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

July 15, 2021

The Ad Hoc Committee on Actuarial Economic Assumptions for the Maryland State Retirement and Pension System convened, via video/audio conference call beginning at 1:03 p.m.

The Committee members present included:

Eric Brotman, Chairman, Presiding	David Brinkley
Thomas Brandt, Vice Chairman	Douglas Prouty
Michael Barry	Michael Stafford, Jr.

Agency Staff members attending included: Martin Noven, Executive Director/Board Secretary

Melody Countess	Angie Jenkins	David Rongione
Anne Gawthrop	Andrew Palmer	Janet Sirkis
Michael Golden	Ken Reott	Scott Bolander (live stream)

Assistant Attorneys General present included: Rachel Cohen, Jody Shaw and Kathleen Wherthey

Other attendees included: Public Advisor Anne Shelton; Brad Armstrong, Brian Murphy, Jeff Tebeau and Amy Williams from GRS; and Frank Benham from Meketa

Call Meeting to Order

Mr. Brotman, Chair of the Committee called the meeting to order and asked that the focus of the meeting be primarily on the issue of the economic assumptions. He indicated that a separate meeting could be scheduled to discuss the amortization policy, if needed.

Minutes

On a motion made by Mr. Stafford and seconded by Mr. Brandt, the Committee approved the May 11, 2021 open session Committee minutes.

Presentation from Meketa Investment Group

The Committee was provided a memorandum from Frank Benham and Mary Mustard, Meketa Investment Group, which provided answers to the questions raised at the May meeting of the Committee. Meketa was asked to clarify the difference in actuarial assumptions being used by corporate and public pension plans, typical inflation assumptions, and the extent to which they impact the System's capital market assumptions.

Mr. Benham reported that the average rate of return assumptions for public pensions has been declining for the past decade. According to a survey conducted by the National Association of State Retirement Administrators (NASRA), the median investment return assumptions has dropped to 7.0%. Mr. Benham stated that the return assumption for corporate plans has declined more rapidly than it has for public plans, most recently reaching 6.5%, noting that corporate pensions plans, unlike public pension plans, generally discount their liabilities (lower) rate than their investment assumption.

Mr. Benham reported that inflation has a direct impact on the System's liabilities and a less direct impact on its investment returns. The inflation assumptions have averaged 2.7% over the past two decades, generally ranging between 2.5% and 3.0%. Mr. Benham stated that Investment return assumptions for corporate plans are roughly 0.5% below those for public pension plans.

Presentation by Gabriel Roeder Smith & Company

The Committee was provided a copy of a presentation by Gabriel Roeder Smith & Company (GRS), which discussed the System's current economic assumptions and the impact of alternate economic assumptions.

Mr. Brian Murphy reported that GRS was asked to present further analysis two alternative investment return assumptions of 6.3% and 7%. Mr. Murphy stated that the presentation included in the meeting book, included information on those assumptions, as well as the return assumptions of 6.8%, as follows:

Baseline Scenario	Alternate Scenario 1	Alternate Scenario 2	Alternate Scenario 3
• 7.40% Investment Return • 2.60% Inflation • 4.80% Real Return • 3.10% Wage Inflation	• 7.00%Investment Return • 2.20% Inflation • 4.80% Real Return • 2.70% Wage Inflation	• 6.80% Investment Return • 2.25% Inflation • 4.55% Real Return • 2.75% Wage Inflation	• 6.30%Investment Return • 2.40% Inflation • 3.90% Real Return • 2.90% Wage Inflation

MSRPS State-Employer Contribution Rates
(Excludes Reinvested Savings)

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Base	17.50%	16.29%	14.93%	13.78%	12.75%	11.62%	12.18%	12.79%	13.45%	14.19%	15.00%
7.00%	17.50%	16.98%	15.53%	14.27%	13.12%	11.79%	12.21%	12.66%	13.13%	13.64%	14.19%
6.80%	17.50%	18.91%	17.47%	16.49%	14.98%	13.57%	13.84%	14.15%	14.47%	14.81%	15.18%
6.30%	17.50%	25.90%	24.57%	23.27%	21.91%	20.26%	19.93%	19.60%	19.29%	18.98%	18.65%

MSRPS State-Funded Ratio

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Base	72.9%	75.9%	79.2%	82.1%	84.5%	87.0%	87.0%	86.7%	86.5%	86.5%	86.5%
7.00%	72.9%	74.9%	78.2%	81.2%	84.0%	86.8%	87.1%	87.3%	87.5%	87.7%	88.1%
6.80%	72.9%	72.9%	85.9%	79.1%	82.0%	85.0%	85.7%	86.1%	86.6%	87.2%	87.8%
6.30%	72.9%	66.8%	69.2%	72.7%	76.0%	79.6%	81.2%	82.6%	84.0%	85.4%	86.8%

Mr. Armstrong reported that inflation expectations have been very low for an extended period and that the current 2.6% is above all expectations. Mr. Armstrong also stated that Meketa's 10-year inflation expectation is 1.8% and the 20-year expectation is 2.2%.

The GRS presentation showed the probability of meeting the return assumptions over time, as follows:

Probability of Exceeding Various Returns over Different Time Periods						
	7%		6.8%		6.30%	
	10 yrs	20 yrs	10 yrs	20 yrs	10 yrs	20 yrs
2021 CMAM	34%	46%	36%	48%	41%	53%
5-yr CMAM Avg.	40%	49%	42%	52%	48%	58%

Based on the information provided and because it is Meketa's expectation over 10 years, GRS' preferred assumption from the above choices is 6.3%. However, Mr. Murphy advised that the Board of Trustees could reasonably select either of the other two alternatives it presented.

Discussion

Mr. Brotman asked GRS if the Committee chose another return assumption over the preferred assumption rate of 6.3%, would it work together with the amortization schedule.

Mr. Murphy responded that it could.

Mr. Brotman expressed his concerns with GRS' preferred assumption rate of 6.3%. He stated that he felt the 6.3% rate was a massive change and would introduce volatility and that the System should adopt a more incremental approach and “continue to move the ball down the line” to being fully funded.

Mr. Brandt pointed out that the probability of achieving the assumed rate of return was less than 50% in the other scenarios.

Mr. Prouty expressed his concerns that lowering the rate to 6.3% would alarm employers and could raise concerns about the soundness of the system.

After further discussion, on a motion made by Mr. Prouty and seconded by Mr. Stafford, the Committee voted to recommend that the Board of Trustees approve scenario 2 with a 6.8% investment return and 2.25% inflation rate.

Ms. Shelton commented, that while she is not a member of the Committee, she wanted to point out that there are credible people who think we are headed for higher inflation.

Mr. Armstrong asked for clarification regarding whether Mr. Prouty’s motion included the asset recognition proposal to recognize 40% of the FY21 gain in the 2021 actuarial valuation, and 15% in each of the following 4 years, rather than the current asset valuation method, which provides for 20% recognition in each of the next 5 valuations.

Mr. Brotman commented that he voted in favor of the motion with the assumption that it included the 40% asset recognition to smooth impact of assumption changes.

Ms. Cohen asked GRS to clarify whether the asset gain recognition is a component of the statutory amortization policy, which requires legislative approval, or part of the assumption that the Board may adopt.

Mr. Murphy responded that the asset gain recognition is not part of the statutory amortization policy and that he had reviewed the section of the statutes related to asset recognition. He stated his belief that the change is within the Board’s purview.

Ms. Cohen commented that State Personnel and Pensions Art., § 21-125(b)(13) provides that “For purposes of actuarial valuation, the Board of Trustees may adopt a generally accepted method for determining the value of assets held by the several systems,” but must use generally accepted account principles for general ledger account and financial reporting. Ms. Cohen asked GRS to advise the committee whether changing the current asset recognition method of 20% annually for 5 years, to a temporary change to recognize 40% in year 1, and 15% in years 2-5, is a generally accepted method for determining the value of assets.

Mr. Murphy responded that in GRS’s view, the temporary change in asset gain recognition is a generally accepted asset valuation method under the circumstances. He stated that he also consulted with a GRS employee who served on the Actuarial Standards Board, who confirmed that that is a reasonable method.

Mr. Noven explained that the temporary change in asset gain recognition was proposed by GRS to avoid a spike in employer contributions by better aligning the one-time change in the return assumptions with the recognition of the investment returns over a five-year period.

Mr. Murphy commented that a move to 6.8% is a very positive step for the System and if a temporary adjustment in asset recognition can help achieve that, then GRS supports it.

Mr. Prouty and Mr. Stafford agreed to modify and second the motion, respectively, to include the 40% recognition.

On a motion made by Mr. Prouty and seconded by Mr. Stafford, the Committee voted to recommend that the Board approve Scenario 2 (6.8% investment return, 2.25% inflation rate, 4.55% real return and 2.75% wage inflation), in combination with a 40% recognition of FY2021 asset gains in year 1, and 15% recognition in each of years 2-5. Mr. Brandt opposed the motion.

Other Business

Mr. Brotman commented that the amortization schedule will be discussed at the next Committee meeting and asked Ms. Jenkins to assist with scheduling that meeting.

Adjournment

There being no further business before the Committee, on a motion made by Mr. Prouty and duly seconded, the meeting adjourned at 3:00 p.m.

Respectfully submitted,

Martin Noven
Secretary to the Board