

# MAINE STATE LEGISLATURE

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HAND DELIVERED

March 1, 2018

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](http://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, 2017.

## INVESTMENTS

The market value of the System's defined benefit plans trust fund at June 30, 2017 was \$13.4 billion. The net position of the trust fund increased as net investment earnings and contributions for the fiscal year were greater than payments to retirees. The market value investment return for fiscal year 2017 was 12.5%. The preliminary fund return through the first eight months of FY 2018 ending February 28<sup>th</sup> was 8.1%.

The System's investment strategy remained consistent throughout FY 2017. This resulted in positive returns to the fund due partially to strong markets in private and public domestic and international equities, and a slightly positive return from fixed income markets.

Fiscal Year Ending	Fund Value	Investment Return*
June 30, 2015	\$12.6B	2.0%
June 30, 2016	\$12.3B	0.6%
June 30, 2017	\$13.4B	12.5%

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

Annualized market value returns, net of management fees, for the three-year, five-year, 10-year, and 30-year periods ending on June 30, 2017 were 4.9%, 8.4%, 4.9%, and 7.9%, respectively. The ten-year and 30-year returns include the 2008-2009 market downturn.

In 2016, the System changed its target asset allocation to 35% publicly traded stocks, 20% fixed income investments, and 45% alternative investments. This change is forward looking and designed to balance risk and returns in current and near-term future markets. The alternative investments allocation includes 10% in infrastructure, 15% in private equity, 10% in real estate, 5% alternative credit, and 5% in natural resources, which may include agriculture, timber, and commodities. The current allocation to alternatives is approximately 31.9% of the System's portfolio at June 30, 2017. In addition, the Board of Trustees has approved a 0% to 10% allocation to risk diversifiers that seeks sound investment strategies that do not fall into one of the other asset categories.

### MainePERS Target Allocation



Total transition to the 2016 Asset Allocation will take several years to complete as the System seeks sound investments in each category.

MainePERS maintains a substantial portion of the fund in return-seeking assets such as publicly traded equities and private equity. This is because most of the System's benefit payments are not due for several decades into the future and current fund liquidity is strong enough to withstand a full-range of market scenario testing. 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 are 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 123<sup>rd</sup> Legislature created an Investment Trust with a \$100 million initial contribution for the purpose of investing funds set aside by the State of Maine to cover Other Post-Employment Benefits (OPEB) liabilities for State retiree health insurance benefits. MainePERS Trustees were named Trustees for this Investment Trust and have the responsibility for investing these funds. As of June 30, 2017, the market value for the OPEB assets was \$229.6 million, an increase of \$30.4 million over the prior year end. The State of Maine contributed \$4.0 million 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 2017 from \$2.557 billion at June 30, 2016 to \$2.581 billion at June 30, 2017. While investment returns on a market value basis were 12.5%, the return on an actuarial value of asset basis was 6.82% for FY 2017 because FY 2015 and FY 2016 losses are still being smoothed in to the actuarial return. This is an increase from the FY 2016 actuarial return of 4.42% as the FY 2017 12.5% market value return is now being smoothed in. The FY 2017 actuarial return is slightly lower than the actuarial investment return assumption of 6.875% which is a contributing factor to the slight increase in the UAL. (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 2017 from 80.4% to 80.9% because of actuarial liability gains. Ten years ago, the funding ratio was 73.9%. Please see the MainePERS CAFR for an understanding of the difference between market and actuarial values.

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

The Legislative Program was funded at 145.9% as of June 30, 2017, 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, 2015 was 96.9%. In fiscal year 2016, the actuarial funded ratio of the plan increased to 100.9% and as of June 30, 2017 the actuarial funded ratio was 102.7%, both as a result of liability gains.

### ***Funding Status of the Participating Local District Consolidated Retirement Plan***

The Participating Local District Consolidated Retirement Plan (PLD Plan) consisted of 305 participating local districts at December 31, 2017. The actuarial funded ratio of the plan increased from 86.1% at June 30, 2016 to 86.5% at June 30, 2017 for the same reasons actuarial funding of other MainePERS retirement plans increased slightly. The Participating Local District Advisory Committee continuously monitors the Consolidated Plan to ensure that it maintains a strong fiscal condition.

MainePERS and the Participating Local District Advisory Committee recently completed a set of proposed changes to the PLD Plan. These changes are designed to manage market risk, strengthen the future funding of the PLD Plan, and strengthen MainePERS ability to pay benefits throughout each retiree's life. Initial proposed changes were shared in 26 two-hour presentations which included over 500 members, employers and retirees. Feedback from these presentations was included and a final set of proposed changes was recently finalized.

The next steps are to finalize the concept bill L.D. 247 for legislative approval, and to conduct rulemaking hearings with a target implementation date of July 1, 2018.

## **OPERATIONS**

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

In June 2017, the Senate confirmed Michael Currie as a Trustee in one of the direct gubernatorial appointment seats. Richard Metivier was reappointed and confirmed by the Senate on March 31, 2017. Brian Noyes was reappointed and confirmed by the Senate on January 23, 2018. Long-standing trustee Peter Leslie ended his tenure as a trustee after twenty-two (22) years. Trustee Brian Noyes was elected Chair of the Board in 2017, succeeding Mr. Leslie.

### ***Legislative***

MainePERS submitted two bills in concept draft during the First Regular Session of the 128<sup>th</sup> Legislature. These include bills to implement changes to the Participating

Local District (PLD) Consolidated Retirement Plan (L.D. 247) and to the disability retirement program administered by MainePERS (L.D. 176). Amendments that set out proposed recommended changes to the PLD Plan and the disability retirement program will be presented for consideration during the Second Regular Session.

Resolve Chapter 14, as enacted by the First Regular Session of the 128<sup>th</sup> Legislature, established a working group to evaluate and design retirement plan options for state employees and teachers. The report of the working group was due on January 1, 2018, and an extension of that deadline to March 15, 2018 was requested. The group is working diligently to complete its report.

### ***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, 2017 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, 2017, in conformity with generally accepted accounting principles.

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

**Government Finance Officers Association Certification** - In 2017, the System submitted its FY 2016 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 thirteenth 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 2017 CAFR has been submitted to the GFOA.

**Public Pensions Standards Award** - In 2017, for the tenth 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***

MainePERS serves approximately 94,000 of active members and retirees as of December 31, 2017. The System approved benefits for 1,699 new retirees during CY 2017. This was almost the same number as 2016, with just under 50% of the new retirees being teachers.

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

### ***Group Life Insurance***

In CY 2017, 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 617 participants totaling approximately \$12.3 million in CY 2017.

### ***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 2017, 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 13 employer training sessions during CY 2017.

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 four (4) times during CY 2017.

### ***Document Center***

The Document Center provides management of MainePERS paperless initiatives. Incoming mail is scanned into a recently upgraded imaging repository. Once in the Snowbound imaging system, the action triggers workflows throughout the business units. This same department also manages outgoing mail for document management prior to its leaving the organization.

### ***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, 2017 was 1.6%. Eligible retirees from the Participating Local District Retirement Program were granted a regular cost-of-living adjustment of 1.6%. Eligible retirees from the State Employee and Teacher, Legislative and Judicial retirement programs were granted a regular cost-of-living adjustment of 1.6% on the first \$21,474.70 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 2017, the task force provided input to the System as it developed legislative proposals aimed at harmonizing program standards with analogous provisions existing elsewhere in Maine's retirement laws and making other changes that are consistent with sound policy and member expectations. The bill (L.D. 176) containing these provisions was carried over from the first regular session and will be considered by the Appropriations Committee during the second regular session.
- **Long Term Disability Insurance (L.T.D.I.)** - MainePERS is working with a consulting firm that has expertise in scoping, forming and drafting requests for



proposals ("RFP") in the disability insurance market. The expectation is that a RFP will be issued for an L.T.D.I. insurance carrier this spring, award the contract in the first half of FY 2019, and have the program operational and available to public employers soon thereafter.

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 2017 include:

- Line of Business Application Upgrade – The software upgrade to the agency's pension administration system was the major focus of efforts this year. This software is the system of record for members, employers, retirees and other beneficiaries. The version upgrade was completed in October.
- The Information Technology Oversight Council continues to guide the development of MainePERS' Cybersecurity Program. The Cybersecurity Program is based upon the National Institute of Standards and Technology (NIST), using the Framework for Improving Critical Infrastructure Cybersecurity. The Council provides oversight and planning responsibilities while fulfilling the roles of virtual Chief Information Officer and Chief Information Security Officer.
- Periodic business continuity plan testing was conducted in 2017. A primary emphasis was on MainePERS ability to generate a retiree benefits payroll from a disaster recovery site. The test was successful.
- MainePERS created and filled the position of Information Security Analyst in 2017. The position plays a critical role in MainePERS security initiatives. Reporting directly to the Deputy Executive Director of Administration, the Security Analyst works with the Security Administrator, focusing on daily log review, compliance review, conducting vulnerability assessments, and other security related duties.
- Ongoing efforts to increase employees' awareness of cybersecurity threats are done through monthly testing and the use of training modules. MainePERS views its employees as the first line of defense in protecting System data.

### *Property*

The former Department of Transportation (DOT) site on Capitol Street was sold to F.D. Stonewater (FDS) in 2017 to allow for development of professional office buildings on the site. MainePERS conducted a thorough cost-benefit analysis of upgrading its existing building, which it owns, or becoming tenants. The cost estimates to renovate the 96 Sewall Street facility far exceeded the building's market value, and MainePERS made the decision to join with the State of Maine as tenants in separate buildings on the former DOT site. Completion of the MainePERS building at 139 Capitol Street is expected in late 2018 or early 2019. Under its agreement with FDS, MainePERS' existing building will be torn down to make way for the State's building and parking spaces.

### *Agency Performance Initiatives*

The Maine Public Employees Retirement System's mission is to serve the public with sound retirement services to Maine government. MainePERS continues its Lean process improvement initiatives including facilitation training for Green Belt status staff. The System remains focused on enhancing the member service experience.

## DEFINED CONTRIBUTION PLANS

### *MaineSTART*

The System continues to promote its pre-tax defined contribution/deferred compensation 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 2017, the total number of PLD employers that offer employees access to MaineSTART was 70, with a total of 1,081 participants.

## BUDGET

The System's administrative costs and expenses 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 2018 Board-approved administration budget is \$13,905,820. MainePERS continuously reviews 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  
Maureen Dawson, Office of Fiscal and Program Review

NEW RETIREES Calendar Year 2017	
5 M.R.S.A. § 17103(F)	
Plan Status	Retired Members
State	461
Teacher	842
Legislative	16
Judicial	1
Participating Local District	379
Total	1,699

NEW ACTIVE MEMBERS Calendar Year 2017	
5 M.R.S.A. § 17103(G)	
Plan Status	New Active Members
State	1,031
Teacher	1,635
Legislative	1
Judicial	1
Participating Local District	1,189
Total	3,857

DISABILITY RETIREMENT and APPEALS Calendar Year 2017		
5 M.R.S.A. § 17103(J)(1)-(4)		
	Count	Percentage
<b>NEW APPLICATIONS<sup>1</sup></b>		
<b>Disability applications processed and acted upon in 2017<sup>2</sup></b>	86	
Applicants awarded disability retirement at applications stage	41	48%
Applications terminated due to death	0	
Applicants denied at the application stage <sup>3</sup>	45	52%
<b>DISABILITY APPEALS<sup>4</sup></b>		
Number of appeals pending 12/31/2016 <sup>5</sup>	63	
Number of appeals filed in 2017	29	
Total active appeals closed in 2017	50	
Appeals Withdrawn or Abandoned	20	
Appeals Resolved on the Merits	30	
Total resulting in denial of benefits	16	
Total resulting in the award of benefits <sup>6</sup>	14	47%
Number of Appeals Pending 12/31/17	42	

<sup>1</sup> In July 2017, MainePERS instituted the opportunity for a member to submit additional records after an initial review of the medical information provided to that point in the process. This change resulted in very few final decisions issuing between July 1, 2017 and December 31, 2017. Anyone in that time frame who it appeared would not receive approval was given additional time to supplement the record.

<sup>2</sup> Eleven (11) applications were withdrawn by members prior to a decision being issued.

<sup>3</sup> 5 M.R.S. §17103 (11) (J) (2) and (3) require the System to report on processes that are no longer in effect. In lieu of the information originally required, the System offers an accounting of the disposition of cases in the application phase.

<sup>4</sup> This section addresses appeals of application denials. Appeals may not be filed and often are not completed in the same calendar year as the application denial.

<sup>5</sup> This differs from the number of cases reported open at the end of 2016 in last year's report due to a change in when a case is considered to be closed. To make this data more meaningful and consistent, a case now is considered to be closed when the Board approves final agency action. Previously a case was considered closed when the System administratively closed the file.

<sup>6</sup> This consists of 13 cases where the Executive Director granted benefits upon reconsideration after receiving additional information during the appeals process and one case where the Board of Trustees reversed the denial based on a recommendation from an independent hearing officer. 47% of cases resolved on the merits during an appeal resulted in the award of benefits. Of appeals closed in 2017, which includes withdrawn and abandoned appeals, 28% resulted in benefits.



**BUDGET STATUS OF ADMINISTRATIVE OPERATIONS AND  
FUNCTIONS  
FY 2017-2018**

**5 M.R.S.A. § 17103(E)**

	FY 2017 Budget	07/01/2017- 12/31/2017 Actual	01/01/2018- 06/30/2018 Expected	Projected Surplus /(Deficit) <sup>1</sup>
<b>Personal Services</b>	7,798,053	3,423,141	3,853,354	521,558
<b>Professional Services<sup>2</sup></b>	1,395,200	441,078	691,390	262,732
<b>Communications</b>	582,391	270,505	265,108	46,778
<b>Building Operations</b>	290,400	135,359	152,348	2,693
<b>Computer Maintenance and Supplies</b>	1,822,100	978,369	839,849	3,882
<b>Depreciation</b>	1,185,620	364,607	728,213	92,800
<b>Professional Development</b>	140,210	36,600	98,861	4,749
<b>Medical Records and Exams</b>	232,500	101,379	101,379	29,742
<b>Miscellaneous Operating Expenses</b>	459,348	148,960	222,143	88,245
<b>Total Administrative Expenses</b>	<b>13,905,822</b>	<b>5,899,997</b>	<b>6,952,646</b>	<b>1,053,179</b>

<sup>1</sup>The Projected Surplus at December 31, 2017 is attributable in part to vacant positions occurring during the fiscal year. Any realized savings at the close of the fiscal year will inure to the trust funds.

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

<b>SUMMARY OF ADMINISTRATIVE EXPENSES</b>	
<b>FY 2017</b>	
<b>5 M.R.S.A. § 17103(D)</b>	
<b>Personal Services</b>	<b>7,302,945</b>
<b>Professional Services</b>	<b>2,027,842</b>
<b>Communications</b>	<b>392,801</b>
<b>Computer Support and System Development</b>	<b>279,035</b>
<b>Office Rent</b>	<b>264,991</b>
<b>Computer Maintenance and Supplies</b>	<b>943,159</b>
<b>Depreciation</b>	<b>778,165</b>
<b>Professional Development</b>	<b>72,237</b>
<b>Medical Records and Exams</b>	<b>30,820</b>
<b>Miscellaneous Operating Expenses</b>	<b>337,096</b>
<b>Total Administrative Expenses<sup>1</sup></b>	<b>12,429,091</b>

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

## EMPLOYER CONTRIBUTIONS IN 2017

### 5 M.R.S.A. § 17103(I)

Plan Status	Employee Contributions	Employer Contributions	Total Payments to Retirees
State <sup>1</sup>	46,298,301	163,300,394	293,963,564
Teacher	93,165,983	163,817,134	486,362,417
Judicial	584,451	1,144,445	3,651,927
Legislative	202,388	-	469,043
Participating Local Districts	46,157,634	52,017,650	148,940,873
<b>Total</b>	<b>186,408,757</b>	<b>380,279,623</b>	<b>933,387,824</b>

<sup>1</sup>State Plan totals include Governors.