

MAINE STATE LEGISLATURE

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HAND DELIVERED

February 29, 2016

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 and Financial Affairs Committee:

Please accept the Maine Public Employees Retirement System's ("MainePERS" or "System") annual report to the Joint Standing Committee on Appropriations and Financial Affairs. This report is prepared in response to 5 M.R.S. § 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 are being provided to the Committee and which is available at www.mainepers.org, provides detailed information that supplements this report.

We are pleased to provide this information based on operations through June 30, 2015.

INVESTMENTS

The ending market value of the System's defined benefit plans trust fund was \$12.6 billion for the fiscal year 2015. The net position of the trust fund decreased slightly, as net investment earnings and contributions for the fiscal year were less than payments to retirees. The investment return for fiscal year 2015 was 2.0%, which was less than the 7.125% actuarially assumed investment rate of return. The negative markets have continued into 2016.

These returns resulted primarily from the behavior of the capital markets, because the System's investment strategy remained consistent. For the fiscal year ended June 2015, the

trust fund received a strong positive return from domestic stocks, significant negative trust from foreign stocks, and a modest positive return from fixed income markets.

Fiscal Year Ending	Fund Value	Investment Return*
June 30, 2013	\$11.3B	11.1%
June 30, 2014	\$12.7B	16.7%
June 30, 2015	\$12.6B	2.0%

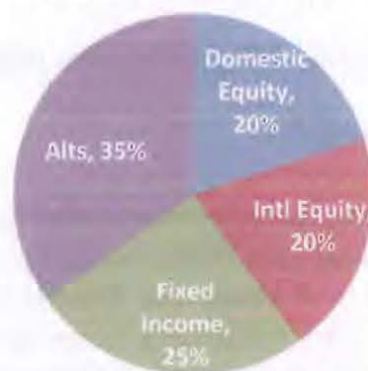
*Refers to performance of the investments, not the change in Fund Value

Annualized returns, net of management fees, for the three-year, five-year, 10-year, and 30-year periods ending on June 30, 2015 based on market value were 9.8%, 10.2%, 5.9%, and 8.7%, respectively. The ten year returns include the 2008-2009 market downturn.

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% 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 allocation to alternative investments. On an invested basis, alternative investments comprised approximately 19.5% of the System's portfolio at June 30, 2015.

MainePERS Target Asset Allocation



MainePERS maintains a substantial portion of its assets in return-seeking assets, such as publicly traded equities and private equity 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 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. As of June 30, 2015, the market value for the OPEB assets was \$195.3 million, an increase of \$5.5 million over the prior year end due to investment activity. An additional \$1.5 million was contributed by the State of Maine in August 2015.

Public Law Chapter 602 (L.D. 1806), An Act To Implement the Recommendations Contained in the State Government Evaluation Act Review of the Maine Public Employees Retirement System, 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 of Trustees in January 2015. The Board voted unanimously to adopt the policy. The ESG Policy and Taskforce Report were provided to the Appropriations and Financial Affairs Committee and are 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 was reduced in FY 2015 from \$2.303 billion at June 30, 2014 to \$2.241 billion at June 30, 2015. While investment returns on a market value basis were 2.0% as stated earlier, the return on an actuarial value of asset basis was 6.45% for FY 2015, a decrease from the FY 2014 actuarial return of 12.20%. This actuarial return is lower 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 2015 from 81.3% to 82.2%. Ten years ago, the funding ratio was 69.7%.

(Note: Please see the MainePERS Comprehensive Annual Financial Report for an understanding of the difference between market and actuarial values.)

Funding Status of the Legislative Retirement Program

The Legislative Program is funded at 148.4% as of June 30, 2015, 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 overfunded status of the program.

Funding Status of the Judicial Retirement Program

The actuarial funded ratio of the Judicial Retirement Program has in recent years remained close to 100%. The actuarial funded ratio as of June 30, 2013 was 97.5%. In fiscal year 2014, the actuarial funded ratio of the plan increased to 101.6% and as of June 30, 2015 the actuarial funded ratio was 96.9%.

Funding Status of Consolidated Plan for Participating Local Districts

The Consolidated Plan consisted of 294 participating local districts at December 31, 2015. The actuarial funded ratio of the plan decreased slightly from 89.5% at June 30, 2014 to 89.4% at June 30, 2015. 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

There were no changes to Board membership in 2015. The reappointment of two Board members was confirmed by the Legislature in early 2016. One position on the Board remains vacant pending gubernatorial appointment.

Legislative

As in prior year reports, MainePERS is not reporting information as set forth in the requirement of 5 M.R.S. §17103, sub-§11, paragraph C. This requirement refers to a law pertaining to divestment from South Africa that has since been repealed. L.D. 1021, currently pending consideration by the Governor, repeals the reporting requirement.

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. The IRS has announced that it is eliminating the cyclical determination letter program and will now issue determination letters only for new or terminating plans and in other limited circumstances that will be identified in future IRS guidance. MainePERS continues to closely monitor tax law changes to ensure the pension plans continue to comply with federal law and maintain their qualified status.

Audit

The independent audit of the MainePERS financial statements for the year ended June 30, 2015 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, 2015, in conformity with generally accepted accounting principles. This is the sixth consecutive year that the System has received no management letter comments in addition to an unqualified opinion.

Awards and Certifications

Government Finance Officers Association Certification - In 2015, the System submitted its FY 2014 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 eleventh 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 2015 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2015, for the eighth 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 Retirement Services

More than 90,000 of Maine's public employees were members or retirees, served by MainePERS at December 31, 2015. The System approved benefits for 1,804 new retirees during CY 2015. This represents a decrease of 5% from 2014. Nearly 50% of the new retirees in 2015 were teachers.

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

Group Life Insurance

Approximately 50,500 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. MainePERS approved life insurance claims for approximately 635 participants totaling approximately \$11 million in 2015.

Employer Services

State employers report earnings, contributions and work history information each month regarding their employees, totaling 56,150 at December 31, 2015. 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. The System provided 27 employer training sessions during CY 2015.

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 State of Maine's 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 (6) times during CY 2015.

Records Management

MainePERS continues to refine its Records Management practice for all incoming documents being imaged upon receipt, which in turn triggers workflow for the appropriate MainePERS business unit. Outgoing correspondence flows through the Document Center and is included in the membership records of the System.

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 (COLA) 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, 2015 was .1%. Eligible retirees from the Participating Local District Retirement Program were granted a regular cost-of-living adjustment of .1%. As a result of the enactment of Public Law Chapter 334 (L.D. 86), An Act to Improve Retirement Security for Retired Public Employees in 2015, eligible retirees from the State and Teacher Program, the Legislative Program and the Judicial Program were granted a regular cost-of-living adjustment of 2.55% on the first \$20,000

indexed) of benefit. This legislation also provides eligible retirees from those programs with a 2.55% cost-of-living adjustment in 2016 on their indexed benefit.

Disability Services

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

- **Disability Retirement Task Force** - A MainePERS constituted task force has been meeting since late 2014 to oversee a comprehensive review of the MainePERS disability retirement program. Part of the taskforce's work last year included an independent audit of the MainePERS disability retirement application review process. The audit report was provided to the Appropriations and Financial Affairs Committee. The audit found that the MainePERS process uses industry best practices.
- **Task Force Outcomes** - Two significant outcomes have occurred from the task force and audit efforts. The first is the recognition that the MainePERS program is widely confused with long-term disability insurance. The Appropriations and Financial Affairs Committee has requested that MainePERS perform a study of how this insurance could be offered to its' members. The second outcome is an in-depth review of the disability application process using Lean Thinking methods and tools. This involves not only MainePERS staff, but stakeholders involved in the disability process. MainePERS feels confident that improvement is always possible and that the member experience can be improved. That review has started, and MainePERS anticipates changes not only to its processes, but possibly the introduction of some legislation to update the program provisions.

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

Information Technology

- **Wireless Infrastructure Upgrade** - MainePERS completed a project in 2015 to install a new wireless infrastructure in the Augusta and Portland locations. This Cisco system provides significantly greater Wi-Fi coverage while providing enhanced security features that can monitor and alert for any attempted intrusions into the wireless network.
- **Line of Business Application Upgrade** - A comprehensive line of business system software upgrade continues and is projected to be completed in late 2016. The newer version of the existing software will provide improvements to the existing line of business processing. The project includes hardware infrastructure upgrades

that will improve application performance as well as enhancements to the security of the membership data.

- New Phone System Implementation – Installation of a new VOIP phone system was completed in 2015. The new system provides new features including enhanced call center functionality. The prior telephone system was 13 years old and significantly outdated.
- IT Security - Security remains the primary focus of the Information Technology Security Council formed by MainePERS in 2013. The Council guides development of security policies, provides infrastructure oversight and planning, identifies technology trends and fulfills a virtual Chief Information Officer role.

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 40 BSC performance improvement projects with the goal of improving system-wide standardization. One of the projects that we believe will provide continuous improvement to the System and its members is the implementation of Lean Thinking in order to further improve service to members in a cost-effective manner.

DEFINED CONTRIBUTION PLANS

MaineSTART

The System continues to promote its pre-tax 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 six new employers in MaineSTART in CY 2015, bringing the total number of participating PLD employers to 69, with a total of 997 participants at the close of the year.

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 reported to this Committee.

The FY 2016 Board-approved administration budget is \$12,362,819. 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.

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/mg

Attachments

cc: Members, Board of Trustees
Grant T. Pennoyer, Executive Director, Legislative Council
Rachel Tremblay, Office of Fiscal and Program Review

NEW RETIREES	
Calendar Year 2015	
5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	492
Teacher	879
Legislative	17
Judicial	4
Participating Local District	410
Total	1,802

NEW ACTIVE MEMBERS	
Calendar Year 2015	
5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	1,060
Teacher	1,649
Legislative	0
Judicial	1
Participating Local District	1,158
Total	3,868

DISABILITY RETIREMENT and APPEALS Calendar Year 2015		
5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2015 ¹	166	
Applicants awarded disability retirement at applications stage	63	38%
Applications terminated due to death	3	
Applicants denied at the application stage ²	103	62%
DISABILITY APPEALS		
Number of appeals filed in 2015 ³ (Note: Includes some 2014 denials)	69	
Number of carryover appeals	102	
Total active appeals	97	
Number of appeals completed in 2015	74	57%
Number of applicants granted disability following appeal ⁴	21	28%

¹Four (4) applications were withdrawn by members prior to a decision being issued and three (3) members died while their applications were pending.

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.

³This number represents appeals of new applications and does not include reviews.

⁴Of the 21 granted disability following appeal, 14 were granted by the Executive Director after reconsideration of prior decisions and 7 were granted by a Hearing Officer.

BUDGET STATUS OF ADMINISTRATIVE OPERATIONS AND FUNCTIONS FY 2015-2016				
5 M.R.S.A. § 17103(E)				
	FY16 Budget	07/01/2015- 12/31/2015 Actual	01/01/2016- 06/30/2016 Expected	Projected Surplus /(Deficit) ¹
Personal Services	7,263,590	3,137,129	3,624,557	501,904
Professional Services ²	1,350,300	604,767	601,074	144,459
Communications	447,840	165,879	224,375	57,586
Computer Support and System Development ³	332,340	166,170	166,170	-
Building Operations	326,674	143,060	147,926	35,688
Computer Maintenance and Supplies ⁴	1,399,100	593,560	735,663	70,877
Depreciation	500,631	316,602	391,602	(207,573)
Professional Development	77,150	21,382	55,768	-
Medical Records and Exams	204,000	103,278	112,778	(12,056)
Miscellaneous Operating Expenses	461,194	197,923	236,625	26,646
Total Administrative Expenses	12,362,819	5,449,750	6,295,538	617,531

¹The Projected Surplus at December 31, 2015 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 disability 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 FY15	
5 M.R.S.A. § 17103(D)	
Personal Services	6,614,238
Professional Services	1,886,122
Communications	436,078
Computer Support and System Development	654,565
Office Rent	372,624
Computer Maintenance and Supplies	750,704
Depreciation	549,926
Professional Development	49,625
Medical Records and Exams	25,261
Miscellaneous Operating Expenses	862,846
Total Administrative Expenses¹	12,201,989

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 2015			
5 M.R.S.A. § 17103(I)			
Plan Status	Employee Contributions	Employer Contributions ²	Total Payments to Retirees
State ¹	35,285,382	129,416,996	279,365,230
Teacher	88,243,425	191,332,652	443,359,028
Judicial	549,691	979,281	3,383,995
Legislative	193,356	4,418	439,112
Participating Local Districts	37,297,388	44,283,401	181,195,544
Total	161,569,242	366,016,748	907,742,909

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.