

MAINE STATE LEGISLATURE

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HAND DELIVERED

February 27, 2015

Senator James Hamper, 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 Hamper, Representative Rotundo and Members of the Appropriations Committee:

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

We are pleased to provide this information based on operations through June 30, 2014.

INVESTMENTS

The ending market value of the System's defined benefit plans for the fiscal year 2014 was \$12.7 billion. The net position of the trust fund increased substantially, as net investment and other income for the fiscal year significantly exceeded payments to retirees. The investment return for fiscal year 2014 was 16.7%, which compares favorably to the 7.125% actuarially assumed investment rate of return.

These results were achieved almost entirely by behavior of the capital markets because the System's investment strategy has remained stable. For the fiscal year ended June 2014, the trust fund received strong gains from domestic and foreign stock markets while fixed income markets experienced modest positive returns.

Fiscal Year Ending	Fund Value	Investment Return*
June 30, 2012	\$10.5B	0.6%
June 30, 2013	\$11.3B	11.1%
June 30, 2014	\$12.7B	16.7%

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

Annualized returns, net of management fees, for the three-year, five-year, 10-year, and 30-year periods ending on June 30, 2014 based on market value were 9.3%, 12.2%, 6.9%, and 9.5%, respectively.

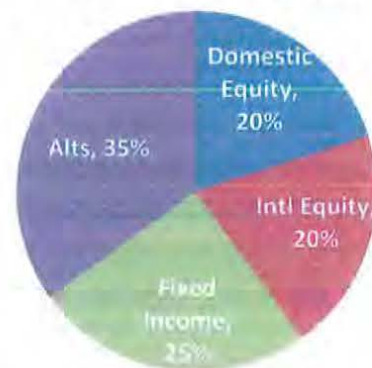
Negative returns for the fiscal years ended June 30, 2008 and 2009, which impacted the System's 10-year return, were the result of major declines in domestic and foreign stock markets, partially offset by gains in the domestic bond market.

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

The System's allocation to alternative investments targets 10% in infrastructure, 10% in private equity, 10% in real estate, and 5% in natural resources, which may include agriculture, timber, and commodities. In addition, the Board of Trustees has approved a 0% to 10% allocation to an "Other" category that seeks sound investment strategies that do not fall into one of the other asset categories. While the Board has approved the new Asset Allocation targets, it will take several years to fully implement and fund the alternatives allocation. Alternative investments comprised approximately 13.5% of the System's portfolio on an invested basis at June 30, 2014.

Investment performance affects employer contribution rates because investment earnings are a significant contributor to the total fund. MainePERS maintains a substantial portion of its assets in publicly traded equities and private equity and other return-seeking investments because most of the System's benefit payments are not due for several decades into the future. For the past ten years, the System has invested between 60% and 70% of its assets in equities. Over sufficiently long periods, equities have been shown to outperform bonds. The System expects this relationship to hold in the future. All of the assets of the System's

MainePERS Target Asset Allocation



retirement plans and other funds continue to be in portfolios managed by professional investment management firms. These managers act as fiduciaries and invest the assets assigned to them in accordance with the System's investment policies and the individual agreements between MainePERS and the investment managers.

The 123rd Legislature created an Investment Trust with a \$100 million initial contribution for the purpose of investing funds set aside by the State of Maine to cover Other Post-Employment Benefits (OPEB) liabilities for State retiree health insurance benefits. The Trustees of MainePERS were named Trustees for this Investment Trust and have the responsibility for investing these funds. The market value for the OPEB assets at June 30, 2014 was \$189.8 million, reflecting a 12-month increase of \$29.5 million from investment activity. No funds were contributed by the State of Maine during fiscal year 2014.

L.D. 1806 became effective in August 2014. Part C of the bill supported the System's environmental, social and governance (ESG) efforts by establishing a taskforce to make a recommendation to the MainePERS Board on ESG policy. The ESG Taskforce presented a recommended policy and report to the Board in January 2015. The Board voted unanimously to adopt the policy. The ESG Taskforce progress report was also provided to the Appropriations Committee and is available on the MainePERS website.

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 2014 from \$2.653 billion at June 30, 2013 to \$2.303 billion at June 30, 2014. While investment returns on a market value basis were 16.70% as stated earlier, the return on an actuarial value of asset basis was 12.20% for FY 2014, an increase from the FY 2013 actuarial return of 6.76%. This actuarial return is higher than the actuarial investment return assumption of 7.125%. (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 2014 from 77.6% to 81.3%. Ten years ago, the funding ratio was 68.3%.

Funding Status of the Legislative Retirement Program

The Legislative Program is funded at 143.6% as of June 30, 2014, primarily because few legislators qualify for a retirement benefit under the terms of the program even though contributions were made on their behalf at one point in time. No employer contribution is currently required because of the resulting overfunded status of the program.

Funding Status of the Judicial Retirement Program

The funding status of the Judicial Program increased from 97.5% at June 30, 2013 to 101.6% at June 30, 2014. This increase was due primarily to strong investment returns.

Funding Status of Consolidated Plan for Participating Local Districts

The Consolidated Plan consisted of 291 participating local districts at December 31, 2014. The funding level of the plan increased from 86.6% at June 30, 2013 to 89.5% at June 30, 2014. The Participating Local District Advisory Committee continuously monitors the Consolidated Plan to ensure that it maintains a strong fiscal condition.

OPERATIONS

Changes in Board Membership

Terry Hayes became State Treasurer and assumed the duties of Trustee *ex officio* in 2015.

Legislative

As in prior years' reports, MainePERS is not reporting information as set forth in the requirement of 5 M.R.S.A. §17103, sub-§11, paragraph C. This requirement refers to a law pertaining to divestment from South Africa that has since been repealed. We therefore recommend that the report requirement found in paragraph C likewise be repealed. MainePERS has included this recommendation in the System's proposed omnibus bill that will be heard later this session.

Public Law 2013, Chapter 602, Part C directed MainePERS to establish a task force "to further the system's work on corporate governance by completing an environmental, social and governance policy" and to submit a report of the task force's recommendations, and any resulting actions taken by the MainePERS Board of Trustees, to the Legislature by January 15, 2015. This report was submitted to the Appropriations Committee on January 8, 2015.

Private and Special Law 2013, Chapter 30 directed MainePERS to complete a benefit analysis pertaining to specific groups of active members who are covered by the 1998 Special Plan, and to report the results of that analysis to the Legislature by January 15, 2015. This report was submitted to the Appropriations Committee on January 8, 2015.

Qualified Plan Status

In 2014, 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 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 requires resubmission of the plans for updated determination letters by January 31, 2019.

Legal

On June 27, 2014, the 1st Circuit Court of Appeals affirmed the grant of summary judgment issued by the United States District Court for the District of Maine in *Maine Association of Retirees, et al. v. Board of Trustees of the Maine Public Employees Retirement System*, effectively dismissing all claims brought against the Trustees by the Plaintiffs--the Maine State Employees Association, the Maine Education Association and the Maine State Troopers Association. The Plaintiffs had filed suit seeking the District Court to declare that the 2011 cost-of-living adjustment (“COLA”) statutes violated either or both the Contract Clause of and the Fifth Amendment to the Federal Constitution. The 1st Circuit agreed with the District Court that the legislation was not unconstitutional. The Court’s decision constitutes the final judgment in the lawsuit.

Audit

The independent audit of the MainePERS financial statements for the year ended June 30, 2014 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, 2014, in conformity with generally accepted accounting principles.

Awards and Certifications

Government Finance Officers Association Certification - In 2014, the System submitted its FY 2013 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 tenth 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 2014 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2014, for the seventh consecutive year, the System was awarded the Public Pension Coordinating Council's Recognition Award for Funding. To receive this award, retirement programs must meet professional standards for plan funding as set forth in the Public Pension Standards. The regular flow of required contributions and the up-front funding of new liabilities were listed as factors contributing to the System's receipt of this award.

Member and Retiree Services

More than 90,000 public employees in Maine are members, or retirees, of MainePERS. MainePERS approved benefits for 1,904 new retirees in 2014. This represents an increase of over 12% from 2013, the majority of which was teacher retirements.

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

Group Life Insurance

Approximately 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 2014, MainePERS approved life insurance claims for 573 participants.

Employer Services

Approximately 540 teacher, participating local district and State employers each month report earnings, contributions and work history information on approximately 51,000 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 2014, the System conducted 33 employer training sessions.

MainePERS continues to solicit feedback and guidance from an Employer Reporting Work Group comprised of teacher and participating local district employers. Regular meetings with the Office of the State Controller help to assure balanced consideration of reporting needs and improved system capability. The System's website includes a section specifically for employers. The *Employer Update*, an electronic update focused on employer specific matters, was published six times in 2014.

Records Management

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

Cost-of-Living Adjustment (COLA)

The Board of Trustees is directed by statute to annually adjust the retirement benefits of its eligible retirees by a cost-of-living adjustment equal to the change in the Consumer Price Index for All Urban Consumers (CPI-U) over the 12 months preceding June 30 of each year. The CPI-U at June 30, 2014 was 2.1%. Eligible retirees from the State and Teacher Program, the Legislative Program and the Judicial Program were granted a regular cost-of-living adjustment of 2.1% on the first \$20,000 of benefit. Additionally, MainePERS paid the final one-time, noncumulative COLA provided to retirees from those Programs by legislative action taken in 2011. As a result of action taken by the Legislature in 2014, the one-time payment was 1.8% (based on the 2013 CPI-U) on the first \$30,000 of benefit. Eligible retirees from the Participating Local District Retirement Program were granted a regular cost-of-living adjustment of 2.1%.

Disability Program

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

- The formation of a stakeholders' working group in 2013 led to the issuance of a Request for Proposal for a consultant to aid the working group in examining best practices for a modern disability program.
- The Disability Program continues to work with employers' Equal Employment Opportunity (EEO) Coordinators and supervisors in an effort to obtain a more thorough understanding of employees' job duties when evaluating the impossibility standard of the application process.
- The staff continues in their outreach efforts to State of Maine Human Resource professionals to facilitate a deeper understanding of the program for both the employer and the employee.
- Recruitment for Medical Board physicians is an ongoing effort in order to align physicians' expertise with the types of medical conditions claimed during the application process.

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

Information Technology

Technological advances continue at MainePERS with an ongoing emphasis of data protection and security.

- In 2013, the System formed an Information Technology (IT) Security Council to oversee the System's IT Security policies and the development of technology plans. The Council continues to function successfully in guiding the development of security policies, infrastructure oversight and planning, and identifying technological trends.
- Security monitoring improvements included introduction of an alternate third party monitoring service that analyzes network activity and provides alerts in real time. This redundancy provides MainePERS with an alternate review of system event monitoring and further ensures data security oversight.
- MainePERS undertook a number of infrastructure upgrades in 2014. These included upgrading internal data/voice wiring, communication switching and routing, bandwidth expansion, active directory upgrade, server upgrades, and implementation of a paperless solution for its Board of Trustees and Medical Board.
- Software upgrades included an upgrade to replication software providing real time replication of data to the disaster recovery site, further ensuring data integrity and security.

Agency Performance Initiatives

The Maine Public Employees Retirement System's mission is to serve the public with sound retirement services to Maine government.

MainePERS adopted the Balanced Scorecard (BSC) in 2012 to create performance improvements and metrics using continuous improvement in program quality and operations. The System has initiated over 20 BSC performance improvement projects with the goal of improving system-wide standardization. One of the projects is to adopt and implement LEAN Thinking in order to further improve cost-effectiveness.

DEFINED CONTRIBUTION PLANS

MaineSTART

The System continues 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 one new employer in MaineSTART in 2014, bringing the total number of participating PLD employers to 61, with a total of approximately 928 participants.

BUDGET

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

The FY 2015 Board-approved budget is \$11,950,000. We continuously review costs to identify efficiency improvements.

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

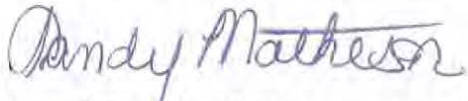
REQUESTED LEGISLATION

The personal financial information of defined benefit plan members and participants in the MaineSTART defined contributions plans administered by the System is currently not confidential under Maine law. As a result, the System has no ability to maintain the confidentiality of personal financial information in the possession of the System relating to members and participants, including the value of a member's contributions and of a participant's account balance and investment allocation. MainePERS believes this information should be confidential and therefore requests a statutory amendment. A draft of a proposed bill addressing this issue is attached for the Committee's consideration (see Attachment 6).

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
Grant T. Pennoyer, Executive Director, Legislative Council
Rachel Tremblay, Office of Fiscal and Program Review

NEW RETIREES	
Calendar Year 2014	
5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	511
Teacher	984
Legislative	2
Judicial	4
Participating Local District	403
Total	1904

NEW ACTIVE MEMBERS	
Calendar Year 2014	
5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	1131
Teacher	1544
Legislative	30
Judicial	1
Participating Local District	1107
Total	3813

DISABILITY RETIREMENT and APPEALS Calendar Year 2014		
5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2014 ¹	164	
Applicants awarded disability retirement at applications stage	49	30%
Applications terminated due to death	2	
Applicants denied at the application stage ²	108	66%
DISABILITY APPEALS		
Number of appeals filed in 2014 (Note: Includes some 2013 denials)	93	
Number of carryover appeals	139	
Total active appeals	122	
Number of appeals completed in 2014	110	47%
Number of applicants granted disability following appeal	18	16%

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

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

**BUDGET STATUS OF ADMINISTRATIVE OPERATIONS AND
FUNCTIONS
FY 2014-2015**

5 M.R.S.A. § 17103(E)

	FY15 Budget	07/01/2014- 12/31/2014 Actual	01/01/2015- 06/30/2015 Expected	Projected Surplus /(Deficit)¹
Personal Services	6,666,831	3,050,604	3,424,706	191,521
Professional Services²	1,533,150	622,675	717,923	192,552
Communications	508,073	250,771	256,575	727
Computer Support and System Development³	185,000	92,500	92,500	-
Building Operations	370,362	198,104	185,181	(12,923)
Computer Maintenance and Supplies⁴	1,281,825	768,184	640,913	(127,272)
Depreciation	680,000	218,645	340,000	121,355
Professional Development	115,850	17,443	60,675	37,732
Medical Records and Exams	205,500	85,697	102,750	17,053
Miscellaneous Operating Expenses	403,409	173,587	198,956	30,866
Total Administrative Expenses	11,950,000	5,478,210	6,020,179	451,611

¹The Projected Surplus at December 31, 2014 is attributable in part to vacant positions occurring during the fiscal year. Any realized savings at the close of the fiscal year will inure to the trust funds.

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

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

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

SUMMARY OF ADMINISTRATIVE EXPENSES FY14	
5 M.R.S.A. § 17103(D)	
Personal Services	5,928,397
Professional Services	1,750,155
Communications	403,789
Computer Support and System Development	698,443
Office Rent	268,610
Computer Maintenance and Supplies	746,121
Depreciation	423,674
Professional Development	48,950
Medical Records and Exams	29,424
Miscellaneous Operating Expenses	326,789
Total Administrative Expenses¹	10,624,352

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 2014			
5 M.R.S.A. § 17103(I)			
Plan Status	Employee Contributions	Employer Contributions ²	Total Payments to Retirees
State ¹	34,491,103	121,150,835	273,370,679
Teacher	86,542,050	183,293,028	415,820,352
Judicial	528,192	932,223	3,219,479
Legislative	139,501	3,857	317,606
Participating Local Districts	33,304,646	33,374,006	131,761,477
Total	155,005,492	338,753,949	824,489,593

¹State Plan totals include Governors.

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

**An Act to Make Specific Personal Financial Information in the Possession of the
Maine Public Employees Retirement System Confidential**

Be it enacted by the People of the State of Maine as follows:

Sec. 1. 5 MRSA §17057, sub-§2, as repealed and replaced by PL 1991, c. 824, Pt. A, §7, is amended to read:

2. Financial information. The following private financial and personal information of members, beneficiaries, or participants of any of the programs of the retirement system, in the possession of the retirement system, is confidential and not open to public inspection and does not constitute "public records" as defined in Title 1, section 402, subsection 3:

A. Information regarding member, beneficiary, or participant accounts with financial institutions, including account numbers;

B. Information regarding participation in defined contribution or deferred compensation plans, including account numbers, investment allocations, contributions, distributions, and balances;

C. Information regarding designated beneficiaries; and

D. ~~Group life insurance information.~~ Information in the possession of the retirement system regarding a participant's designated beneficiary or amount of insurance coverage or group life insurance is confidential and not open to public inspection and does not constitute "public records" as defined in Title 1, section 402, subsection 3.

SUMMARY

This bill makes specific private financial and personal information of members, beneficiaries and participants of any of the programs of the Maine Public Employees Retirement System, in the possession of the System, confidential and not open to public inspection.