



December 15, 2015

**MARYLAND
STATE RETIREMENT
and PENSION SYSTEM**

STATE RETIREMENT AGENCY
120 East Baltimore Street
Baltimore, MD 21202
Tel: 410-625-5555
1-800-492-5909
TDD/TTY 410-625-5535
sra.maryland.gov

BOARD OF TRUSTEES
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R. Dean Kenderdine
Executive Director
Secretary To The Board

Dear Members, Retirees and Beneficiaries:

On behalf of the Board of Trustees, we are pleased to present the Comprehensive Annual Financial Report of the Maryland State Retirement and Pension System for the fiscal year ended June 30, 2015. This report provides information on the financial status of the retirement system during a period when the system issued, on average, approximately \$277 million in monthly payments to nearly 148,000 retirees and beneficiaries.

The board's fundamental mission is to ensure that retirement benefits are paid in full, and in an accurate and timely manner. The board oversees the investment of the Maryland State Retirement and Pension System assets in order to help ensure the funding necessary to meet those obligations.

The pension fund realized modest gains in fiscal 2015, earning 2.68 percent for the year and beating the policy benchmark of 0.88 percent by 1.80 percentage points, but falling short of the 7.65 percent actuarial target. The policy benchmark represents what the fund would have earned had it been indexed, or passively managed.

Investment returns moderated over fiscal year 2015 relative to recent years, particularly in foreign equities, as the strong dollar and concerns relating to global growth and the Greek debt situation weighed on performance. While absolute performance did not meet the actuarial target for the fiscal year, we are very pleased with the performance of our active management program, which continues to add significant value over the overall plan benchmark. For the fiscal year, active management added roughly \$800 million in excess of the benchmark.

While earnings for this one year fell short of our expected rate of return, the board continues to focus on long-term performance. Over the last five years our average return has been 9.36 percent. Although this has been a challenging year for most institutional investors, the long term positive returns confirm the appropriateness of the Board's decision, some time ago, to more broadly diversify its portfolio to reduce the volatility of annual returns.

The capital markets are always going to experience volatility, which will result in good years and bad years. Being a long-term investor allows the system to weather the short-term volatility for long-term returns. Over the last 25 years—a period that has included multiple economic cycles—the system has earned an average return of 7.51%.

Your retirement system remains administratively and financially sound. As a participant in the system, you can remain confident that your pension benefits are secure. As always, your commitment to and involvement in the concerns of the system are greatly appreciated. We value your input—this is your system. If you have any questions, please do not hesitate to contact us.

Sincerely,

NANCY K. KOPP
Chairman

PETER FRANCHOT
Vice Chairman



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LETTER OF TRANSMITTAL

December 15, 2015

Honorable Chairman and Members of the Board of Trustees:

We are pleased to submit the Comprehensive Annual Financial Report for the Maryland State Retirement and Pension System for the fiscal year ended June 30, 2015. We believe this report fairly presents the operating results achieved during this 12-month reporting period.

The System is responsible for properly administering retirement, disability, and death benefits. At the same time, it strives to keep employer contribution rates as reasonable as possible by maximizing investment returns while maintaining an acceptable level of risk. Members covered by the plans include state employees, teachers, law enforcement officers, legislators, judges, as well as local government employees and correctional personnel whose employers have elected to participate in the System.

The System currently provides monthly allowances to about 148,000 retirees and beneficiaries, and is an essential element of the future financial security for more than 193,000 active participating members. Descriptions of the membership requirements and benefits provided by each plan administered by the System are included in the Plan Summary Section starting on page 116.

This Comprehensive Annual Financial Report contains six sections. The Introductory Section provides information about the administrative structure of the System. The Financial Section provides a comprehensive review of the System's financial position, the results of its operations and its funded status. It also contains the report from the System's independent auditor, the combined financial statements and supplementary financial data. The Investment Section includes a report highlighting the System's investment performance in addition to various summary level portfolio compositions and other investment data. The Actuarial Section contains the independent actuary's report on the results of the System's annual actuarial valuation. The Statistical and Plan Summary Sections provide demographic composition of the System's membership segments affected by each plan and detailed descriptions of the various plans' provisions. In addition to this Letter of Transmittal, additional narrative, overview, and analysis can be found in Management's Discussion and Analysis beginning on page 18.

INVESTMENTS

The System's investment portfolio returned 2.68 percent in fiscal year 2015, exceeding the plan's policy benchmark of 0.88 percent by 180 basis points, but falling short of the 7.65 percent actuarial return target. The plan policy benchmark is a point of reference that compares the System's total investment performance against the weighted average of the benchmark performance of each of the System's underlying asset classes.

Investment returns moderated over fiscal year 2015 relative to recent years, particularly in foreign equities, as the strong dollar, concerns relating to global growth and the Greek debt situation weighed on performance. While absolute performance did not meet the actuarial target for the fiscal year, the performance of the system's active management program continues to add significant value over the overall plan benchmark.

After the payment of benefits, the market value of assets increased by approximately \$450 million from \$45.3 billion on June 30, 2014 to \$45.8 billion on June 30, 2015.

The System's target asset allocation is comprised of 35 percent public equities, 10 percent fixed income, 10 percent private equities, 10 percent credit/debt strategies, 10 percent real estate, 14 percent real return, 10 percent absolute return and 1 percent cash. The System's portfolio is balanced across several asset and sub-asset classes and is globally diversified. This, coupled with a long term investment horizon, allows the System to weather short term market volatility.

MAJOR ISSUES

The General Assembly passed legislation during the 2015 session that repeals the corridor funding method beginning in fiscal 2017 and returns the System to the preferred actuarial funding method, seven years earlier than under the ten year phase out that was enacted during the 2013 session.

Under the corridor funding method, contribution rates were fixed from year to year as long as the funded status for each of these systems remained in a “corridor” of 90% to 110%. When it was adopted in 2002, both systems were within the corridor, but within three years, the employees’ plan dropped out of the corridor and the teachers’ plan followed in 2006.

Since its enactment, the corridor funding method has resulted in annual reductions of between \$100 million and \$200 million in the state’s employer contributions, and thus contributed to the declining funded ratio for Maryland State Retirement and Pension System because it creates deliberate short-term underfunding of the system’s liabilities. The Board of Trustees has been on record in opposition to this methodology since its implementation.

Under the Budget and Reconciliation and Financing Act (BRFA) of 2015, the state will also continue the ongoing supplemental contribution of reinvested savings begun in 2011, but limit it to \$75 million annually until the fund is 85 percent funded. The BRFA also requires that beginning in fiscal 2017, one-half of the unappropriated general fund balance in excess of \$10 million be paid to the pension fund. Under this scenario, payments are capped at \$50 million annually through fiscal 2020 at which time this provision will terminate.

FINANCIAL INFORMATION

System management has committed the resources necessary to maintain an internal control structure that provides reasonable assurance that assets are adequately safeguarded, financial records are consistently and accurately maintained, and transactions are properly executed to permit preparation of financial statements in accordance with generally accepted accounting principles. The System’s internal control structure includes written policies and procedures and an internal audit division that reports to the Board.

ACCOUNTING SYSTEM AND REPORTS

The System reports its transactions on the accrual basis of accounting. Under this method, revenues are reported in the accounting period they are earned and become measurable, and expenses are reported when the related liability is incurred and measurable. Investments are reported at fair value at fiscal year-end. Investment purchases and sales are reported in the accounting period in which the related trade dates occur.

REVENUES

The reserves necessary to finance retirement allowances and other benefits are accumulated through investment earnings and the collection of employer and member contributions. During fiscal year 2015, investment earnings were \$1.19 billion, while revenues from employer and member contributions were \$1.86 billion and \$755.4 million, respectively. For fiscal year 2015, member contribution rates on average were 7 percent, while employer rates varied depending on the System.

EXPENSES

The System’s expenses consist of monthly retirement allowances, refunds of contributions to terminated and transferring members, withdrawing employers, and the administrative cost of System operations. Payments to retirees, beneficiaries and transferring or withdrawing members and employers continued to be the System’s primary disbursements during FY 2015, totaling \$3.3 billion. In addition, the System disbursed \$377.0 million to manage the investment portfolio and to administer the System, of which \$348.9 million was paid for investment management, portfolio custody, and securities lending services and \$29.1 million used to fund the System’s administrative operations.

FUNDING

Funds are derived from the excess of additions, which include contributions and investment earnings, over deductions, which are comprised of benefits and administrative expenses. Funds are accumulated to meet future benefit obligations to retirees and beneficiaries. This accumulated balance is referred to as the “net position held in trust for pension benefits” in the Statement of Plan Net Position in the Financial Section of this report. The actuarial accrued liability is not disclosed in the basic financial statement but is disclosed in Other Supplementary Information (OSI) to the basic financial statements. The funded status schedule presented in OSI shows the actuarial value of assets, which is based on a five-year smoothed expected rate of return, wherein the excess or shortfall of investment income over or under the actuarial assumed income of 7.65 (for FY15) percent is recognized over a five-year period. This is the value of assets used by the actuary in determining contribution rates for the Systems as disclosed in note five to the basic financial statements.

For funding purposes, the actuarial accrued liability of the Systems is also determined by the actuary. It is a measure of the present value of actuarial accrued liabilities estimated to be payable in the future to current retirees, beneficiaries and employees for service earned to date. The percentage computed by dividing the actuarial value of net assets available for benefits by the actuarial accrued liability is generally referred to as the “funded ratio.” This ratio provides an indication of the funded status of the System on a going-concern basis and generally, the greater this percentage, the stronger the System. The System’s funded ratio increased from 68.67 percent at June 30, 2014 to 69.66 percent at June 30, 2015.

At June 30, 2015, the System's actuarial accrued liability was \$66.2 billion and the unfunded actuarial accrued liability totaled \$20.1 billion, resulting in a funded status ratio of 69.6 percent. The unfunded actuarial accrued liability is being amortized over a closed 25-year period.

PROFESSIONAL SERVICES

The System contracts for the services of various independent consulting, investment advisory and financial professionals to assist the Board of Trustees in carrying out its fiduciary responsibility to efficiently and effectively manage the System. Actuarial services were provided by Gabriel Roeder Smith & Company and independent financial statement audit services were provided by SB & Company, LLC. The System's asset custody and portfolio accounting services were provided by the State Street Bank & Trust Company under a multi-year, master custody arrangement. Meketa Investment Group, Inc. served as the System's general investment consultant. Specialty consulting services were provided by Altius Associates Limited and Pension Consulting Alliance, Inc. for private equity and real estate, respectively. Albourne America LLC advises staff on the retirement System's Absolute Return portfolio and Barra and Factset provides risk consulting services. A complete listing of the System's professional consultants and external investment advisors is presented on page 11.

AWARDS

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Maryland State Retirement and Pension System for its Comprehensive Annual Financial Report for the fiscal year ended June 30, 2014. This was the twenty-sixth consecutive year (1989 through 2014) that it has received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Additionally, the Maryland State Retirement and Pension System received the Public Pension Coordinating Council's (PPCC) 2015 Recognition Award for Administration, in recognition of meeting professional standards for plan administration as set forth in the Public Pension Standards.

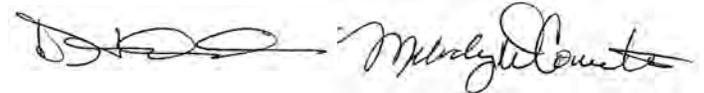
The PPCC is a coalition of associations that represent public pension funds that cover the vast majority of public employees in the U.S., including the National Association of State Retirement Administrators (NASRA), the National Council on Teacher

Retirement (NCTR), and the National Conference on Public Employee Retirement Systems (NCPERS).

The Public Pension Standards are intended to reflect expectations for public retirement Systems management and administration, and serve as a benchmark by which all defined benefit public plans should be measured. The Maryland State Retirement and Pension System is proud to be a recipient of this award.

ACKNOWLEDGMENTS

This annual report reflects the dedicated efforts of the System's staff under the steady direction of the Board of Trustees. We extend our sincere gratitude to each member of the Board, the System's staff, the Board's advisors and the many people who worked with diligence and dedication throughout fiscal year 2015. Special thanks to the members of the Maryland State Retirement Agency's senior executive team and agency staff of professionals and para-professionals who helped to gather and prepare the information for this report.



R. Dean Kenderdine
Executive Director
Secretary to the Board

Melody Countess, CPA
Chief Operating Officer

BOARD OF TRUSTEES



NANCY K. KOPP, *Chairman*
State Treasurer
Ex Officio since February 14, 2002
Member, Administrative Committee
Member, Corporate Governance Committee
Member, Investment Committee



PETER FRANCHOT, *Vice Chairman*
State Comptroller
Ex Officio since January 22, 2007
Member, Investment Committee



DAVID S. BLITZSTEIN
April 3, 2008 – July 31, 2016
Chairman, Corporate Governance Committee
Member, Investment Committee



DAVID R. BRINKLEY
Ex Officio since January 21, 2015
Member, Administrative Committee
Member, Corporate Governance Committee
Member, Investment Committee



JAMES A. BUSH, JR.
August 1, 2013 - July 31, 2017
Member, Audit Committee
Member, Investment Committee



ROBERT R. HAGANS, JR.
November 15, 2011 – Present
Member, Audit Committee
Member, Investment Committee



KENNETH B. HAINES
January 1, 2012 – July 31, 2017
Member, Administrative Committee
Member, Audit Committee
Member, Investment Committee



JAMES M. HARKINS
October 1, 2004 - Present
Chairman, Administrative Committee
Member, Corporate Governance Committee
Member, Investment Committee

BOARD OF TRUSTEES



LINDA A. HERMAN
August 1, 2013 - July 31, 2017
Member, Audit Committee
Member, Investment Committee



SHEILA HILL
August 1, 2015 – July 31, 2019
Member, Administrative Committee
Member, Audit Committee
Member, Investment Committee



F. PATRICK HUGHES
April 20, 2004 – June 30, 2017
Chairman, Audit Committee
Vice Chairman, Investment Committee
Member, Securities Litigation Committee



THERESA LOCHTE
August 1, 2007 – July 31, 2019
Vice Chairman, Administrative Committee
Member, Corporate Governance Committee
Member, Investment Committee



RICHARD E. NORMAN
August 1, 2014 – July 31, 2018
Member, Administrative Committee
Member, Audit Committee
Member, Investment Committee



HAROLD ZIRKIN
September 10, 2007 - Present
Chairman, Investment Committee
Vice Chairman, Securities Litigation Committee
Member, Corporate Governance Committee



THURMAN W. ZOLLIFFER, JR.
September 12, 2007 - Present
Chairman, Securities Litigation Committee
Vice Chairman, Corporate Governance Committee
Member, Investment Committee

ADVISORS TO THE INVESTMENT COMMITTEE



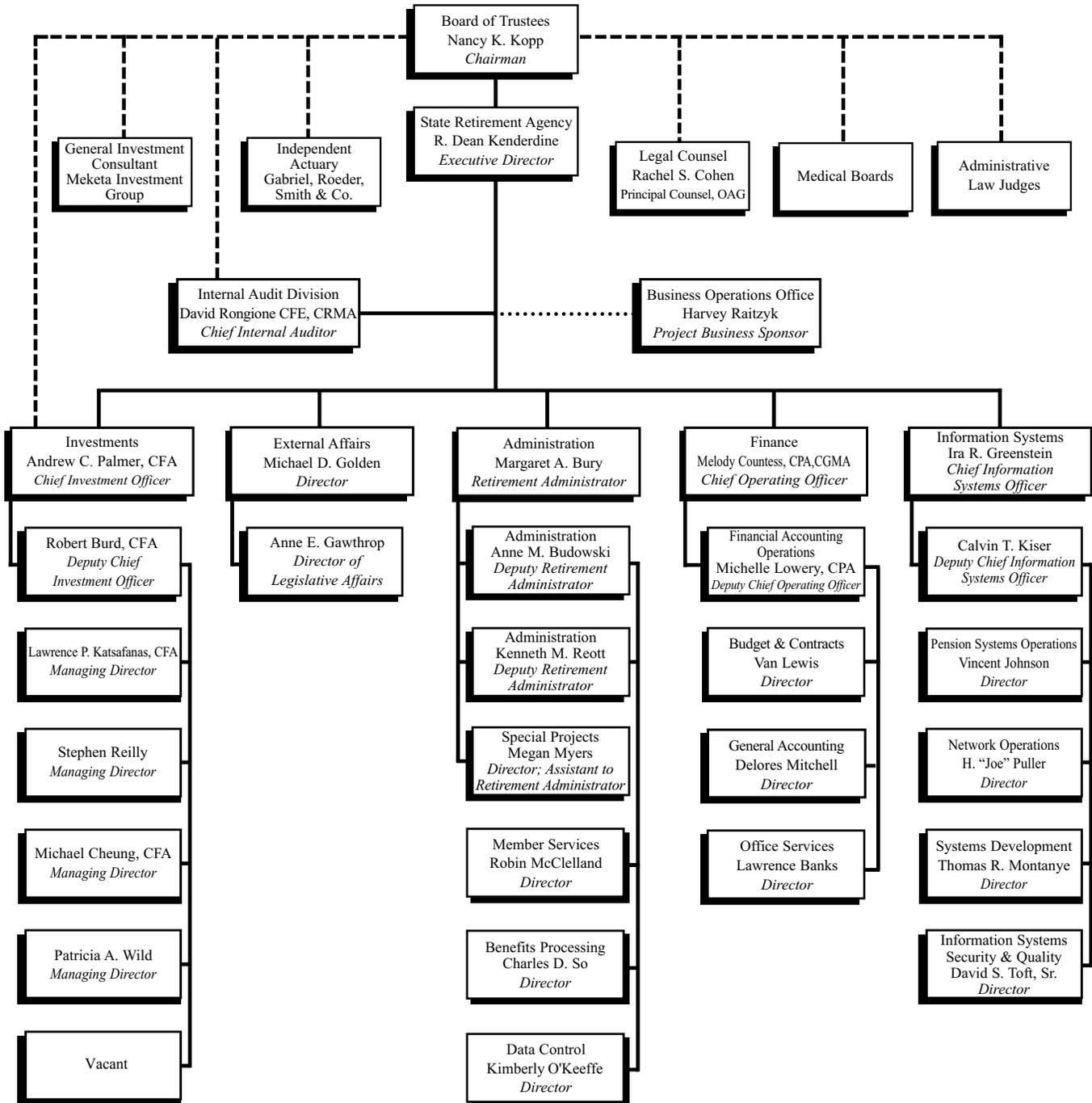
LARRY E. JENNINGS, JR.



STEFAN A. STREIN



BRIAN B. TOPPING



*Additional information regarding investment professionals who provide services to the System can be found on pages 11, and 69-73.

PROFESSIONAL SERVICES

Global Custodial Bank & Security Lending

State Street Bank and Trust Company
Boston, Massachusetts

Hearing Officers

Office of Administrative Hearings
Baltimore, Maryland

Independent Actuary

Gabriel Roeder Smith & Company
Southfield, Michigan

Independent Public Accountant

SB & Company, LLC
Hunt Valley, Maryland

Independent Investment Consultants

Altius Associates Limited
Richmond, Virginia

Meketa Investment Group, Inc.
Westwood, Massachusetts

Pension Consulting Alliance
Encino, California

Albourne America, LLC
San Francisco, California

Medical Board

Dr. Elizabeth Adegboyega-Panox
Dr. Eroll L. Bennett
Dr. Robin A. Conwit
Dr. Vinu Ganti
Dr. Arthur Hildreth
Dr. Bruce Kohn
Dr. Archana Goel Leon-Guerrero
Dr. Christian E. Jensen
Dr. John Parkerson
Dr. William B. Russell
D. William Smulyan
Dr. Zia Zakai

Operational Banking Services

M & T Bank
Baltimore, Maryland

The Harbor Bank of Maryland
Baltimore, Maryland



Government Finance Officers Association

**Certificate of
Achievement
for Excellence
in Financial
Reporting**

Presented to

**Maryland State Retirement
and Pension System**

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

June 30, 2014

Executive Director/CEO



Public Pension Coordinating Council

***Recognition Award for Administration
2015***

Presented to

Maryland State Retirement and Pension System

In recognition of meeting professional standards for
plan administration as
set forth in the Public Pension Standards.

Presented by the Public Pension Coordinating Council, a confederation of

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

A handwritten signature in cursive script, reading 'Alan H. Winkle', is centered on the page.

Alan H. Winkle
Program Administrator



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