

BOARD OF TRUSTEES  
FOR THE  
STATE RETIREMENT AND PENSION SYSTEM  
OF MARYLAND

MINUTES OF MEETING

July 16, 2002

The Board of Trustees for the State Retirement and Pension System of Maryland met in the Boardroom of the SunTrust Building, 120 East Baltimore Street, Baltimore, Maryland, at 9:45 a.m. There were present Chairman William Donald Schaefer, Vice-Chairman Nancy K. Kopp, Secretary T. Eloise Foster (joined meeting at 10:30 a.m. via Tele-conference), Dr. Nancy Grasmuck, William D. Brown, Carl D. Lancaster, Major Morris L. Krome, Colonel David D. Mitchell, Debra Humphries, G. Bruce Harrison, Dr. Ali A. Alemu, Trustees, and, Margaret A. Bury, Acting Secretary. Agency Staff members also attending were Deborah Bacharach, Robert Feinstein, and Carla Katzenberg, Assistant Attorneys General, Carol Boykin, Chief Investment Officer, Howard Fleines, Legislative Director, Thomas Gigliotti, Chief Internal Auditor, Gary Scribner, Chief Information Officer, Rick Harrison, Chief Financial Officer, and Gwen Mulkey, Executive Associate.

Also present were, Paul Schlitz, attorney for Darrel Bailey, Ronald Ruffo, Maryland Retired Teachers Association, and Donna Hill-Staton, Deputy Attorney General.

Minutes 1 Dr. Alemu noted for the record that although he was absent from the June 2002 Board meeting he wished to express his support of the election of Comptroller Schaefer as Chairman of the Board, and Treasurer Kopp as Vice-Chairman of the Board.

On motion made by Mr. Harrison and seconded by Dr. Grasmuck, the minutes of the Executive Sessions of the Board of Trustees for the State Retirement and Pension System of Maryland, held on June 16, 2002, were unanimously approved as amended.

Minutes 2 On motion made by Dr. Alemu and seconded by Colonel Mitchell, the minutes of the Executive Sessions of the Board of Trustees for the State Retirement and Pension System, held on March 19, 2002, April 16, 2002, and May 21, 2002 were unanimously approved.

Darrel Bailey 3 The Board considered the report of David Hofstetter, the Administrative Law Judge in connection with the claim of Darrel Bailey, for accidental disability benefits. The report included a report by the Medical Board and related medical documentation.

The Medical Board denied Mr Bailey's claim for accidental disability retirement benefits based on their determination that the reported accident was not the direct cause of the Claimant's disability Mr Bailey appealed the Medical Board's decision

Paul Schlitz, attorney for Mr Bailey appeared before the Board and presented his arguments opposing the Agency's position and the Administrative Law Judge's recommendations Ms Carla Katzenberg, attorney for the Agency, addressed the Board and argued that the Board should adopt the Administrative Law Judge's recommendations Following discussion, the Board deferred further consideration to Executive Session

Committee  
Establishment

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The Board discussed the establishment of an Ad-Hoc Benefits Improvements Sub-committee Dr Alemi recalled that the Board had attempted to create an Ad-Hoc Benefit Improvement Sub-committee in November of 2001, but postponed action in deference to the wishes of the Legislature Dr Alemi stated that he felt a fiduciary obligation to the members of the system to study benefit improvements Additionally, Dr Alemi recommended Vice-Chairman Kopp as Chairman of the Sub-committee Mr Brown stated that the Board should try to understand the General Assembly's sensitivity to the issue of benefit improvements Mr Brown noted that changes should be made through employee and teacher groups, he also noted that the process of improving benefits has been made more complicated by collective bargaining Attachment A

Vice-Chairman Kopp, in reference to Dr Alemi's suggestion that she Chair the Sub-committee, thanked him for his vote of confidence, but declined Additionally, Vice-Chairman Kopp stated that there are other ways to seek pension enhancements Vice-Chairman Kopp also indicated that there are key funding and investment issues to strengthen the existing benefits that currently require the Board's attention more than the issue of future benefit improvements

Chairman Schaefer stated that he feels strongly that the Board is obligated to study benefits Additionally, Chairman Schaefer stated that there is nothing wrong with studying benefits and recommending changes Mr Harrison stated that the issue of benefit improvement is a complex one that should be driven by employees Additionally Mr Harrison stated that the Board's beliefs might differ greatly from what members may seek as improvements Mr Harrison finally stated that the Board needs to act as facilitators for employees Ms Humphries asked if there was a way to establish the Sub-committee and still include the General Assembly and employee groups Chairman Schaefer stated that the issue need not be complicated He believed the Sub-committee should consist of Trustees only but the employee organizations should be provided the opportunity to attend the Sub-committee meetings

On motion made by Chairman Schaefer and seconded by Dr Grasmick, the Board voted to establish the Ad-Hoc Sub-committee on Benefit Improvements with membership composed of Trustees, Mr Harrison, Mr Caple, Mr Lancaster, and two additional members to be selected by the Chairman. The Ad-Hoc Sub-committee will investigate and report back to the full Board its findings with respect to the benefit levels of the various Systems as compared to those of other employers with which Maryland competes for employees. Additionally, the Ad-Hoc Sub-committee will study, analyze, and report on the relationship between employee and employer contribution rates, giving due consideration to risk sharing and cost/benefit ratios. Chairman Schaefer, Dr Grasmick, Dr Alemi, Major Krome, Colonel Mitchell, Messrs Lancaster, Harrison, and Ms Humphries, registered yea votes. Vice-Chairman Kopp and Mr Brown registered nay votes.

Investment Committee 5

Mr Lancaster, Vice-Chairman of the Investment Committee, reported on the meeting held on July 12, 2002. Mr Lancaster stated that he would report on the *Investment Committee* activities to the extent that discretion permitted, but noted that a portion of the information needed to be reported in closed session. Attachment B

Mr Lancaster reported that Ms Sarah Teslik, Executive Director of the Council of Institutional Investors delivered a presentation to the Committee. Ms Teslik discussed changes in the corporate world where fraud and mismanagement are more prevalent and more readily detected today than in the past. She focused on related causes and recommendations for corporate governance-orientated action recommendations for the System. Mr Lancaster reported that Ms Teslik said that even the most diligent investors cannot detect or prevent fraud in advance of its occurrence. She summarized by saying that shareholders should act more like owners of companies.

Mr Lancaster noted that during the presentation Ms Carmen Shepard, Deputy Attorney General, was present and recommended that the System retain a firm to provide independent advice on claims so that the System can make a sound decision as to whether it should be an active or a passive participant in class action suits.

Mr Lancaster informed the Board that red flag systems and other controls, which detect guidelines violations, were discussed.

Mr Lancaster noted that there was a need for updated proxy guidelines. Ms Humphries recommended that the Investment Operations Manual Sub-committee pursue this topic. A motion passed to assign review of the proxy policy to the Investment Operations Manual Sub-committee.

Mr Lancaster then reported that the Investment Committee passed a motion to authorize the elimination of high yield bonds from the System's internally managed investment grade bond portfolios and to create a policy which prevents holding high yield bonds in these portfolios past the date when they exit the high grade index as a result of a downgrade.

Mr Lancaster noted that a similar motion passed to eliminate high yield bonds from the Standish portfolios. This motion also included instructions to shift cash that has been raised in the Standish portfolios into Treasury securities, which match the duration of the Salomon BIG (Broad Investment Grade) benchmark for duration.

Mr Lancaster then noted that a motion passed to actively manage the Standish portfolios to the Salomon BIG Benchmark, since they have not been actively managed since February when this manager was terminated. This motion supercedes the portion of the preceding motion, which instructed staff to manage the Standish cash.

- Mr Lancaster informed the Board that the Committee was apprised of actions taken by New York, North Carolina and California to address conflicts of interest by adding provisions to their managers' guidelines and contracts.

Mr Lancaster reported that Ms Humphries discussed follow-up items related to investing \$100 million of the remaining proceeds from Chapman.

Mr Lancaster stated that a motion passed to direct staff to search for minority managers to invest \$100 million. This motion was contingent upon not having exclusionary provisions and not excluding consideration of separate accounts.

Mr Lancaster stated that the Committee agreed to schedule presentations with Greenbelt and Morgan Stanley for its August 2002 meeting.

On motion made by Mr Harrison and seconded by Dr Grasmuck, the Board voted unanimously to approve the recommendations of the Investment Committee.

The Board accepted Mr Lancaster's report.

Executive Director's Report 6

Ms Bury reported that there were 2,200 new retirees added to the System bringing the total number of retirees to 89,300. Ms Bury also stated that 84% of the retirees now have their allowances electronically deposited.

Ms Bury stated that July was the first month in which the payee social security numbers are no longer printed on the monthly benefit checks and advice notices. For security of the members and retirees, the Agency will no longer include the social security numbers on any check, letter, or annual benefit statement.

Major Krome inquired about Mr Vaughn's health, Ms Bury indicated that Ms Mulkey spoke with him last and reported that he was feeling better.

The Board accepted Ms Bury's report.

Mr Brown, Chairman of the Executive Committee reported on the regular meeting held July 9, 2002 Attachment C

Mr Brown reported to the Board that Administrative expenses and manager fees were reviewed and accepted

Mr Brown indicated to the Executive Committee that Agency expenses remain on target and that he anticipated ending the year slightly under budget. He noted that in June he had advised that the Agency had received notice that it was not subject to an additional budget cut and therefore, monies were available to meet Agency needs before the close of FY2002. Mr Harrison stated that the majority of these dollars were being used to meet anticipated postage needs and to cover contractual services associated with improvements to the Legacy System. With these expenditures, he anticipated ending the fiscal year about \$7,000 under budget.

Mr Brown reported that Ms Bury invited Mr Gene Kalwarski, Principal Actuary for Milliman USA to discuss the possibility that Milliman would seek to limit that firm's liability to its clients. This is an important issue since the Board must consider exercising a one-year extension of Milliman's current contract or initiate the 'Request for a Proposal' process. Ms Bury indicated that several large actuarial firms had attempted to place contractual liability limits on their public clients. Since Milliman, USA was finalizing their decision, the Executive Committee thought it important to ask Mr Kalwarski to address the Board on his firm's decision. The Board debated whether Mr Kalwarski's presentation necessitated discussion in closed session. The Board opted to remain in open session but deferred future action pending additional information from Mr Kalwarski.

Mr Brown noted that Kent County Government enrolled in the Employees' Contributory Pension System and the Law Enforcement Officers' Pension System effective July 1, 2002. As part of the requirements to participate, the County had obtained a private letter ruling from the Internal Revenue Service dealing with the transfer of assets from a defined contribution plan.

As part of that private letter ruling, the County asked for and received permission to participate in the State's Pick-Up Program. Ms Bury noted that the Retirement Agency found the approval to be in proper order, and recommended that the Executive Committee approve Kent County's participation.

The Executive Committee recommended to the Board of Trustees that it accept Kent County's request to participate in the State's Employer Pick-Up Program. On motion made by Mr Brown and seconded by Dr. Alemi, the Board voted unanimously to accept Kent County's request to participate in the State's Employer Pick-Up Program.

Mr Brown reported that Mr Howard Pleines had presented information concerning the request by Ms Sandra A Marron for a hearing Ms Marron asked to receive the Option 2 survivorship benefit amount quoted on the disability retirement estimate prepared for a September 1, 2001 retirement date rather than the amount she receives that is based upon her actual December 1, 2001 retirement date The Option 2 benefit estimate amount is \$14 41 more per month than the allowance she is receives Mr Vaughn recommended that her request for a hearing be rejected

Ms Margaret Bury noted that this is a very unusual occurrence Most disability retirees are not working and retire retroactively In Ms Marron's case, her service and salary were projected so that there is no difference in salary credit or service credit between the estimate and the final retirement calculation When she retired on December 1, her actual service increased, while her projected service decreased without changing total service credit used to calculate the allowance In both cases, the projected salary was current salary so there was also no change to the salary amount The change occurred in the applied actuarial factor that is based on Ms Marron's age at retirement Delaying retirement changed the actuarial factor resulting in a benefit allowance decrease Ms Bury noted that the Agency is paying the benefit to which Ms Marron is entitled under law To provide her with a greater benefit would violate pension law

The Executive Committee recommended to the Board of Trustees that it accept the Executive Director's recommendation and deny Ms Marron's request for a hearing On motion made by Mr Brown and seconded by Dr Alemi, the Board voted unanimously to accept the Executive Director's recommendation and deny Ms Marron's request for a hearing

Mr Brown indicated that the Committee considered 4 extraordinary salary increases Three of the increases were presented as information only, reflect increases less than \$25, which may be approved by the Executive Director These are salary increases for Joyce Angyal and Linda Vann whose employer condensed longevity steps after union negotiations, and Michael Rozalski whose increase resulted from an increase in hours worked as required by his employer The Board of Trustees has found these reasons acceptable on previous occasions

The fourth member, Susan Buhner, received a salary increase from Prince George's County Board of Education based on condensing longevity steps through union negotiations The resulting salary increased her allowance by \$41 04

The Executive Committee recommended to the Board of Trustees that it approve the extraordinary salary increase for Susan Buhner, which will increase her allowance \$41 04 per month On motion made by Mr Brown and seconded by Dr Grasmuck, the Board voted unanimously to approve the extraordinary salary increase for Susan Buhner

Mr Brown stated that the Strategic System update would be given by Mr Scribner during Executive Session

Mr Brown informed the Board that Ms Bury presented statistical information to the Executive Committee covering service retirees who have been re-employed by a participating employer Ms Bury noted that Major Krome had asked for details covering the 900 retirees for which the Agency identified as working for a participating employer Ms Bury also noted that each participating employer, including the State, is required to send the Retirement Agency payroll information on all employees who received earnings during a calendar year That information is matched against the retiree file The matched records are reviewed to determine if a benefit offset applies From the match, 748 of the 900 retirees were determined to be exempt from the earnings limitation These include teachers, principals, and health care practitioners who are exempt through June 2004 Also, retirees working for a different participating employer are now exempt from an earnings limitation Of the 900 individuals, only 152 retiree benefits will be reduced Ms Bury emphasized that these numbers do not reflect retirees who are re-employed but whose earnings did not exceed their earnings limitation, nor does it include those retirees who have been retired more than 10 years The current Legacy System programs only identify those retirees in the 10<sup>th</sup> year of retirement

Mr Brown noted that Major Krome asked Ms Bury for this detailed analysis as a means to demonstrate the fallacies of the re-employment restrictions in pension law Major Krome stated that the numbers indicate 15% of retirees are subject to the restrictions, with 85% being granted an exemption Major Krome agreed that for all the effort that goes into monitoring re-employment, he believes the Board would be justified in seeking a total repeal of the earnings limitation

Mr Brown informed the Board that the Executive Committee concurred with Major Krome and asked staff to continue to develop information on re-employment The report will be presented to the Joint Committee on Pensions

The Board accepted Mr Brown's report

Committee and 8  
Sub-Committee Reports  
and Recommendations

Vice-Chairman Kopp, Chairman of the Ad-Hoc Communications Committee noted that the Board received a packet of recent press clippings, published after the previous Board meeting Vice-Chairman Kopp stated that the primary purpose of this Committee is to improve relations with the press Chairman Schaefer commented that the report on WorldCom was excellent

Ms Humphries, Chairman of the Investment Operations Manual Sub-committee reported that Mr Lancaster covered most of the information in his report Ms Humphries noted that the Sub-committee would meet within the week for the final review of asset allocation process

Ms Humphries reported that there would be updates on the Minority Brokerage Sub-committee and the Minority Participation Policy Sub-committee at the next Board meeting

Special Option 7  
Allowance

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On motion made by Major Krome and seconded by Dr Alemi, the Board unanimously approved the selection of Special Option 7 in the case of William May This selection is consistent with the Board's policy and is actuarially sound Attachment D

Earnings  
Limitation

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The report of the Agency for offsets of certain retirees was accepted by the Board On motion made by Colonel Mitchell and seconded by Mr Brown, the Board authorized the reduction of the pensions of affected retirees as provided for under the State Personnel and Pensions Article Sections 22-406 (b) (2) and 23-407 (b)(2)] The pension offsets are based on calendar 2001 earnings that will be offset from pension benefits paid in fiscal year 2003 Attachment E

Disability Offset

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The Board accepted the reports of the Medical Board for offsets of disability retirees On motion made by Dr Alemi and seconded by Major Krome, the Board authorized the reduction of the pensions of affected retirees as provided for under the State Personnel and Pensions Article The offsets are based on calendar 2001 earnings that will be offset from pension benefits paid in fiscal year 2003 Attachment E

Medical Board

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On motion made by Mr Harrison and seconded by Dr Alemi, the Board voted unanimously to accept and approve the reports of the Medical Board in connection with applications of members for ordinary and accidental retirement allowances The Medical Board's conclusions were reached after its review of the evidence provided by the claimants Attachment G

Supplemental  
Board Reports

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The Board, on motion made by Dr Alemi and seconded by Dr Grasmick voted unanimously to accept and approve the Supplemental report of the Medical Board in connection with applications of members for ordinary and accidental retirement allowances The Medical Board's conclusions were reached after its review of the evidence provided by the claimants

Attachment H

On motion made by Vice-Chairman Kopp and seconded by Mr Brown, the Board voted unanimously to meet in Executive Session to consider the following matters deliberations regarding the disability appeals, advice and discussion with staff and counsel State Govt Article, Section 10-503(a)(1) authorizes the Board to meet in closed session to exercise a quasi-judicial function Section 10-508(a)(7) authorizes the Board to meet in closed session to obtain legal advice, and Section 10-508(a)(8) authorizes the Board to meet in closed session to consult with staff or other individuals about pending or potential litigation

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EXECUTIVE SESSION

The Board met in Executive Session at 11 05 a m in the Boardroom of the SunTrust Building at 120 East Baltimore Street to consider the appeals of Darrel Bailey, to receive advice of counsel, and discuss the investment of public funds. All of the persons present at the beginning of the meeting were present in Executive Session except the following Ronald Ruffo, Carla Katzenberg, and Paul Schlitz, attorney for Darrel Bailey. The Board adjourned its Executive Session at 1 05 p m and returned to regular session to complete the agenda.

On motion made by Major Krome and seconded by Dr Alemi, the Board voted unanimously to ratify actions taken in Executive Session.

Darrel Bailey

Chairman Schaefer made a motion to reject the Administrative Law Judge's Proposed Findings and grant Mr Bailey accidental disability benefits, there being no second, the motion failed.

On motion made by Ms Humphries and seconded by Dr Grasmick, the Board voted to accept the Administrative Law Judge's Proposed Findings and deny Mr Bailey accidental disability benefits with a vote of 8 yeas, 2 nays, and 1 abstention. Vice-Chairman Kopp, Dr Grasmick, Major Krome, Colonel Mitchell, Messrs Lancaster, Harrison, Brown, and Ms Humphries, registered yea votes. Chairman Schaefer and Dr Alemi registered nay votes. Secretary Foster abstained.

Other Business 14

Adjournment 15 There being no further business, the meeting adjourned at 1 10 pm

*Margaret A Bury*  
Margaret A Bury  
Acting Secretary to the Board