

MAINE STATE LEGISLATURE

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HAND DELIVERED

February 26, 2020

Senator Shenna Bellows, Senate Chair
Representative Mike Sylvester, House Chair
Members, Joint Standing Committee on Labor and Housing
100 State House Station
Augusta, ME 04333-0100

Dear Senator Bellows, Representative Sylvester and Members of the Joint Standing Committee on Labor and Housing:

Please accept the Maine Public Employees Retirement System's ("MainePERS" or "System") annual report to the Joint Standing Committee on Labor and Housing. 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, 2019.

INVESTMENTS

The market value of the System's defined benefit plans trust fund at June 30, 2019 was \$14.9 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 2019 was 7.3%. The preliminary fund return through the first seven months of FY 2020 ending January 31st was 4.53%.

The System's investment strategy remained consistent throughout FY 2019. This resulted in positive returns to the fund due to strong markets in private and public domestic and international equities, as well as positive returns from fixed income markets.

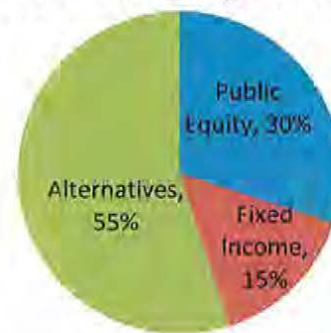
Fiscal Year Ending	Fund Value	Investment Return*
June 30, 2017	\$13.4B	12.5%
June 30, 2018	\$14.3B	10.3%
June 30, 2019	\$14.9B	7.3%

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

Annualized market value returns, net of management fees, for the 3-year, 5-year, 10-year, and 30-year periods ending on June 30, 2019 were 10.0%, 6.4%, 9.3%, and 8.1%, respectively. The 30-year return includes the 2000-2002 and 2008-2009 market downturns.

In 2017, the System changed its target asset allocation to 30% publicly traded stocks, 15% fixed income investments, and 55% 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% in alternative credit, and 5% in natural resources, which may include agriculture, timber, and commodities. In addition, the Board of Trustees has approved a 10% allocation to risk diversifiers that seek sound investment strategies that do not fall into one of the other asset categories. The current allocation to alternatives is approximately 52.8% of the System's portfolio at June 30, 2019.

MainePERS Target Allocation



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 123rd Legislature created an Investment Trust in FY 2008 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, 2019, the market value for the OPEB assets was \$275.7 million, an increase of \$20.8 million over the prior year end. The State of Maine contributed \$2.0 million in August 2019.

PROGRAM FUNDING

Funding Status of the State Employee and Teacher Retirement Program

The actuarial funded status of the State Employee and Teacher Retirement Program, or the ratio of plan assets to plan liabilities, increased in FY 2019 from 81.4% to 81.8%, primarily due to small investment gains. Ten years ago, the funding ratio was 67.6%. Please see the

MainePERS Comprehensive Annual Financial Report for an understanding of the difference between market and actuarial values.

The unfunded actuarial liability (UAL) of the State Employee and Teacher Retirement Program increased slightly in FY 2019 from \$2.611 billion at June 30, 2018 to \$2.653 billion at June 30, 2019. The increase resulted from liability losses from salaries and a cost-of-living adjustment greater than the actuarial assumptions.

Investment returns on an actuarial value of asset basis was 7.38% for FY 2019. This is higher than the actuarial investment return assumption of 6.75%, resulting in an actuarial gain to the plan. (See the Investments section for market returns.)

Funding Status of the Legislative Retirement Program

The Legislative Program was funded at 144.4% as of June 30, 2019, 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%. As of June 30, 2019, the actuarial funded ratio was 105.0%.

Funding Status of the Participating Local District Consolidated Retirement Plan

The Participating Local District Consolidated Retirement Plan (PLD Plan) consisted of 307 participating local districts at December 31, 2019. The actuarial funded ratio of the Plan increased from 89.5% at June 30, 2018 to 89.6% at June 30, 2019. The Participating Local District Advisory Committee continuously monitors the PLD Plan to ensure that it maintains a strong fiscal condition.

MainePERS and the Participating Local District Advisory Committee completed a set of changes to the PLD Plan designed to manage market risk, strengthen the future funding of the Plan, and strengthen MainePERS ability to pay benefits throughout each retiree's life. These changes were enacted by PL 2017, c. 392 and through rulemaking, with most of the changes effective July 1, 2019. These changes have received national recognition for their contribution to Plan sustainability.

OPERATIONS

New Office Location

MainePERS recently completed its first year its new location. The floor plan design has proven beneficial with the ability to group work units in sections of the building where business interactions are more easily conducted. Member and retiree feedback on the location and design has been very favorable. Other public sector organizations have requested tours of the facility and consultation with the team that led the buildout and relocation as they likewise plan for new facilities.

Changes in Board Membership

State Treasurer Henry Beck became a Trustee in January of 2019 upon taking office. In June 2019, the Senate confirmed John Beliveau as a Trustee in one of the direct gubernatorial appointment seats and Mark Brunton as a Trustee in the seat that is elected by the Maine Service Employees Association.

Legislative

Resolve Chapter 57, as enacted by the Second Regular Session of the 128th Legislature, authorized the continuation of the working group established to evaluate and design retirement plan options for state employees and teachers. A report of the working group was due on December 1, 2019; an extension was requested for submission of this report by February 28, 2020.

Public Law Chapter 378, as enacted by the Second Regular Session of the 128th Legislature, authorized MainePERS to offer long-term disability insurance coverage. The enacted law required MainePERS to report on the use of that authority by January 31, 2020 and a report was submitted to the Committee on January 30, 2020. MainePERS is in the final due diligence stage of selecting an LTDI provider. The insurance is expected to be available in 2020.

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.

In 2019 MainePERS discovered that it had not been following its established process for making required minimum distributions ("RMDs"). Under federal law, RMDs are required to be made after a member reaches 70.5 years of age (recently changed to 72) unless the member is still working. MainePERS' Rule Chapter 414 provides for a process to satisfy the RMD requirements. Due to human error, this process had not been followed.

MainePERS worked to correct this failure by making the missed distributions, plus interest, and providing information to the affected members. MainePERS is preparing a filing through the IRS's Voluntary Correction Program to request IRS acceptance of our corrections and a waiver of excise taxes that otherwise would be imposed on members for taking late RMDs. MainePERS understands that a waiver here is likely, but that the IRS may impose a penalty on MainePERS in conjunction with granting a waiver.

MainePERS has developed an operational compliance program to help prevent or quickly correct operational issues like the missed RMDs and has hired its first compliance officer.

Audit

The independent audit of the MainePERS financial statements for the year ended June 30, 2019 resulted in an unmodified opinion. An unmodified 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, 2019, in conformity with generally accepted accounting principles.

Awards and Certifications

Government Finance Officers Association Certification - In 2019, the System submitted its FY 2018 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 fifteenth 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 2019 CAFR has been submitted to the GFOA.

Public Pensions Standards Award - In 2019, for the twelfth 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 was serving approximately 99,000 active members and retirees as of December 31, 2019. The System approved monthly pension benefits for 1,921 new retirees during CY 2019. This is consistent with the number who retired during CY 2018, with 47% of the CY 2019 retirees being teachers.

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

Group Life Insurance

At the end of CY 2019, approximately 51,000 state, teacher and participating local district employees and retirees had Group Life Insurance coverage under the program administered by MainePERS. Employers remit premium payments to MainePERS in order to provide basic coverage to these participants. Supplemental and dependent coverage is paid for by participants who elect to have it. MainePERS approved 585 life insurance claims with a value of approximately \$11 million in CY 2019.

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 benefits and the amount the member will receive as monthly payments. For CY 2019, MainePERS received and processed a wide variety of employer-provided records regarding more than 58,000 public employees who work at one or more of the 600 employer locations served.

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 22 in-person employer training sessions during CY 2019.

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 three times during CY 2019.

Document Center

Continuous improvement is actively pursued in the Document Center, which serves as the entry point for induction of paper into images and workflow triggers. Doing more with less space has created opportunities for efficiencies, new processes, and a just-in-time approach to stocking certain forms and supplies.

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, subject to certain limitations. The CPI-U at June 30, 2019 was 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 \$22,451.03 of benefit. Eligible retirees from the Participating Local District Consolidated Retirement Program were granted a regular cost-of-living adjustment of 1.6%.

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 regularly met from late 2014 to 2018 to oversee a comprehensive review of the MainePERS disability retirement program. Meeting frequency of that group slowed in CY 2019 as the Long Term Disability Insurance Program involvement it previously had moved to implementation.
- Long Term Disability Insurance (L.T.D.I.) – MainePERS has issued a request for proposals ("RFP") for an L.T.D.I. insurance carrier and expects to award the contract in the second half of FY 2020. The program is expected to become 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 environment underwent a significant shift in 2019 as new servers and a corporate network were brought into production. Security continues to be at the forefront of MainePERS technology initiatives. Activities in 2019 included the following:

- The early part of 2019 saw check and 1099-R production occurring at the Disaster Recovery site. This served a two-fold process of demonstrating the business continuity aspect of retiree payroll production and left staff some time to settle into the print production environment in the new building. MainePERS replicates its Augusta environment to its Off-Site Data Center. Periodic testing and check production continues to occur in that location in order to maintain staff proficiency.
- The Information Technology Oversight Council continues in its role of guiding technical operations of the Information Technology Department. MainePERS continues to refresh its Cybersecurity Program, which is based upon the National Institute of Standards and Technology (NIST), with annual reviews. The council is an invaluable resource to MainePERS given its membership that includes both cybersecurity and infrastructure experts.
- With a refresh of the technology environment resulting from the move to a new facility, MainePERS employs layers of tools to ensure its security posture. An example is its email appliance, which filtered over 125,000 messages monthly; of these messages, approximately 31,000 were deemed valid business messages. This type of tool buffers our staff from known malicious actors, reducing our risk profile.
- Initiatives to strengthen MainePERS security posture are supported by monthly training conducted using the KnowBe4 software. This tool is highly rated in the security industry and offers staff the opportunity to test their understanding of cybersecurity safe practices. MainePERS also conducts annual cybersecurity training with cybersecurity experts.

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 2019, the total number of PLD employers that offer employees access to MaineStart was 71 with a total of 1,341 participants. This represents approximately a 16% increase over the amounts at the close of CY 2018.

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.

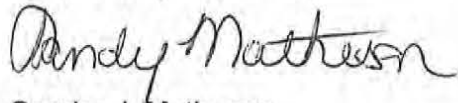
The FY 2020 Board-approved administration budget is \$15,633,339. MainePERS continuously reviews costs to identify efficiency improvements.

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 - 5

cc: Members, Board of Trustees
Grant T. Pennoyer, Executive Director, Legislative Council
Rachel Tremblay, Office of Fiscal and Program Review
Colleen McCarthy Reid, Esq., Office of Policy and Legal Analysis

NEW RETIREES Calendar Year 2019 5 M.R.S. § 17103(F)	
Plan Status	Retired Members
State	534
Teacher	915
Legislative	20
Judicial	2
Participating Local District	450
Total	1921

NEW ACTIVE MEMBERS Calendar Year 2019 5 M.R.S. § 17103(G)	
Plan Status	New Active Members
State	1428
Teacher	1808
Legislative	0
Judicial	0
Participating Local District	1544
Total	4780

DISABILITY RETIREMENT and APPEALS Calendar Year 2019 5 M.R.S. § 17103(J)(1)-(4)		
	Count	Percentage
NEW APPLICATIONS		
Disability applications processed and acted upon in 2017 ¹	84	
Applicants awarded disability retirement at the applications stage	55	65%
Applications terminated due to death	1	
Applicants denied at the application stage ²	29	35%
DISABILITY APPEALS³		
Number of appeals pending 12/31/2018	37	
Number of appeals filed in 2019	15	
Total appeals closed in 2019	21	
Appeals Withdrawn or Abandoned	5	
Appeals Resolved on the Merits	16	
Total resulting in denial of benefits	10	
Total resulting in the award of benefits ⁴	6	38%
Number of Appeals Pending 12/31/19	31	

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

² 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, an accounting of the disposition of cases in the application phase is provided.

³ 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.

⁴ This consists of five 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. Thirty-eight percent of cases resolved on the merits during an appeal resulted in the award of benefits. Of appeals closed in 2019, which includes withdrawn and abandoned appeals, twenty-nine percent resulted in the award of benefits.

BUDGET STATUS OF ADMINISTRATIVE OPERATIONS AND FUNCTIONS FY 2019-2020 5 M.R.S. § 17103(E)				
	FY 2020 Budget	07/01/2019- 12/31/2019 Actual	01/01/2020- 06/30/2020 Expected	Projected Surplus /(Deficit) ¹
Personal Services	7,629,283	3,668,756	4,257,765	(297,238)
Professional Services ²	1,367,222	594,699	643,123	129,400
Communications	474,582	197,533	214,115	62,934
Building Operations	818,106	451,852	427,766	(61,512)
Computer Maintenance and Supplies	2,710,445	1,310,651	1,573,006	(173,212)
Depreciation	1,896,083	947,061	969,553	(20,531)
Professional Development	155,891	27,794	42,800	85,297
Medical Consultation and Records	261,000	179,737	140,532	(59,269)
Miscellaneous Operating Expenses	320,727	180,345	143,663	(3,281)
Total Administrative Expenses	15,633,339	7,558,428	8,412,323	(337,412)

¹ The Projected Deficit at December 31, 2019 is attributable in part to the addition of one new position added to the personnel roster at the beginning of the fiscal year as well as several one-time costs incurred related to a new facility.

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

SUMMARY OF ADMINISTRATIVE EXPENSES FY 2019	
5 M.R.S. § 17103(D)	
Personal Services	7,757,444
Professional Services	3,203,000
Communications	475,038
Office Rent	298,430
Computer Maintenance and Supplies	985,440
Depreciation	1,673,829
Professional Development	46,532
Medical Records and Exams	29,268
Miscellaneous Operating Expenses¹	677,532
Total Administrative Expenses	15,146,513

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 2019			
5 M.R.S. § 17103(I)			
Plan Status	Employee Contributions	Employer Contributions	Total Payments to Retirees
State ¹	47,854,879	161,661,506	313,295,405
Teacher	98,164,172	189,850,260	538,358,153
Judicial	620,075	1,212,666	4,067,506
Legislative	220,610	-	606,841
Participating Local Districts	54,995,911	62,125,983	168,444,091
Total	201,855,647	414,850,415	1,024,771,996

¹State Plan totals include Governors