



**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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Chairman

Peter Franchot
Vice Chairman

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R. Dean Kenderdine
Executive Director
Secretary To The Board

Introduction

December 15, 2018

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, 2018. This report provides information on the financial status of the Retirement System during a period when the System issued approximately \$316 million in average monthly payments to more than 160,000 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 ensure the funding necessary to meet those obligations.

The System's portfolio returned 8.06 percent on investments for the fiscal year 2018—exceeding the plan's 7.50 percent assumed actuarial return rate and the policy benchmark of 7.59 percent. As a result, the fund's performance raised the assets of the System to \$51.8 billion, an increase of \$2.8 billion over the previous fiscal year.

Despite rising interest rates in the United States and trade tensions surfacing late in the year, strong economic and corporate earnings growth in the United States provided an environment that propelled all of the System's major asset classes to positive returns.

While investment returns have been strong over the past two years, the Board anticipates, and history has shown, that returns will vary from year to year. Recognizing the long-term nature of the benefit payments due participants, the Board has adopted investment policies designed to minimize the downside impact of such volatility on the value of System assets, while still capturing significant value when markets are strong.

Reforms enacted by the Maryland General Assembly in 2011 and in subsequent years continue to show positive results for the System and, in fact, continue to exceed earlier projections. Required employer contributions for the coming fiscal year are projected to be 17.71% of payroll, significantly lower than the 19.06% predicted at the time of the 2011 reforms. As of June 30, 2018, the System's funded ratio is 72.5%, higher than the 69.9% predicted at the same time. The System is on track to be 80% funded by 2026; 85% funded by 2030; and 100% funded by 2039.

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, 2018

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, 2018. 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 more than 160,000 retirees and beneficiaries, and is an essential element of the future financial security for more than 192,000 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 132.

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 experienced a dollar-weighted return of 8.08 percent on investments for the fiscal year 2018—exceeding the 7.50 percent assumed actuarial return rate and the plan's policy benchmark of 7.59 percent. After the payment of benefits, the market value of assets increased by roughly \$2.8 billion from \$49.1 billion on June 30, 2017 to \$51.8 billion on June 30, 2018.

The System's long-term target asset allocation is comprised of 37 percent public equities, 19 percent rate sensitive assets, 13 percent private equities, 9 percent credit/debt strategies, 14 percent real return, and 8 percent absolute return. 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, provides the System with greater protection during short-term market volatility.

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 2018, investment earnings were \$3.9 billion, while revenues from employer and member contributions were \$1.948 billion and \$791.0 million, respectively. For fiscal year 2018, 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 2018, totaling \$3.8 billion. In addition, the System disbursed \$432.4 million to manage the investment portfolio and to administer the System, of which \$399.2 million was paid for investment management, portfolio custody, and securities lending services and \$33.2 million was 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 assets held in trust for pension benefits" in the Statement of Fiduciary Net Position Restricted for Pension in the Financial Section of this report. The actuarial accrued liability is not disclosed in the basic financial statement but is disclosed in note nine to the basic financial statements. The funded status schedule presented in note nine 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 7.50 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.

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 71.8 percent at June 30, 2017 to 72.5 percent at June 30, 2018.

At June 30, 2018, the System's actuarial accrued assets and liabilities were \$52.6 billion and \$72.6 billion, respectively. The unfunded actuarial accrued liability totaled \$20.0 billion, resulting in a funded status ratio of 72.5 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 GRS Retirement Consulting 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 Pavilion Alternatives Group, LLC for private equity and Townsend Holdings, LLC for real estate. Albourne America, LLC advises staff on the retirement System's Absolute Return portfolio. A complete listing of the System's professional service providers 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, 2017. This was the twenty-ninth consecutive year (1989 through 2017) 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.

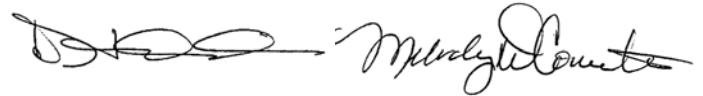
Additionally, the Maryland State Retirement and Pension System received the Public Pension Coordinating Council's (PPCC) 2018 Recognition Award for meeting professional standards for plan funding and administration, as set forth in the Public Pension Standards.

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 2018. Special thanks go to the members of the Maryland State Retirement Agency's senior executive team and the agency's staff of professional 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, CGMA
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 R. BRINKLEY
Ex Officio since January 21, 2015
Member, Administrative Committee
Member, Corporate Governance Committee
Member, Investment Committee



ERIC D. BROTMAN
January 19, 2016 - June 30, 2019
Member, Investment Committee



JAMAAL R. A. CRADDOCK
June 19, 2018 - July 31, 2021
Member, Investment Committee



DAVID B. HAMILTON
August 5, 2016 - July 31, 2020
Chairman, Securities Litigation Committee
Member, Audit Committee
Member, Investment Committee



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



LINDA A. HERMAN
August 1, 2013 - Present
Vice Chairman, Investment Committee

BOARD OF TRUSTEES



SHEILA HILL
August 1, 2015 – July 31, 2019
Chairman, Corporate Governance Committee
Member, Administrative Committee
Member, Investment Committee



F. PATRICK HUGHES
April 20, 2004 – June 30, 2021
Chairman, Investment Committee
Member, Audit Committee
Member, Securities Litigation Committee



CHARLES W. JOHNSON
January 14, 2016 – July 31, 2019
Vice Chairman, Securities Litigation Committee
Member, Corporate Governance Committee
Member, Investment Committee



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



RICHARD E. NORMAN
August 1, 2014 – July 31, 2022
Vice Chairman, Audit Committee
Member, Administrative Committee
Member, Investment Committee



DOUGLAS PROUTY
August 1, 2017 – July 31, 2021
Member, Investment Committee



MICHAEL J. STAFFORD, JR.
October 26, 2017 – July 31, 2019
Member, Investment Committee

ADVISORS TO THE INVESTMENT COMMITTEE



MICHAEL K. BARRY



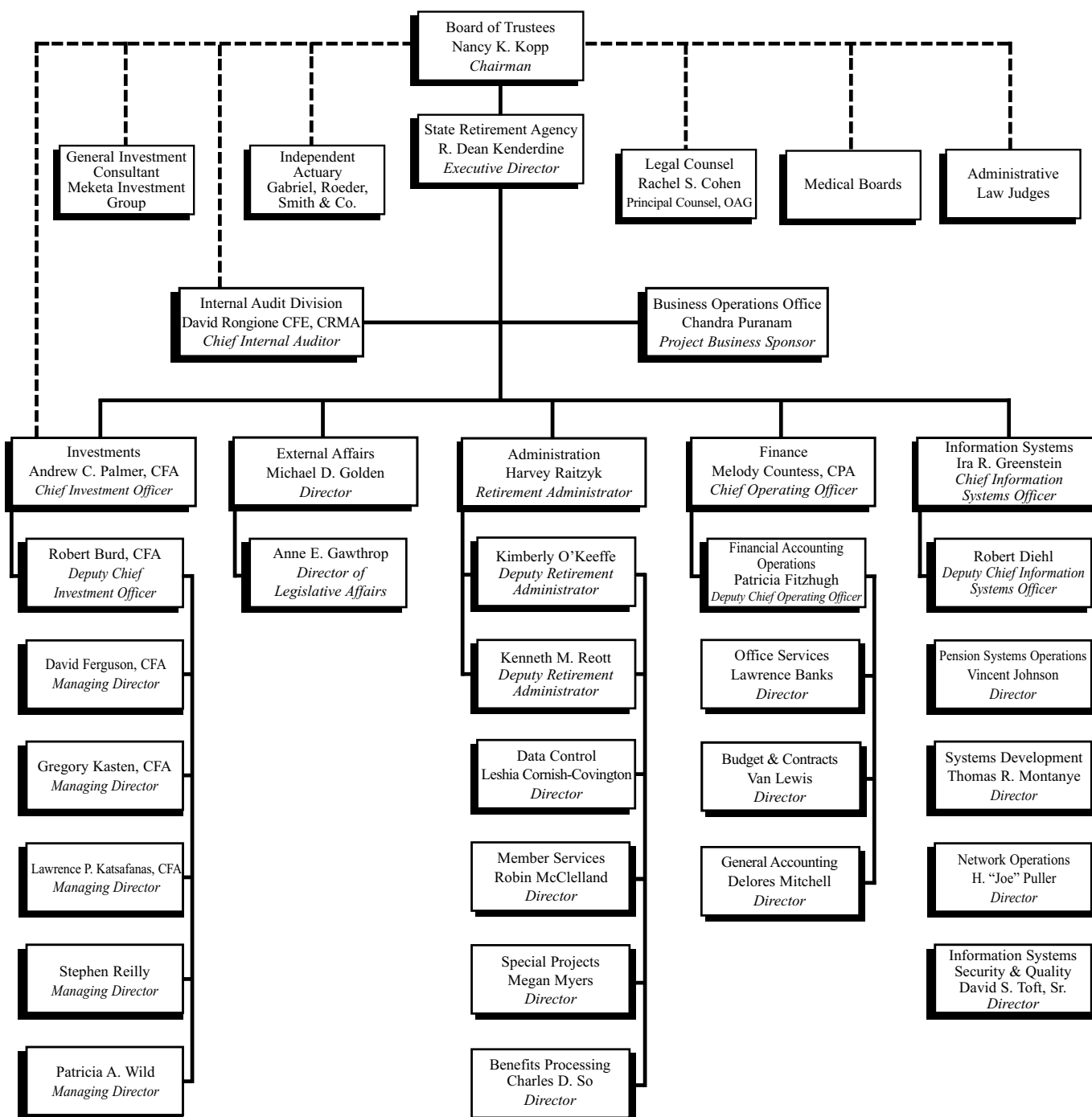
STEPHEN M. KITSOULIS



MONTE TARBOX

ORGANIZATIONAL CHART

(November 2018)



*Additional information regarding investment professionals who provide services to the System can be found on pages 11, and 83-87.

PROFESSIONAL SERVICES

Global Custodial Bank and Security Lending

State Street Bank & Trust Company
Boston, Massachusetts

Hearing Officers

Office of Administrative Hearings
Baltimore, Maryland

Independent Actuary

GRS Retirement Consulting
Southfield, Michigan

Independent Public Accountant

SB & Company, LLC
Hunt Valley, Maryland

Independent Investment Consultants

Pavilion Alternatives Group, LLC
El Dorado Hills, California

Meketa Investment Group, Inc.
Westwood, Massachusetts

Townsend Holdings, LLC
Cleveland, Ohio

Aksia, LLC
New York, New York

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, 2017

Christopher P. Morrell

Executive Director/CEO



Public Pension Coordinating Council

***Public Pension Standards Award
For Funding and Administration
2018***

Presented to

Maryland State Retirement and Pension System

In recognition of meeting professional standards for
plan funding and 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 black ink, reading 'Alan H. Winkle'. The signature is fluid and cursive, with the first name 'Alan' and last name 'Winkle' clearly visible.

Alan H. Winkle
Program Administrator



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