

MAINE STATE LEGISLATURE

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HAND DELIVERED

February 24, 2017

Senator James Hamper, Senate Chair
Representative Drew Gattine, House Chair
Members, Joint Standing Committee on Appropriations and Financial Affairs
5 State House Station
Augusta, ME 04333-0005

Dear Senator Hamper, Representative Gattine 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.maineopers.org, provides detailed information that supplements this report.

We are pleased to provide this information. Except where indicated, this report is based on operations through June 30, 2016.

INVESTMENTS

The ending market value of the System's defined benefit plans trust fund was \$12.3 billion for FY 2016. 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 2016 was 0.6%, which was less than the 6.875% actuarially assumed investment rate of return. The fund has returned 5.9% for the first seven months of FY 2017.

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 2016, the trust fund received a positive return from domestic stocks, significant negative return from foreign stocks, and a positive return from fixed income markets.

Fiscal Year Ending	Fund Value	Investment Return*
June 30, 2014	\$12.7B	16.7%
June 30, 2015	\$12.6B	2.0%
June 30, 2016	\$12.3B	0.6%

*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, 2016 based on market value were 6.2%, 6.0%, 5.2%, and 7.9%, 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 27.9% of the System's portfolio at June 30, 2016.

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,

MainePERS Target Asset Allocation



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, 2016, the market value for the OPEB assets was \$199.2 million, an increase of \$3.9 million over the prior year end. An additional \$4.0 million was contributed by the State of Maine in September 2016.

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 2016 from \$2.241 billion at June 30, 2015 to \$2.557 billion at June 30, 2016. While investment returns on a market value basis were 0.6% as stated earlier, the return on an actuarial value of asset basis was 4.42% for FY 2016, a decrease from the FY 2015 actuarial return of 6.45%. This actuarial return is lower than the actuarial investment return assumption of 6.875%. (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 2016 from 82.2% to 80.4%. Ten years ago, the funding ratio was 71.2%.

(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 148.5% as of June 30, 2016, 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, 2014 was 101.6%. In fiscal year 2015, the actuarial funded ratio of the plan decreased to 96.9% and as of June 30, 2016 the actuarial funded ratio was 100.9%.

Funding Status of Consolidated Plan for Participating Local Districts

The Consolidated Plan consisted of 299 participating local districts at December 31, 2016. The actuarial funded ratio of the plan decreased from 89.4% at June 30, 2015 to 86.1% at June 30, 2016. 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

In March 2016, the Senate confirmed Philip Brookhouse as a Trustee to complete the term of a prior trustee. Mr. Brookhouse was reappointed and confirmed by the Senate on February 2, 2017, and serves in the seat that represents retired teachers.

Legislative

A law passed by the 127th Legislature required MainePERS to study and report to the Legislature on issues related to MainePERS offering long term disability insurance. The System submitted this report on January 18, 2017.

Another law passed required MainePERS and the State Department of Administrative and Financial Services ("DAFS") to identify pre-July 1, 2015 State retirees whose benefits were negatively impacted by pay freezes and to determine the cost to permit those retirees to include those wages in their benefit calculations. The System submitted its report of this information on January 31, 2017.

MainePERS has submitted several bills for consideration during the 128th Legislative Session. These include the System's omnibus bill, which makes minor changes to several parts of retirement-related law; a Freedom of Access bill that would expand the categories of non-public information to include additional member and retiree information in the possession of MainePERS; a Constitutional Amendment to extend

the period over which experience losses are amortized; a concept draft to implement changes to the Participating Local District (PLD) Retirement Program; and, a concept draft to implement reforms to the disability retirement program administered by MainePERS.

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 subsequently eliminated the cyclical determination letter program and will now issue determination letters only for new or terminating plans and in certain other limited circumstances. MainePERS continues to closely monitor tax law changes to ensure that 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, 2016 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 position of the System as of June 30, 2016, in conformity with generally accepted accounting principles.

Awards and Certifications

Government Finance Officers Association Certification - In 2016, the System submitted its FY 2015 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 twelfth 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 2016 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2016, for the ninth 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 94,000 of Maine's public employees were members or retirees served by MainePERS at December 31, 2016. The System approved benefits for 1,783 new retirees during CY 2016. This was almost the same number as 2015, with just over 40% of the new retirees in 2016 being teachers.

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

Group Life Insurance

In CY 2016, approximately 50,800 state, teacher and participating local district employees and retirees had Group Life Insurance coverage under the plan administered by MainePERS. Employers collect participant premiums and submit payments to MainePERS. MainePERS approved life insurance claims for 598 participants totaling approximately \$11.5 million in CY 2016.

Employer Services

MainePERS relies on participating employers to electronically report earnings, contributions, and work history at least once a month in order to maintain the up-to-date information needed to determine a member's eligibility for retirement and the amount the member will receive in benefits. For CY 2016, MainePERS received and processed employer-provided records regarding approximately 57,100 unique employees.

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 20 employer training sessions during CY 2016.

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 2016.

Document Center

MainePERS' Document Center supports the organization's paper reduction initiatives by conducting front-end imaging of incoming mail, triggering workflows throughout the business units. Outgoing mail is also processed for document management prior to leaving the organization. Preparation is underway to upgrade scanning equipment for the imaging 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, 2016 was 1.0%. Eligible retirees from the Participating Local District Retirement Program were granted a regular cost-of-living adjustment of 1.0%. As a result of the enactment of Public Law 2015 Chapter 334, An Act to Improve Retirement Security for Retired Public Employees, 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.

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 regularly meeting since late 2014 to oversee a comprehensive review of the MainePERS disability retirement program. During 2016, the task force provided input to the System as it developed proposed operational modifications that are intended to provide members with better service and understanding of the program. Many of those changes are being implemented in the first quarter of CY 2017.
- Long Term Disability Insurance (L.T.D.I.) - In conjunction with the Task Force, during CY 2016, MainePERS studied the viability of offering L.T.D.I. to its

members. As directed in Public Law 2015 Chapter 392, a report summarizing the findings of that study was submitted to the Committee in January 2017. The recommendation in that report is for enactment of a law that would allow MainePERS to offer L.T.D.I. to members through their employers. The approach, in general, would be to allow employers to voluntarily participate, adopt a suitable option for the payment of costs, and have all employees at a participating employer automatically enrolled with the chance to opt-out.

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

Information Technology

MainePERS technology continues to evolve as business needs and security demands dictate. Activities in 2016 include:

- Infrastructure Security Upgrades – MainePERS has completed a number of information security infrastructure projects since our last report. In particular, we have installed upgrades to our network firewall (Cisco FirePower) and added two client endpoint protection technologies (Cisco AMP and Invincea).
- Unified Communications Upgrades – MainePERS has added integrations between voice systems (NEC PBX) and its Microsoft Exchange email and group communications platform. Users now have capability to manage voice messages through the Exchange/Outlook environment.
- Line of Business Application Upgrade – A comprehensive line-of-business (LOB) system software upgrade continues. LOB refers to the full range of services and products offered by MainePERS to its stakeholders beginning with active employees and their employers all the way through to retirement and beneficiary payment processing. The new version provides improvements to the existing line of business system. Required hardware and infrastructure upgrades are done, and major software functionality enhancements have been completed. The project is currently in the user acceptance testing phase, and is projected to be completed in 2017.
- IT Security - Security remains the primary focus of the Information Technology Oversight Council (formerly known as the Information Technology Security Council). The Council guides development of an information security program and policies using best practices as established by the National Institute of Standards and Technology; provides infrastructure oversight and planning; identifies technology trends; and fulfills a virtual Chief Information Officer role.

- Ongoing Security Assessments – Each year, MainePERS performs multiple assessments measuring the effectiveness of security controls and takes remediation steps as necessary. During this period, MainePERS engaged a third-party audit firm to perform a comprehensive audit of information technology. This was the first ever comprehensive audit of information technology and has proven to be very useful.

Agency Performance Initiatives

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

MainePERS completed notable Balanced Scorecard (BSC) projects including adoption of the "Lean" process improvement methodology in October of 2015 with a focus on delivering improved and cost-effective service to its members. The work includes sustainability planning with MainePERS personnel being trained and earning Green Belt status that enables them to lead future Lean process improvement ("Kaizen") events. During the Lean adoption period MainePERS realized substantial process improvement outcomes. With continuous improvement projects scheduled for the 2017 calendar year, the System remains focused on enhancing the member service experience.

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. At the close of 2016, the total number of PLD employers that offer employees access to MaineStart was 69, with a total of 1,052 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 reported to this Committee.

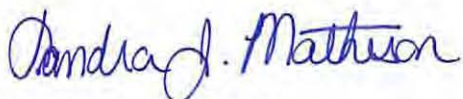
The FY 2017 Board-approved administration budget is \$13,403,720. We continuously review costs to identify efficiency improvements.

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 2016 5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	533
Teacher	843
Legislative	7
Judicial	4
Participating Local District	396
Total	1,783

NEW ACTIVE MEMBERS Calendar Year 2016 5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	1,189
Teacher	1,687
Legislative	18
Judicial	3
Participating Local District	1,155
Total	4,052

DISABILITY RETIREMENT and APPEALS Calendar Year 2016		
5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2016 ¹	121	
Applicants awarded disability retirement at applications stage	39	32%
Applications terminated due to death	0	
Applicants denied at the application stage ²	82	68%
DISABILITY APPEALS		
Number of appeals filed in 2016 ³ (Note: Includes some 2015 denials)	54	
Number of carryover appeals	99	
Total active appeals	80	
Number of appeals completed in 2016	73	
Number of applicants granted disability following appeal ⁴	23	32%

¹Four (4) applications were withdrawn by members prior to a decision being issued.

²5 M.R.S. §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.

³These numbers represent appeals of new applications and do not include reviews.

⁴Of the 23 granted disability retirement following appeal, 20 were by the Executive Director after reconsideration of prior decisions and 3 were by a Hearing Officer.

BUDGET STATUS OF ADMINISTRATIVE OPERATIONS AND FUNCTIONS FY 2016-2017

5 M.R.S.A. § 17103(E)

	FY16 Budget	07/01/2016- 12/31/2016 Actual	01/01/2017- 06/30/2017 Expected	Projected Surplus /(Deficit) ¹
Personal Services	7,365,975	3,339,526	3,898,688	127,761
Professional Services ²	1,337,800	537,912	617,217	182,671
Communications	490,785	233,763	249,942	7,080
Computer Support and System Development ³	258,670	258,670	-	-
Building Operations	315,065	125,384	140,045	49,636
Computer Maintenance and Supplies ⁴	1,805,639	866,561	918,081	20,997
Depreciation	1,088,225	392,835	625,390	70,000
Professional Development	88,060	31,562	62,298	(5,800)
Medical Records and Exams	204,000	93,241	98,741	12,018
Miscellaneous Operating Expenses	449,498	198,426	229,286	21,786
Total Administrative Expenses	13,403,717	6,077,879	6,839,688	486,149

¹The Projected Surplus at December 31, 2016 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.

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 FY16	
5 M.R.S.A. § 17103(D)	
Personal Services	6,831,875
Professional Services	1,876,125
Communications	365,494
Computer Support and System Development	332,339
Office Rent	351,020
Computer Maintenance and Supplies	750,220
Depreciation	714,265
Professional Development	47,469
Medical Records and Exams	25,798
Miscellaneous Operating Expenses	327,748
Total Administrative Expenses¹	11,622,353

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 2016

5 M.R.S.A. § 17103(I)

Plan Status	Employee Contributions	Employer Contributions	Total Payments to Retirees
State ¹	35,826,925	153,863,387	283,134,342
Teacher	89,697,062	157,827,166	461,389,402
Judicial	549,845	1,077,545	3,501,911
Legislative	137,893	-	445,330
Participating Local Districts	40,945,019	48,407,790	142,699,304
Total	167,156,744	361,175,890	891,170,289

¹State Plan totals include Governors.