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

April 24, 2017

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 9:01 a.m.

The Trustees present included:

F. Patrick Hughes, Chairman, Presiding	James Bush
Linda Herman, Vice Chairman (via phone)	Theresa Lochte
David Brinkley	John Kenney (Designee for Comptroller Franchot)
Susanne Brogan (Designee for Treasurer Kopp)	Nancy K. Kopp (via phone)

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

Anne Gawthrop	Angie Jenkins	Harvey Raitzyk
Michael Golden	Andrew Palmer	Janet Sirkis

Assistant Attorneys General present included: Rachel Cohen

Other Attendees included: Phillip Anthony, Michael Rubenstein, Brian Murphy (via phone), Brad Armstrong, and Mary Mustard.

Minutes

On a motion made by Mr. Bush and seconded by Ms. Lochte, the Ad Hoc Committee ratified the approval of the November 21, 2016 open session meeting minutes.

Charge to Committee

Mr. Hughes, Chairman of the Committee, reminded the members 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.

Update on U.S. Public Pension Plan Actions

The Committee was provided a copy of the "NASRA Issue Brief: Public Pension Plan Investment Return Assumptions", issued by the National Association of State Retirement Administrators in February, 2017. The brief discusses how investment return assumptions are established and evaluated, compares the assumptions with public funds' actual investment experience, and the challenging investment environment public retirement systems currently face.

Mr. Kenderdine commented that as of February 2017, 75% of the public pension plans, including the Maryland State Retirement and Pension System, have lowered the plan's assumed rate of return and that an increasing number of plans, like Maryland, are incrementally changing their assumptions. Mr. Kenderdine pointed out that with the recent number of plan rate reductions around the country, Maryland's assumed rate of return of 7.55% is no longer below the median, which is now 7.5%.

Projected Funding and Contribution Outcomes Under Select Inflation and Real Return Assumptions

The Committee was provided with a document produced by Gabriel Roeder Smith & Company (GRS), which showed the Projected Results Based on the June 30, 2016 Valuations and several alternate economic scenarios.

Current View on Inflation Expectations

Andrew Palmer, Chief Investment Officer and Mary Mustard from Meketa Investment Group, reviewed the PowerPoint document on inflation assumptions that was originally presented at the Committee's November 21, 2016 meeting. The document presents and discusses Capital Market Assumptions through the first quarter of 2017.

Mr. Hughes commented that he believes that looking at investing long-term as opposed to short term (5-10 year term), remains appropriate for the System. Mr. Hughes asked Mr. Palmer how the fund was currently performing.

Mr. Palmer responded that fiscal year to date, the fund was up 6.8%.

Mr. Palmer reported that there has not been much change in inflation or inflation outlooks, but that real return remains the challenge.

Ms. Mustard addressed the risk levels required to expect a 7.55% return over the next 10 and 20 years and restated that the "modest change" column of the document shows "tweaks" on the margins based on the fund's current policy.

Ms. Herman stated that the report, produced by Meketa, does not include alpha, which is what the CIO and staff are paid to obtain.

Ms. Herman commented that the System's investment risk is lower than its peers. Ms. Herman believes that the Board could look at ways to take on additional risk to support remaining at 7.55%.

Ms. Brogan asked if the asset allocation is being driven by the rate of return or is the rate of return being driven by the asset allocation. Ms. Brogan asked how the System allocates the assets.

Ms. Mustard responded that clients build portfolios in response to and to exceed the assumed rate of return.

Mr. Hughes commented that if the System "dials down" the assumed rate of return, but does not change its portfolio, the probability of achieving the rate of return is much higher.

Mr. Palmer responded that the System's portfolio has the same expected return as our peers, with lower risk. The difference between the System's asset allocation and its peers is its U.S. equity exposure is lower, and peers are weighted more heavily towards U.S. equities. The U.S. equity asset class was rewarded handsomely over the last few years.

In addition, Mr. Palmer responded that a key question for the Board is what risk it wants to take.

Ms. Brogan commented that the question is the level of risk and the Board's risk tolerance. The answer to that question can drive the decision as to what the assumed rate of return should be.

Mr. Hughes suggested that a presentation to the Board by the Chief Investment Officer regarding risk assessment, would be helpful.

Secretary Brinkley commented that at the time asset allocation was set in 2015, the Board lowered risk. He asked where the fund is in the transition to that asset allocation.

Mr. Kenderdine responded that in equities, the target is 47% and the fund is currently at 49.4%. We are below target in real assets and absolute return.

Ms. Mustard further responded that the System is making gradual changes and moving toward the target goals.

Ms. Brogan asked how Meketa would guide the Board to increase risk.

Ms. Mustard responded that Meketa would offer scenarios based on statistical and historic analyses and what the Board would want long term.

Mr. Hughes asked Ms. Herman what her thoughts were on this discussion.

Ms. Herman responded that despite the equity risks, there are ways to get equity returns, such as through high-yield bonds. The System has the leverage to invest in other ways that would support the current rate.

Mr. Palmer responded that while the CIO has the flexibility to invest the System's assets as suggested, the existing, highly diversified, asset allocation, the large number of private investments used to implement that allocation and the skill set and depth of staff, present a resource challenge in substantially increasing the complexity of the investment program. In other words, the resources of the investment division have not kept pace with the growing complexity of the asset allocation.

Mr. Hughes requested that Mr. Palmer provide to the Committee a 1-page list of what resources are needed and a summary of what "plan B" is, if those resources are not available.

Mr. Palmer asked how the System went from 7.75% to the 7.55% assumed rate of return.

Mr. Kenderdine responded that the decision of the Board to reduce the assumed rate of return to 7.55% was guided by the actuary after the Experience Study completed in 2011. At that time the Board decided to reduce the assumed rate of return to 7.55%, but to do it on an incremental basis by dropping the rate five basis points each year for five years.

Discussion

Mr. Hughes called for a sense of the Committee and on a motion by Mr. Bush, seconded by Ms. Lochte, by a vote of 4 to 2, a majority expressed support for keeping the assumed rate of return at 7.55%. The Trustees in favor of remaining at 7.55% were: Mr. Bush, Ms. Lochte, Ms. Brogan and Ms. Herman. The Trustees in opposition were Mr. Kenney and Mr. Brinkley.

The Chairman will schedule another Ad Hoc Committee meeting after the May Investment Committee and Board of Trustees meeting, where the Trustees will discuss and possibly adjust the System's Asset Allocation. Therefore, after further discussion, the Committee agreed that the current sense of the Committee to keep the assumed rate of return at 7.55%, would not be presented to the Board pending the May Board meeting and the next meeting of the Ad Hoc Committee.

Adjournment

There being no further business before the Committee, on a motion made by Mr. Bush and seconded by Ms. Lochte, the meeting adjourned at 10:42 a.m.

Respectfully submitted,

R. Dean Kenderdine
Secretary to the Board