initiate the application at the MainePERS disaster recovery site within one hour.
- MainePERS and security partner Sage completed the installation of a new security product known as nDiscovery. This package collects data from various points within the MainePERS technology infrastructure. This data is then sorted into a

viewable report format that includes information related to system changes and other anomalies occurring throughout the MainePERS network.

- MainePERS completed the final phases of an Exchange 2010 upgrade that included a Zixmail secure email implementation. This system allows for the secure transfer of confidential information via email. A secure portal has been established through the MainePERS website where members, retirees and other interested external parties can create a secure email to be sent to MainePERS.
- As a means of enhancing its disaster recovery capabilities, MainePERS has partnered with Iron Mountain for secure backup tape storage and retrieval. An online system called SecureSync allows MainePERS IT staff to manage the daily pickup and return process and recall tapes from storage when needed.

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 1 new employer in MaineSTART in 2012, bringing the total number of participating PLD employers to 58, with a total of approximately 850 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 2013 Board-approved budget is \$11,101,554. 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 "Sandra J. Matheson". The signature is fluid and cursive, with a long horizontal stroke extending from the end.

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 2012 5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	538
Teacher	926
Legislative	2
Judicial	3
Participating Local District	327
Total	1796

NEW ACTIVE MEMBERS Calendar Year 2012 5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	1074
Teacher	1403
Legislative	38
Judicial	1
Participating Local District	948
Total	3464

DISABILITY RETIREMENT and APPEALS Calendar Year 2012 5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2012	197	
Applicants awarded disability retirement at applications stage	91	46%
Applications terminated due to death	4	
Applicants denied at the application stage ¹	102	52%
DISABILITY APPEALS		
Number of appeals filed in 2012 (Note: Includes some 2011 denials)	88	
Number of carryover appeals	132	
Total active appeals	141	
Number of appeals completed in 2012	79	56%
Number of applicants granted disability following appeal	15	19%

¹ 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 2012-2013**

5 M.R.S.A. § 17103(E)

	FY13 Budget	07/01/2012- 12/31/2012 Actual	01/01/2013- 06/30/2013 Expected	Projected Surplus /(Deficit) ¹
Personal Services	6,378,967	2,624,385	3,462,936	291,646
Professional Services ²	933,500	644,114	430,482	(141,096)
Communications	608,370	200,569	304,185	103,616
Computer Support and System Development ³	185,000	92,500	92,500	-
Building Operations	447,216	184,345	222,808	40,063
Computer Maintenance and Supplies ⁴	1,428,300	523,180	714,150	190,970
Depreciation	385,000	174,179	192,500	18,321
Professional Development	111,435	19,633	55,717	36,085
Medical Records and Exams	232,200	73,306	116,100	42,794
Miscellaneous Operating Expenses	391,566	110,838	196,583	84,145
Total Administrative Expenses	11,101,554	4,647,049	5,787,961	666,544

¹The Projected Surplus at December 31, 2012 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 and Plan Design 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.

⁴Computer Maintenance and Supplies include equipment, supplies and supports necessary to prepare for go-live with the new member recordkeeping system which was implemented in October 2011.

SUMMARY OF ADMINISTRATIVE EXPENSES FY12	
5 M.R.S.A. § 17103(D)	
Personal Services	5,880,290
Professional Services	1,354,235
Communications	486,562
Computer Support and System Development	778,563
Office Rent	458,519
Computer Maintenance and Supplies	289,317
Depreciation	351,547
Professional Development	79,967
Medical Records and Exams	36,105
Miscellaneous Operating Expenses	311,966
Total Administrative Expenses ¹	10,027,071

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 2012

5 M.R.S.A. § 17103(I)

Plan Status	Employee Contributions	Employer Contributions	Total Payments to Retirees
State ¹	35,206,022	95,727,829	256,193,546
Teacher	85,992,905	156,847,798	377,343,760
Judicial	517,419	810,721	3,171,846
Legislative	133,579	n/a ²	279,701
Participating Local Districts	32,449,139	22,362,532	134,368,130
Total	154,299,064	275,748,880	771,356,983

¹ State Plan totals include Governors.

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