AD HOC COMMITTEE ON ACTUARIAL VALUATIONS AND ECONOMIC ASSUMPTIONS MEETING MINUTES
BOARD OF TRUSTEES
MARYLAND STATE RETIREMENT AND PENSION SYSTEM

August 30, 2016

The Ad Hoc Committee on Actuarial Valuations and Economic Assumptions met in the Boardroom of the SunTrust Building, 120 East Baltimore Street, 16th Floor, Baltimore, Maryland, beginning at 1:01 p.m.

The Trustees present included:

F. Patrick Hughes, Chairman, Presiding	James Bush
Linda Herman, Vice Chairman (via phone)	James "Chip" DiPaula (via phone)
David Brinkley	Theresa Lochte
Susanne Brogan (Designee for Treasurer Kopp)	John Kenney (Designee for Comptroller Franchot)
Eric Brotman	Richard Norman

Agency Staff members attending included: R. Dean Kenderdine, Executive Director/Board Secretary

Margaret Bury	Anne Gawthrop	Angie Jenkins
Melody Countess	Michael Golden	Andrew Palmer
		Janet Sirkis

Assistant Attorneys General present included: Rachel Cohen

Other Attendees included: Nathan Bowen, Michael Rubenstein, Laura Vykol and Brian Murphy (via phone) and Brad Armstrong from GRS.

Charge to Committee

Mr. Hughes, Chairman of the Committee, explained that, as established by the Board of Trustees, the Committee was charged with examining the System's current actuarial economic assumption for the System's Investment Rate of Return and possibly make recommendations to the Board as to whether changes in the rate or its components should be implemented, and if implemented, where that assumption should be set. Mr. Hughes further explained that the Committee may make more than one recommendation and that the Committee should consider alternative Investment Rate of Return assumptions within a range of acceptable rates provided by the System's actuary based upon statistics from the set of investment consultants that the actuary monitors.

Mr. Hughes reported that the Board approved the 7.55% Assumed Rate of Return in 2013.

Review of the July 19, 2016 Presentation to the Board of Trustees on Interest Rate

The Committee was provided a copy of the PowerPoint document presented, by Gabriel Roeder Smith & Company (GRS), to the Board at its July 19, 2016 meeting, entitled "MSRPS Interest Rate Discussion, July 19, 2016."

Brian Murphy from GRS reported that the current Maryland assumptions are reasonable even by the new standards, but if return expectations continue to fall, they may not remain reasonable much longer. Current assumptions are at the upper end of the acceptable range.

Mr. Murphy recommended that the Committee's focus be on what is likely to occur. If the System's assumptions do not accurately reflect what actually happens and contribution rates are understated, the difference must be made up with interest. If the System continues with the 7.55% assumed rate of return, but does not actually reach that rate of return, it could require $5.7 Billion in increased employer contributions over the current projection period to offset the effect of the near term under performance.

Economic Outlook

Mr. Palmer discussed the long range outlook for inflation. He cited four factors that have contributed to the low inflation that has been realized in the United States in recent years. Those factors include: Globalization, Global Deleveraging, Global capacity surplus and demographics. Globalization has lowered the inflation in goods as production costs have fallen. It has also contributed to low wage growth in developed economies. Aging populations and slowing population growth has slowed potential GDP for most developing countries. Slower growth is not popular so policy makers have promoted the expansion of debt in an attempt to maintain growth patterns. The financial crisis was the beginning of the unwinding of this large debt burden which provides deflationary forces into the global economy. As part of the struggle to maintain growth, many countries, particularly China, have invested heavily in productive capacity to maintain employment. This productive capacity remains in operation despite being unprofitable to maintain acceptable levels of employment.

While these forces are in play, inflation will have trouble gaining substantial traction. These are long lived trends and should be in place for an extended period. However, one of the ways that Governments can achieve a lower real debt burden is to refinance all of their debt at low rates and then use monetary policy to generate inflation that will erode the value of the payments to bondholders. This risk seems remote at this time but is reason to believe that inflation may be resurgent in the out years.

Inflation and Real Return Assumptions

Mr. Kenney asked what Mr. Palmer's views on inflation were.

Mr. Palmer responded that there are three ways to get out of debt; default, inflate or change terms, but that the most likely choice would be by inflation.

Mr. Brotman commented that there are two points that the Board can control, the first being what the System's assumptions will be and the second being how the portfolio is structured.

Discussion

Mr. Murphy commented that if decisions are made by the Board within the next month, they affect the FY2016 valuations and the contribution rates for the FY2018 budget.

Ms. Herman stated that the System is a long term investor and as such should not have a knee jerk reaction to the current market environment. She stated that YTD thru July most pension systems are up 7-8%, Ms. Herman noted that the Board's discussion of lowering the investment now only to raise it in the future would not bode well with the bond rating agencies and would play havoc with the contribution rates paid by participating governments.

Mr. DiPaula commented that the Committee is charged with looking at the rate of return and that he was open to reducing the rate of return, but that the decision to do so, would be served best if the Committee looked deeper into the totality of the components.

Ms. Lochte commented that most Systems are reducing their assumed rate of return and that if Staff feels that the System is not going to hit the current assumed rate of return, then it would be prudent to reduce the System's rate of return.

Mr. Brotman commented that the funding ratio will go down if the Board does nothing and that changing the portfolio is the prudent thing to do.

Secretary Brinkley asked in what year is the System expected to be fully funded.

Mr. Kenderdine responded that the System is expected to be fully funded in 2039.

Mr. Murphy commented that, in his opinion, in the next 4-5 years, both inflation and the rate of return will be very low.

Ms. Brogan commented that it would be helpful for the Committee to have additional information on inflation and real return projections to help the Committee determine if the System's rate of return is realistic based on the current asset allocation and to make a more informed decision.

The Committee asked that staff schedule a follow-up meeting to review the additional information on inflation and real return rates, for its next meeting.

Adjournment

There being no further business before the Committee, on a motion made by Ms. Lochte and seconded by Mr. Norman, the meeting adjourned at 2:46 p.m.

Respectfully submitted,

R. Dean Kenderdine,
Secretary to the Board