

G20J01
State Retirement Agency

Operating Budget Data

(\$ in Thousands)

| | <u>FY 05</u> <u>Actual</u> | <u>FY 06</u> <u>Working</u> | <u>FY 07</u> <u>Allowance</u> | <u>FY 06-07</u> <u>Change</u> | <u>% Change</u> <u>Prior Year</u> |
|--------------------|-------------------------------|--------------------------------|----------------------------------|----------------------------------|--------------------------------------|
| Special Fund | \$24,703 | \$20,700 | \$22,035 | \$1,335 | 6.5% |
| Rejected Amendment | | <u>-439</u> | | | |
| Total Funds | \$24,703 | \$20,261 | \$22,035 | \$1,774 | 8.8% |

- The fiscal 2006 working appropriation reported by the Department of Budget and Management mistakenly included \$439,437 from a proposed budget amendment that was not processed. The correct fiscal 2006 working appropriation is therefore \$20.26 million.
- Rapid growth in pension and health insurance costs (\$580,584), staff increases (\$443,179), and new investment consultants and research (\$441,263) are the major factors contributing to the 8.8% increase in the agency's allowance over the fiscal 2006 working appropriation.
- The General Assembly reduced the Governor's allowance for investment research by \$100,000, reflecting the fact that the agency's investments portfolio is managed entirely by external managers.

Personnel Data

| | <u>FY 05</u> <u>Actual</u> | <u>FY 06</u> <u>Working</u> | <u>FY 07</u> <u>Allowance</u> | <u>FY 06-07</u> <u>Change</u> |
|------------------------|-------------------------------|--------------------------------|----------------------------------|----------------------------------|
| Regular Positions | 163.00 | 172.00 | 175.00 | 3.00 |
| Contractual FTEs | <u>26.64</u> | <u>26.50</u> | <u>27.00</u> | <u>0.50</u> |
| Total Personnel | 189.64 | 198.50 | 202.00 | 3.50 |

Vacancy Data: Regular Positions

| | | |
|-----------------------------------|-------|-------|
| Turnover, Excluding New Positions | 5.88 | 3.36% |
| Positions Vacant as of 12/31/05 | 15.00 | 8.72% |

- To promote staff retention, the Governor's allowance converts 3.0 full-time equivalent (FTE) contractual positions to regular positions: 2.0 FTE in the agency's administrative division, and 1.0 FTE in the Human Resources office.

Note: Numbers may not sum to total due to rounding.

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- The Governor’s allowance provides funding for 3.5 FTE new contractual positions and for 2.0 FTE contractual positions that were previously authorized but not funded. Of the new positions, 3.0 FTE are to replace three experienced employees in the administrative division who were transferred to the agency’s information technology (IT) upgrade project, and 0.5 FTE is to provide analytic support to the investment division. Despite being unfunded, the remaining 2.0 FTEs were authorized and filled in fiscal 2006 to support the agency’s legacy computer system.
- The agency’s turnover rate was budgeted to fall substantially despite a marked increase in vacant positions. The agency had more vacancies (15) in December 2005 than it did in December 2004 (11). For that reason, the General Assembly increased the agency’s turnover rate to 5.0%, a \$109,000 reduction that allowed the agency to maintain eight vacant positions.

Analysis in Brief

Major Trends

Call Center Performance: The percentage of dropped calls and average wait times for member telephone calls both increased for the third straight year in fiscal 2005. The agency’s performance in both areas should improve in 2006.

Processing of Benefit Estimate Requests: The backlog of requests for benefit estimates was reduced substantially.

Long-term Investment Returns Improve but Still Lag behind Other Funds: The State Retirement and Pension Systems’ Trust Universe Comparison Service rankings for five- and ten-year annual returns improved somewhat but remain in the bottom quartile for public pension plans of similar size.

Issues

Retirement Agency Continues Planning for New Procurement to Upgrade Its Information Technology System: The agency’s new project manager and his staff made progress in developing a plan to replace the outdated system with the Maryland Pension Administration System (MPAS). The plan involves implementing MPAS in steps, with Step 1 being modernizing the system’s technological base, and Step 2 focusing on improving the quality and organization of data entered and analyzed by the system. The agency expects the total cost for Step 1 to be between \$8 million and \$11 million over two years. There are no funds allocated for MPAS in the Governor’s fiscal 2007 allowance. The agency’s procurement effort yielded just one proposal to implement MPAS.

As Teachers’ Plans Fall Out of the Corridor, the Retirement System Board Recommends Ending Corridor Funding Method: In fiscal 2006, the teachers’ combined retirement and pension systems joined the combined employees’ systems in falling out of their funding “corridor” established in Chapter 440, Acts of 2002. The Board of Trustees of the State Retirement and Pension System has recommended ending the corridor method and moving immediately to fund the State pension system

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on a full actuarial basis. This would increase State contributions to the pension system by more than \$200 million in fiscal 2007. The General Assembly did not act on the agency's recommendations to end the Corridor method.

Retirement Agency Opted Not to Seek Independent Salary Setting Authority for 23 Positions, Including Most of Its Investment Division: The agency reports that it is struggling to find and retain qualified candidates, particularly for the investment division because salary ranges for certain professional positions are significantly below those of other public pension plans and private asset management companies. However, findings from a comprehensive compensation study found that while agency salaries were below the mean for other public pension funds, the gap could be closed substantially through the State salary schedule.

Recommended Actions

| | <u>Funds</u> | <u>Positions</u> |
|--|---------------------|-------------------------|
| 1. Delete 1.0 full-time position that has been vacant for more than one year. | \$ 71,091 | 1.0 |
| 2. Delete 2.0 full-time equivalent new regular positions in the Administrative Division. | 39,111 | 2.0 |
| 3. Delete funding for investment research | 100,000 | |
| Total Reductions | \$ 210,202 | 3.0 |

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State Retirement Agency

Operating Budget Analysis

Program Description

The State Retirement Agency (SRA), under the direction of the Board of Trustees of the State Retirement and Pension System (SRPS), is responsible for administering the State's retirement and pension systems. The board-appointed executive director is responsible for policy development, legislation, and legal affairs.

The agency consists of five divisions:

- The administrative division manages employee contributions, offers retirement counseling to members, and pays their benefits.
- The investment division implements the board's investment policy for approximately \$32 billion in assets.
- The finance division provides accounting and financial reporting, budget administration, and procurement functions.
- The internal audit division ensures agency compliance with State laws, rules, and regulations, as well as ensuring employer compliance with agency reporting policies.
- The information systems division maintains existing information systems while designing and implementing upgraded replacement systems.

The agency's administrative budget is funded solely through special funds drawn from the pension trust fund based on statutory authority.

Performance Analysis: Managing for Results

The State Retirement Agency has two primary functions: (1) administer the retirement system so that collection of pension contributions and payment of pension benefits may be made in a timely and accurate manner; and (2) manage the assets of SRPS to maximize the system's risk-adjusted return.

The agency's Managing for Results provides measures illustrating the accuracy and timeliness of the benefit application calculations and benefit payment calculations. The agency remains efficient and accurate in both these areas, comfortably reaching its goal of 98% accuracy in the first

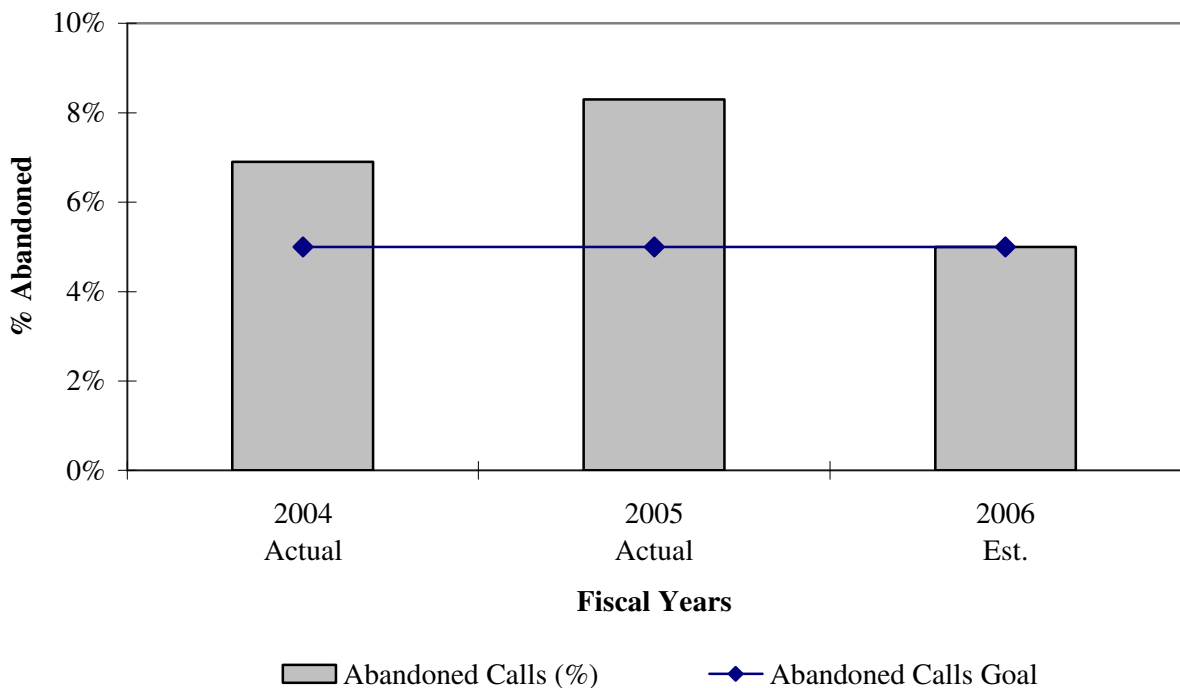
and falling only slightly short of its 100% goal in the second. The agency projects continued high levels of performance.

Call Center Performance

SRA recognizes the importance of providing accurate and timely information to members trying to understand or determine the benefits due to them. For many members, the agency’s call center represents their first and often only contact with benefits counselors. For that reason, the agency tracks both the waiting time for incoming telephone calls and the number of calls that are abandoned because of lengthy waits.

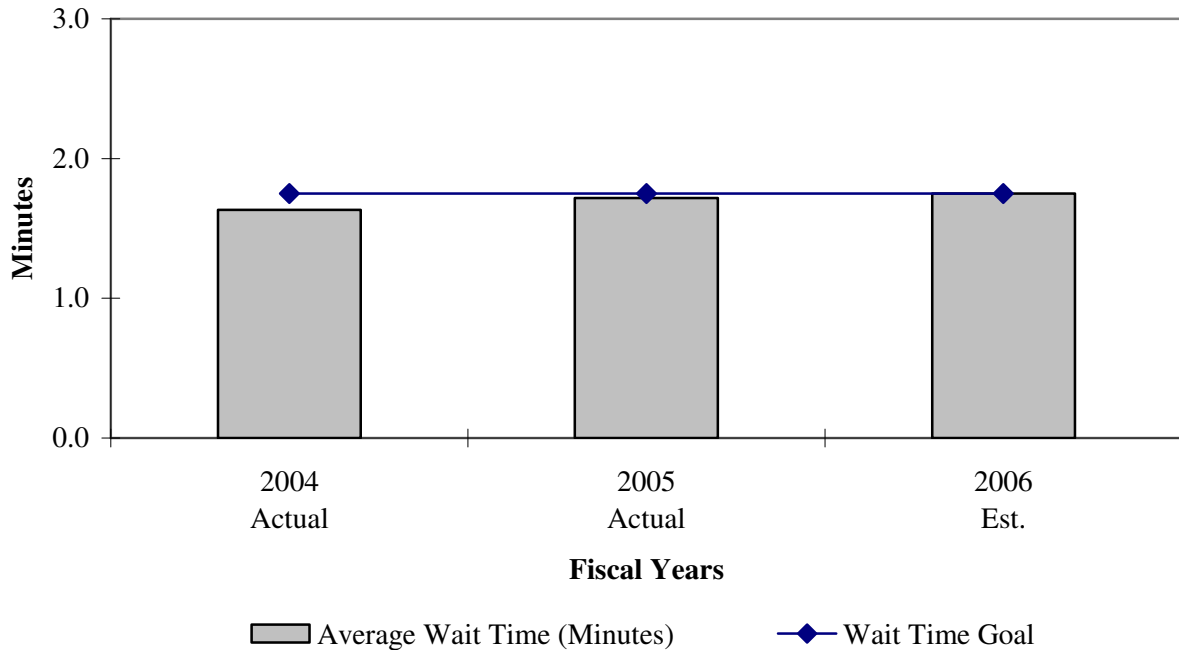
Exhibits 1 and 2 show that average wait times and the percentage of dropped calls for the agency’s call center both increased in fiscal 2005 for the third straight year. The percentage of dropped calls well exceeded the agency’s target of 5.0%, while the average wait times remained just below the agency’s target of 1.75 minutes

Exhibit 1
Percent of Abandoned Calls
Fiscal 2002 – 2006



Source: State Retirement Agency

Exhibit 2
Telephone Call Wait Time
Fiscal 2002 – 2006



Source: State Retirement Agency

Two developments during fiscal 2006 should improve the call center’s performance this year. The first is the installation of a more sophisticated interactive voice response telephone system in January 2006. The new system allows callers to have more of their questions answered by the automated system, thereby reducing the number of callers who will need to speak to a counselor. Also, the fiscal 2006 budget included 2.0 full-time equivalent (FTE) new regular Benefits Counselor positions to answer member telephone calls. The combination of a reduced call volume and more counselors answering telephones should produce noticeable improvements in call center performance during fiscal 2006.

Processing of Benefit Estimate Requests

SRA has made substantial progress in reducing the backlog of requests for benefit estimates it receives from prospective retirees. Members eligible to retire within one year may request estimates of their retirement benefits based on multiple potential retirement dates. Processing these requests is very labor intensive because the agency’s legacy computer system cannot be programmed to automate the calculation of Final Average Salary. This is manually calculated and entered into the system so that the estimate may be processed.

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As of January 3, 2006, the agency had a backlog of 464 requests, a 43% reduction from the number of backlogged requests at the same time last year. As shown in **Exhibit 3**, the agency was able to achieve this reduction in part because the growth rate in the number of member requests submitted to the Benefits Processing unit slowed from double digits each of the previous three years to just 8.6% in 2005. Also, the conversion of 3.0 FTE contractual positions in the Benefits Processing unit to regular positions, authorized in the agency's fiscal 2006 budget, provided workforce stability in that unit.

Exhibit 3
Multiple Requests for Benefit Requests
Fiscal 1999 – 2005

| <u>Fiscal Year</u> | <u>Estimates Completed by Agency Staff</u> | <u>Annual % Increase in Estimates Completed</u> | <u>Individuals Requesting Multiple Estimates</u> | <u>Greatest # of Estimates for One Individual</u> |
|----------------------------|--|---|--|---|
| 1999 | 11,109 | | 598 | 6 |
| 2000 | 11,524 | 3.7% | 616 | 8 |
| 2001 | 11,683 | 1.4% | 562 | 5 |
| 2002 | 13,337 | 14.2% | 691 | 6 |
| 2003 | 15,698 | 17.7% | 1,045 | 8 |
| 2004 | 17,361 | 10.6% | 1,269 | 8 |
| 2005 | 18,850 | 8.6% | 1,230 | 11 |
| 2006 (6-month total) | 7,611 | | 514 | |
| Average 1999 – 2005 | 14,223 | 9.2% | 859 | 7 |

Source: State Retirement Agency

Long-term Investment Returns Improve but Still Lag behind Other Funds

SRPS ended fiscal 2005 with a 9.5% return on its investment portfolio, the second straight year it has exceeded its 7.75% targeted rate of return following several years of sluggish or negative returns. However, the system's 9.5% rate of return was below the median for other large public

pension plans, according to the Trust Universe Comparison Service (TUCS). TUCS, a service of Wilshire Associates is a widely accepted measure of public pension plan performance. SRPS's one-year performance at the end of June 2005 placed it at the 61st percentile when compared with other large pension plans, with the 1st percentile being the highest and 99th percentile the lowest. Long-term returns were ranked even lower, with SRPS's five-year annual returns ranked in the 99th percentile and its 10-year annual returns ranked in the 96th percentile.

Exhibit 4 shows SRPS's short- and long-term investment returns as of September 2005. The systems' TUCS rankings for long-term returns showed moderate improvement over the September 2004 rankings, with five-year returns increasing from the 94th percentile to the 88th percentile, and 10-year returns rising from the 94th percentile to the 90th percentile. These disappointing long-term returns stem in large part from the agency's high exposure to equity investments in the early 2000s, when the stock market experienced heavy losses. Since then, the investment division has diversified the investment portfolio, increasing its exposure to real estate and the potentially very lucrative private equity market. However, its private equity exposure still lags behind that of other large public plans, and private equity holdings typically take several years to reach full maturity.

Exhibit 4
TUCS Comparison to Public Funds > \$1.0 Billion
Rolling Years Ending September 30, 2005

| | <u>3 Months</u> | <u>1 Year</u> | <u>5 Years</u> | <u>10 Years</u> |
|-----------------|-----------------|---------------|----------------|-----------------|
| 5th Percentile | 5.53 | 18.65 | 7.03 | 10.27 |
| 25th Percentile | 4.77 | 15.30 | 5.20 | 9.07 |
| Median | 4.06 | 13.75 | 4.48 | 8.67 |
| 75th Percentile | 3.31 | 11.71 | 3.45 | 7.93 |
| 95th Percentile | -0.25 | 3.31 | 2.74 | 7.06 |
| SRPS* | 3.81 63rd | 13.63 59th | 2.97 88th | 7.51 90th |

* State Retirement and Pension System

Source: State Street Analytics (TUCS Master Trust Report)

Governor’s Proposed Budget

As illustrated in **Exhibit 5**, the agency’s budget increases by 8.8% from the fiscal 2006 working appropriation to the fiscal 2007 allowance. Significant growth in health care and retirement expenses are the largest factors contributing to this expansion. New regular and contractual positions, including 3.0 contractual conversions and 5.5 new or previously unfunded contractual positions, represent the second largest contributing factor. Expanded contractual services are also a major factor, most notably \$241,263 for investment consultants to support the agency’s tactical asset allocation program and external manager oversight.

Exhibit 5
Governor’s Proposed Budget
State Retirement Agency
 (\$ in Thousands)

| How Much It Grows: | Special Fund | Total |
|----------------------------|-------------------------|---------------|
| 2006 Working Appropriation | \$20,261 | \$20,261 |
| 2007 Governor’s Allowance | <u>22,035</u> | <u>22,035</u> |
| Amount Change | \$1,774 | \$1,774 |
| Percent Change | 8.8% | 8.8% |

Where It Goes:

Personnel Expenses

| | |
|---|-------|
| Employee and retiree health insurance | \$470 |
| 5.5 new and unfunded contractual positions..... | 400 |
| Retirement | 111 |
| Turnover budgeted at 3.4%..... | 98 |
| Increments and other compensation | 60 |
| Other fringe benefit adjustments | 49 |
| 3 new regular positions (benefits only) | 43 |
| Deferred compensation match | 24 |

Other Changes

| | |
|--|-------|
| Investment consultants and research studies to support tactical asset allocations and external manager oversight | \$441 |
| Board of Trustees election service for Employee and Teacher representatives on the Board of Trustees..... | 221 |
| Annual rent increases determined by lease..... | 119 |
| Administrative hearings..... | 115 |
| Communication, travel, and motor vehicles | 7 |
| Materials and equipment..... | -19 |

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Where It Goes:

| | |
|---------------------------------|----------------|
| Annual audit | -62 |
| Other contractual services..... | -40 |
| Actuarial audit | -130 |
| Software maintenance..... | -133 |
| Total | \$1,774 |

Note: Numbers may not sum to total due to rounding.

New Personnel

Regular Positions

SRA has added 3 new FTE regular positions in the fiscal 2007 Governor’s allowance, all of which are contractual conversions, as demonstrated in **Exhibit 6**.

**Exhibit 6
New Regular Personnel**

| <u>Classification</u> | <u>Salary & Fringes</u> | <u>Function</u> | <u>Rationale</u> |
|---|---------------------------------|--|--|
| Administrative Division | | | |
| 1.0 FTE Fiscal Account Tech II | \$51,374 | Calculate retirement estimates and final retirement benefits; maintain accounts and payment records. | Loss of contractual employees to permanent employment opportunities elsewhere after significant time and effort is spent in training in plan administration rules and process. |
| 1.0 FTE Admin. Specialist III contractual conversions | \$53,995 | | |
| Human Resources Unit | | | |
| 1.0 FTE Admin. Specialist III contractual conversion | \$59,054 | Assist in employee recruitment and other human resource functions. | Loss of contractual employees to permanent employment opportunities elsewhere after significant time and effort is spent in training in plan administration rules and process. |
| Total budgeted | \$164,423 | | |

Source: State Retirement Agency

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The Department of Legislative Services (DLS) sees no reason to convert two contractual positions in the administrative division to regular positions. These two positions will be assigned either to the benefits processing unit or the data control unit within the administrative division. The Benefits Processing unit, which calculates benefit estimates and processes benefit payments, has performed admirably with its current staffing configuration. The unit has processed 99.9% of retirement applications within its targeted time frame and processed accurately 99.9% of benefit payments. It is difficult to imagine the unit improving on that performance. The number of new retirees each year whose applications must be processed by this unit has been relatively constant for the last five years, so DLS does not see any imminent increase in the unit's workload.

The data control unit, meanwhile, experienced a dramatic reduction in its workload in fiscal 2005. The unit processes employer contributions to the pension system and maintains participant accounts. In fiscal 2005, the number of employer transactions it processed dropped to 4.6 million from 5.4 million in fiscal 2004. More significantly, the number of manual changes to participant records that unit staff made dropped from 115,410 in fiscal 2004 to 106,552 in fiscal 2005, which is more than an 8% drop. The agency's modernized information systems, due to come on-line in the next few years, should further reduce the need for manual adjustments to participant accounts. The data control unit converted 5.0 contractual FTEs to regular positions in fiscal 2006; further conversions are not warranted given the reduction in workload. **Therefore, DLS recommends that the 2.0 FTE contractual positions in the administrative division slated to be converted to regular positions remain contractual positions.**

Moreover, the benefits processing unit has had two regular positions vacant for more than 11 months. One of those positions received a waiver from the Governor's hiring cap more than a year ago but has not been filled, and the other received its waiver more than four months ago. **DLS recommends deleting one of the two regular positions in the administrative division that have been vacant for more than 11 months.**

Contractual Positions

With the proposed conversion of 3.0 FTE contractual positions to regular positions, the net number of contractual employees increases by 0.5 FTE, including 3.0 FTE in the administrative division to replace staff assigned to the agency's information technology (IT) upgrade project, and 0.5 FTE to provide analytic support to the investment division. Also, the allowance provides funding for 2.0 FTE contractual positions in the IT division that were authorized in fiscal 2006 but never funded. All new positions are described in **Exhibit 7**.

Exhibit 7
New Contractual Personnel

| <u>Classification</u> | <u>Salary & Fringes</u> | <u>Function</u> | <u>Rationale</u> |
|---|-----------------------------|---|--|
| Administrative Division 3.0 FTE positions | \$214,079 | Various functions related to administering the agency's multiple pension plans. | Replacing 3.0 FTE positions that were transferred to the agency's information technology (IT) upgrade project. |
| Investment Division 0.5 FTE position | \$36,737 | Analytic support for the division's tactical asset allocation program and external manager compliance function. | Meeting the agency's Investment Due Diligence responsibilities requires additional analytic support. |
| Total Budgeted | \$250,816 | | |

Source: State Retirement Agency

Issues

1. Retirement Agency Continues Planning for New Procurement to Upgrade Its Information Technology System

Following its failed procurement with Syscom, Inc., which cost the agency nearly \$30 million, SRA began planning in 2004 for a new procurement to replace its legacy computer system. The current Legacy Pension System (LPS) is more than 30 years old, cannot adequately perform automated pension benefit calculations for prospective retirees, and lacks the capacity and flexibility to implement significant pension law changes. The fiscal 2005 working appropriation included \$200,000 to launch a project management office to direct the design and development of a new IT system better equipped to handle the agency's data management and programming needs. Similarly, the fiscal 2006 working appropriation added one FTE contractual IT project manager position, which the agency filled. In addition, the agency re-assigned three regular staff from its administrative division to assist the new project manager.

The new project manager and his staff have made progress in developing a plan to replace LPS with a new system dubbed the Maryland Pension Administration System (MPAS). The plan involves implementing MPAS in steps, with Step 1 modernizing the system's technological base, and Step 2 focusing on improving the quality and organization of data entered and analyzed by the system. Although SRA anticipates that more steps will be needed beyond these first two, it has not identified them at this time. This failure to develop a complete system implementation plan raises the prospect that the new technological infrastructure installed in Step 1 may limit or be ill-suited to additional improvements that SRA wishes to make in the future. This could significantly increase project costs if the infrastructure needs to be modified or replaced.

SRA faced a choice in implementing Step 1 between purchasing an existing, or "off-the-shelf," product or hiring a contractor to design and build a custom-made system. After surveying and visiting other pension systems that have recently upgraded their IT systems, SRA determined that the custom-built option yielded a better finished product, was less costly, and could be implemented in a shorter time frame than off-the-shelf products. SRA's project management team has been crafting a Request for Proposals (RFPs) to solicit proposals from contractors interested in completing Step 1 and plans to make an award in May 2006. The agency expects the total cost for Step 1 to be between \$8 and \$11 million over two years. There are no funds allocated for MPAS in the Governor's fiscal 2007 allowance; SRA received a single proposal in response to its RFP.

DLS recommends that SRA present its plans for the design and development of MPAS to the budget committees, including a detailed accounting of the system's total projected cost. This should include an estimate of the amount it expects to request for MPAS, either through deficiency appropriation or budget amendment, for fiscal 2007. SRA should also describe the project oversight mechanisms it has put in place to avoid the mistakes made with the Syscom procurement. Furthermore, SRA should explain its rationale for a phased implementation of MPAS, and why it seeks to begin installing the new system before it has developed a complete implementation plan.

2. As Teachers’ Plans Fall Out of the Corridor, the Retirement System Board Recommends Ending Corridor Funding Method

In fiscal 2006, the teachers’ combined retirement and pension systems joined the combined employees’ systems in falling out of their funding “corridor” established in Chapter 440, Acts of 2002. Chapter 440 sought to mitigate the effects of fluctuations in market returns on employer contribution rates by spreading out those effects over five years. The corridor method froze employer contribution rates for the employees’ and teachers’ systems at their fiscal 2002 levels as long as the two systems remained actuarially funded between 90 and 110%. As the plans fall out of their corridors, the employer contributions increase by an amount equal to one-fifth of the difference between the prior year’s rate and the “true” rate required to fully fund the systems. The employees’ combined systems fell out of their corridor in fiscal 2005.

Exhibit 8 shows the increases in employer contribution rates and funding status for all of the retirement systems from fiscal 2006 to 2007. For the employees’ and teachers’ systems, it shows the difference between the full-funding rates and the rates determined by the corridor method (which are the rates applied in the State budget).

Exhibit 8 Fiscal 2006 and 2007 Employer Contribution Rates and Actuarial Funding Levels*

| <u>Plan</u> | Fiscal 2007 | | | Fiscal 2006 | | |
|------------------------|----------------------|-----------------------|----------------------|----------------------|-----------------------|----------------------|
| | <u>Corridor Rate</u> | <u>Actuarial Rate</u> | <u>Funding Level</u> | <u>Corridor Rate</u> | <u>Actuarial Rate</u> | <u>Funding Level</u> |
| Employees | 6.83% | 11.11% | 84.9% | 5.76% | 9.88% | 89.2% |
| Teachers | 9.71% | 11.17% | 89.3% | 9.35% | 10.16% | 92.8% |
| State Police | | 13.83% | 100.3% | | 8.22% | 107.3% |
| Judges | | 42.43% | 79.3% | | 41.12% | 80.1% |
| LEOPS | | 40.60% | 57.7% | | 38.47% | 63.3% |
| Combined System | 9.18% | 11.58 | 87.8% | 8.46% | 10.42% | 91.7% |

* For fiscal 2006, the funding level as of June 30, 2004; for fiscal 2007, the funding level as of June 30, 2005.

Source: Milliman

This difference is relevant because the Board of Trustees of SRPS has recommended ending the corridor method and moving immediately to fund the State pension system on a full actuarial basis. This would increase State contributions to the pension system by more than \$200 million above what the State will be paying in fiscal 2007 under the increased corridor rates. In making its recommendation to end the corridor, SRPS was motivated in part by its concern that, under the corridor, the employer contribution rates for the employees’ combined systems did not cover normal

costs. Normal costs represent the total pension liability incurred this year by the State for its current employees.

It is important to note that the State pension system is projected to achieve full actuarial funding in about 25 years under both the corridor method and with full actuarial funding. The main difference between these two approaches is the employer contribution rate paid by the State as the system moves toward full actuarial funding. Under the corridor method, the employer contribution rate would remain below the full actuarial rate for about 10 years, after which the corridor rate would exceed the full actuarial rate. The General Assembly did not act on the agency's recommendation to end corridor funding. **DLS asks SRPS and agency staff to explain the rationale for recommending an end to the corridor method.**

3. Retirement Agency to Seek Independent Salary Setting Authority for 23 Positions, Including Most of Its Investment Division

During the 2006 session, SRA indicated its intentions to seek independent salary setting authority for the executive director, retirement benefits administrator, most of its investment division staff, and other selected positions. It also sought an exemption from the State hiring cap. The agency reports that it is struggling to find and retain qualified candidates, particularly for the investment division because its salary ranges for certain professional positions are significantly below those of other public pension plans and private asset management companies. It has contracted with McLagan Partners to conduct a compensation study that compares salary levels for key professional positions within the agency with those of other large public pension plans and private asset management companies. An exemption from the State hiring cap and independent salary authority could have significant budgetary implications in future years as the agency seeks to expand staff and pay them at substantially higher levels. A comprehensive study of the agency's compensation by McLagan Associates confirmed that salary levels for most of the positions it reviewed were below the median levels for public pension funds of similar size. However, the agency was able to adjust salary levels for most of those positions within the current State salary schedule to make them more competitive with those offered by similar public pension plans. **DLS asks the agency to justify its request for an exemption from the State hiring cap and independent salary authority, and to present key findings from the compensation study it procured. It further requests that the agency estimate the cost of offering higher salaries for the 23 identified positions.**

Recommended Actions

| | <u>Amount Reduction</u> | | <u>Position Reduction</u> |
|--|-----------------------------|----|-------------------------------|
| 1. Delete 1.0 full-time equivalent position that has been vacant for more than one year. The personal identification number of the position recommended for deletion is 005348. | \$ 71,091 | SF | 1.0 |
| 2. Delete 2.0 full-time equivalent (FTE) new regular positions in the Administrative Division. These positions will be assigned either to the Benefits Processing unit or the Data Control unit. The Benefits Processing unit, which calculates benefit estimates and processes benefit payments, has performed admirably with its current staffing configuration. The unit has processed 99.9% of retirement applications within its targeted time frame and processed accurately 99.9% of benefit payments. It is difficult to imagine the unit improving on that performance. The number of new retirees each year whose applications must be processed by this unit has been relatively constant for the last five years and there is no evidence to suggest an imminent increase in the unit's workload. The Data Control unit, meanwhile, experienced a dramatic reduction in its workload in fiscal 2005. After converting 5.0 contractual FTEs to regular positions in fiscal 2006, further conversions are not warranted given the unit's reduced workload. | 39,111 | SF | 2.0 |
| 3. Delete funding for investment research. The Governor's allowance includes \$100,000 for internal investment research studies in addition to \$378,000 for investment consultants and a 0.5 FTE contractual position in the investment division. With additional staff and consultant support available to provide investment analyses, there is little need for internal research studies. | 100,000 | SF | |
| Total Special Fund Reductions | \$ 210,202 | | 3.0 |

Current and Prior Year Budgets

Current and Prior Year Budgets State Retirement Agency (\$ in Thousands)

| | <u>General Fund</u> | <u>Special Fund</u> | <u>Federal Fund</u> | <u>Reimb. Fund</u> | <u>Total</u> |
|----------------------------------|--------------------------------|--------------------------------|--------------------------------|-------------------------------|---------------------|
| Fiscal 2005 | | | | | |
| Legislative Appropriation | \$0 | \$15,616 | \$0 | \$0 | \$15,616 |
| Deficiency Appropriation | 0 | 0 | 0 | 0 | 0 |
| Budget Amendments | 0 | 9,178 | 0 | 0 | 9,178 |
| Reversions and Cancellations | 0 | -91 | 0 | 0 | -91 |
| Actual Expenditures | \$0 | \$24,703 | \$0 | \$0 | \$24,703 |
| Fiscal 2006 | | | | | |
| Legislative Appropriation | \$0 | \$20,097 | \$0 | \$0 | \$20,097 |
| Budget Amendments | 0 | 163 | 0 | 0 | 163 |
| Working Appropriation | \$0 | \$20,260 | \$0 | \$0 | \$20,260 |

Note: Numbers may not sum to total due to rounding.

Fiscal 2005

- A special fund budget amendment realigned \$3,610,630 in approved fiscal 2006 funds to fiscal 2005 to pay the loan balance for tenant improvements made when SRA moved to its present location in January 2000. By paying the loan balance before July 2005, SRA saved \$532,000 in fiscal 2006 and \$2.1 million in interest payments over the remainder of the loan.
- A special fund budget amendment totaling \$5,114,376 was approved in fiscal 2005. SRA requested the amendment to recoup \$5,010,720 cut from its fiscal 2005 allowance because it held unneeded encumbrances in that amount for a failed computer procurement. The additional \$103,656 was for vendor services associated with unanticipated election services to replace a deceased Trustee.
- Additional special fund budget amendments approved in fiscal 2005 totaled \$453,428. These paid for an independent risk analysis (\$195,800), an independent assessment of internal control mechanisms (\$99,960), and a \$752 cost-of-living adjustment (COLA) increase approved by the General Assembly (\$157,668).

Fiscal 2006

- A special fund budget amendment approved in fiscal 2006 provided \$163,202 for the 1.5% COLA approved by the legislature during the 2005 session.

Audit Findings

| | |
|------------------------------|------------------------------|
| Audit Period for Last Audit: | July 1, 2002 – June 30, 2004 |
| Issue Date: | October 2004 |
| Number of Findings: | 0 |
| Number of Repeat Findings: | 0 |
| % of Repeat Findings: | 0% |
| Rating: (if applicable) | |

The audit did not disclose any significant deficiencies in the design or operation of the board's internal control or any significant instances of noncompliance with applicable laws, rules, or regulations.

**Object/Fund Difference Report
State Retirement Agency**

| <u>Object/Fund</u> | <u>FY05 Actual</u> | <u>FY06 Working Appropriation</u> | <u>FY07 Allowance</u> | <u>FY06 - FY07 Amount Change</u> | <u>Percent Change</u> |
|--------------------------|------------------------|---|---------------------------|--------------------------------------|---------------------------|
| Positions | | | | | |
| 01 Regular | 163.00 | 172.00 | 175.00 | 3.00 | 1.7% |
| 02 Contractual | 26.64 | 26.50 | 27.00 | 0.50 | 1.9% |
| Total Positions | 189.64 | 198.50 | 202.00 | 3.50 | 1.8% |
| Objects | | | | | |
| 01 Salaries and Wages | \$ 10,658,954 | \$ 11,624,909 | \$ 12,583,237 | \$ 958,328 | 8.2% |
| 02 Technical & Spec Fees | 1,385,929 | 1,288,930 | 1,640,924 | 351,994 | 27.3% |
| 03 Communication | 1,114,920 | 1,010,342 | 1,001,671 | -8,671 | -0.9% |
| 04 Travel | 127,686 | 122,284 | 132,416 | 10,132 | 8.3% |
| 07 Motor Vehicles | 110,025 | 125,167 | 130,318 | 5,151 | 4.1% |
| 08 Contractual Services | 5,174,905 | 4,190,472 | 4,547,965 | 357,493 | 8.5% |
| 09 Supplies & Materials | 170,562 | 195,623 | 181,323 | -14,300 | -7.3% |
| 10 Equip - Replacement | 170,700 | 80,394 | 80,894 | 500 | 0.6% |
| 11 Equip - Additional | 153,871 | 56,153 | 51,245 | -4,908 | -8.7% |
| 13 Fixed Charges | 5,635,528 | 1,566,298 | 1,685,340 | 119,042 | 7.6% |
| Total Objects | \$ 24,703,080 | \$ 20,260,572 | \$ 22,035,333 | \$ 1,774,761 | 8.8% |
| Funds | | | | | |
| 03 Special Fund | \$ 24,703,080 | \$ 20,260,572 | \$ 22,035,333 | \$ 1,774,761 | 8.8% |
| Total Funds | \$ 24,703,080 | \$ 20,260,572 | \$ 22,035,333 | \$ 1,774,761 | 8.8% |

Note: The fiscal 2006 appropriation does not include deficiencies, and the fiscal 2007 allowance does not reflect contingent reductions.

**Fiscal Summary
State Retirement Agency**

| <u>Program/Unit</u> | <u>FY05 Actual</u> | <u>FY06 Wrk Approp</u> | <u>FY07 Allowance</u> | <u>Change</u> | <u>FY06 - FY07 % Change</u> |
|-----------------------------|------------------------|----------------------------|---------------------------|---------------------|---------------------------------|
| 01 State Retirement Agency | \$ 24,703,080 | \$ 20,260,572 | \$ 22,035,333 | \$ 1,774,761 | 8.8% |
| Total Expenditures | \$ 24,703,080 | \$ 20,260,572 | \$ 22,035,333 | \$ 1,774,761 | 8.8% |
| Special Fund | \$ 24,703,080 | \$ 20,260,572 | \$ 22,035,333 | \$ 1,774,761 | 8.8% |
| Total Appropriations | \$ 24,703,080 | \$ 20,260,572 | \$ 22,035,333 | \$ 1,774,761 | 8.8% |

Note: The fiscal 2006 appropriation does not include deficiencies, and the fiscal 2007 allowance does not reflect contingent reductions.

**Summary of State Membership Data by Plan
Fiscal 2001 - 2005**

| | <u>Total</u> | <u>Teachers' Retirement</u> | <u>Teachers' Pension</u> | <u>Employees Retirement</u> | <u>Employees' Pension</u> | <u>Judges' Retirement</u> | <u>State Police Retirement</u> | <u>LEOPs</u> |
|--------------------------------------|--------------|---------------------------------|------------------------------|---------------------------------|-------------------------------|-------------------------------|------------------------------------|--------------|
| <i>From 7/1/00 to 6/30/01</i> | | | | | | | | |
| Active Members | 184,600 | 10,396 | 82,901 | 11,962 | 76,024 | 281 | 1,578 | 1,318 |
| Average Annual Salary | \$39,301 | \$61,453 | \$40,474 | \$38,280 | \$34,554 | \$108,735 | \$50,306 | \$45,856 |
| Retired Members | 84,185 | 29,599 | 10,527 | 25,212 | 16,702 | 297 | 1,518 | 309 |
| Average Annual Retirement Allowance | \$15,707 | \$23,282 | \$11,893 | \$13,137 | \$6,278 | \$55,046 | \$31,695 | \$22,790 |
| Vested Former Members | 43,199 | 1,730 | 15,607 | 1,350 | 24,396 | 13 | 24 | 49 |
| <i>From 7/1/01 to 6/30/02</i> | | | | | | | | |
| Active Members | 190,123 | 9,270 | 87,086 | 11,722 | 78,584 | 281 | 1,589 | 1,410 |
| Average Annual Salary | \$41,383 | \$65,175 | \$42,704 | \$40,135 | \$36,728 | \$113,253 | \$52,323 | \$46,749 |
| Retired Members | 87,367 | 29,989 | 11,931 | 24,904 | 18,205 | 311 | 1,598 | 403 |
| Average Annual Retirement Allowance | \$15,945 | \$23,510 | \$12,788 | \$13,285 | \$6,894 | \$55,377 | \$32,334 | \$24,028 |
| Vested Former Members | 44,355 | 1,643 | 16,397 | 1,331 | 24,845 | 10 | 27 | 66 |
| <i>From 7/1/02 to 6/30/03</i> | | | | | | | | |
| Active Members | 190,021 | 8,199 | 89,099 | 11,347 | 77,939 | 287 | 1,542 | 1,481 |
| Average Annual Salary | \$42,808 | \$67,755 | \$44,520 | \$40,723 | \$38,004 | \$115,571 | \$52,424 | \$46,907 |
| Retired Members | 90,803 | 30,305 | 13,370 | 24,662 | 19,929 | 306 | 1,695 | 503 |
| Average Annual Retirement Allowance | \$16,278 | \$24,156 | \$13,128 | \$13,728 | \$7,284 | \$56,112 | \$33,444 | \$24,804 |
| Vested Former Members | 45,573 | 1,577 | 17,284 | 1,349 | 25,212 | 13 | 41 | 62 |
| <i>From 7/1/03 to 6/30/04</i> | | | | | | | | |
| Active Members | 185,861 | 7,197 | 88,765 | 10,489 | 75,955 | 283 | 1,445 | 1,675 |
| Average Annual Salary | \$44,169 | \$69,819 | \$46,337 | \$41,801 | \$39,024 | \$117,137 | \$53,655 | \$46,942 |
| Retired Members | 94,880 | 30,598 | 15,093 | 24,559 | 21,913 | 309 | 1,790 | 581 |
| Average Annual Retirement Allowance | \$16,785 | \$25,064 | \$13,704 | \$14,343 | \$7,795 | \$56,761 | \$34,822 | \$26,085 |
| Vested Former Members | 46,911 | 1,478 | 18,327 | 1,311 | 25,626 | 14 | 44 | 81 |
| <i>From 7/1/04 to 6/30/05</i> | | | | | | | | |
| Active Members | 188,050 | 6,255 | 91,535 | 9,869 | 76,787 | 282 | 1,439 | 1,826 |
| Average Annual Salary | \$49,163 | \$74,291 | \$50,152 | \$42,934 | \$41,509 | \$120,206 | \$53,934 | \$48,700 |
| Retired Members | 100,196 | 30,921 | 17,170 | 24,633 | 24,525 | 316 | 1,909 | 708 |
| Average Annual Retirement Allowance | \$17,269 | \$26,066 | \$14,171 | \$15,025 | \$8,318 | \$58,454 | \$36,005 | \$27,534 |
| Vested Former Members | 47,664 | 1,351 | 18,792 | 1,291 | 26,058 | 15 | 47 | 104 |