

MEMORANDUM

April 18, 2013

TO: Government Operations and Fiscal Policy Committee

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Office of Legislative Oversight

SUBJECT: FY14 County Government Retirement Plans /Consolidated Retiree Health Benefits Trust -
Administrative and Operating Expenses

The purpose of this discussion is to review the administrative and operating expenses of three County Government retirement plans: the Employees' Retirement System, the Retirement Savings Plan, the Deferred Compensation Plan, and the Consolidated Retiree Health Benefits Trust.

A staff recommendation regarding these expenses will appear in Staff Director Farber's memorandum for the April 25 GO Committee meeting on agency compensation issues.

Background

The County manages three programs that offer retirement benefits as well as an additional program that provides retiree health benefits. Last year, the Chief Administrative Officer (who serves as the Administrator for County Government retirement plans) approved the consolidation of all retirement related functions into one organization, Montgomery County Employee Retirement Plans (MCERP). The MCERP is responsible for retirement plan investments, administration, and accounting functions. The cost of administering retirement and retiree health programs is included in the MCERP budget.

Employees' Retirement System

The Employees' Retirement System (ERS) is a defined benefit (pension) plan for eligible County Government employees. Uniformed public safety employees, as well as general government employees hired before October 1, 1994, participate in the ERS. The ERS also serves general government employees hired starting October 1, 1994 who have elected to participate in the Guaranteed Retirement Income Plan (GRIP).

The Board of Investment Trustees (BIT) invests and manages ERS assets. As stated in the BIT Annual Report, "the Board works to control the risk to which the ERS is exposed while maximizing the potential for long term increases in the value of the assets."¹

¹ Board of Investment Trustees, Montgomery County Employee Retirement Plans Annual Report: Fiscal Year ending June 30, 2012, page 6.

The table below shows FY13 approved and FY14 recommended ERS administrative and operating expenses.

Employees' Retirement System Administrative and Operating Expenses

	FY13 Approved	FY14 Recommended	\$ Amount Change FY13 to FY14	Percent Change FY13 to FY14
Investment Management	\$21,200,000	\$23,000,000	\$1,800,000	8.5%
Salaries and Benefits	\$1,654,200	\$1,582,700	-\$71,500	-4.3%
Professional Services	\$813,933	\$895,900	\$81,967	10.1%
Benefit Processing	\$375,000	\$130,000	-\$245,000	-65.3%
Office Management	\$240,887	\$99,300	-\$141,587	-58.8%
Due Diligence/Education	\$55,500	\$64,700	\$9,200	16.6%
TOTAL	\$24,339,520	\$25,772,600	\$1,433,080	5.9%

The investment management costs shown above represent the fees paid based on the investment performance of assets held in the ERS trust fund. As assets grow from contributions and investment earnings, fees increase. The \$1.8 million increase in ERS investment management costs from FY13 to FY14 is a direct result of the projected increase in trust fund assets.

Retirement Savings Plan

The Retirement Savings Plan (RSP) is a defined contribution plan providing benefits to non-public safety employees, and certain public safety employees, hired after 1994. The County Government contributes a defined percent of salary into RSP participants' retirement savings accounts. Employees also contribute to their RSP account and self-manage investment choices. As stated in the BIT Annual Report, "the Board oversees the [RSP] investment program, providing a variety of investment options for participants to choose from."² BIT also provides investment education sessions for RSP participants. The table below shows FY13 approved and FY14 recommended RSP administrative and operating expenses.

Retirement Savings Plan Administrative and Operating Expenses

	FY13 Approved	FY14 Recommended	\$ Amount Change FY13 to FY14	Percent Change FY13 to FY14
Investment Management	\$9,000	\$9,000	\$0	0.0%
Salaries and Benefits	\$205,460	\$157,400	-\$48,060	-23.4%
Professional Services	\$89,500	\$89,200	-\$300	-0.3%
Office Management	\$23,430	\$6,700	-\$16,730	-71.4%
Due Diligence/Education	\$2,000	\$2,000	\$0	0.0%
TOTAL	\$329,390	\$264,300	-\$65,090	-19.8%

² Ibid, page 8.

Deferred Compensation Plan

County Government employees, if eligible, may elect to participate in the Deferred Compensation Plan (DCP) created pursuant to Section 457 of the Internal Revenue Code. The DCP is a voluntary deferred compensation plan that allows employees to make tax-deferred contributions into a retirement savings account. Employees self-manage DCP investment choices. BIT contracts with a record keeper who administers the mutual and commingled fund options selected by the Board and offered to DCP participants. The table below shows FY13 approved and FY14 recommended DCP administrative and operating expenses.

Deferred Compensation Plan Administrative and Operating Expenses

	FY13 Approved	FY14 Recommended	\$ Amount Change FY13 to FY14	Percent Change FY13 to FY14
Investment Management	\$9,000	\$9,000	\$0	0.0%
Salaries and Benefits	\$91,873	\$125,700	\$33,827	36.8%
Professional Services	\$5,500	\$5,000	-\$500	-9.1%
Office Management	\$5,310	\$6,700	\$1,390	26.2%
Due Diligence/Education	\$1,000	\$1,000	\$0	0.0%
TOTAL	\$112,683	\$147,400	\$34,717	30.8%

Consolidated Retiree Health Benefits Trust Fund

The County has established a Trust Fund to set aside funds for retiree health benefits, similar to the County's practice of prefunding for retiree pension benefits. The Office of Human Resources is responsible for the administration of the Trust Fund and the Board of Investment Trustees is responsible for investing the trust fund assets with the goal of managing risk exposure while maximizing asset growth. The table below shows FY13 approved and FY14 recommended retiree health benefits trust fund administrative and operating expenses.

Retiree Health Benefits Trust Fund Administrative and Operating Expenses

	FY13 Approved	FY14 Recommended	\$ Amount Change FY13 to FY14	Percent Change FY13 to FY14
Investment Management	\$308,000	\$1,500,000	\$1,192,000	387.0%
Salaries and Benefits	\$52,500	\$170,000	\$117,500	223.8%
Professional Services	\$0	\$0	\$0	--
Due Diligence/Education	\$6,000	\$48,000	\$42,000	700.0%
Office Management	\$1,200	\$9,400	\$8,200	683.3%
TOTAL	\$367,700	\$1,727,400	\$1,359,700	369.8%

The Executive recommends a \$1.4 million increase for the consolidated retiree health trust fund related to the investment of trust fund assets. This large increase is for both external investment manager fees and increased staff resources due to the change in BIT's asset allocation policy and the projected increase in

the assets of the trust fund. Projected investment management fees are based on the amount of assets held in the trust fund. In FY13, the County will contribute \$105.4 million in other post-employment benefits (OPEB) funding into the trust fund. For FY14, the Executive recommends an OPEB contribution of \$144.1 million. With the size of the trust increasing, the Board revised their asset allocation policy to include the introduction of new asset classes, such as commodities, private and hedge funds, and the use of active investment managers versus passive investment vehicles where prudent. The combined effect of the FY13 and FY14 contributions will more than triple trust fund assets, and along with the investment program structure changes, will result in significantly higher external investment management fees.

Previously, trust fund assets were invested primarily in “passive” investment vehicles. Passive investments provide broad market exposure by replicating major market indices (such as the S&P 500) with relatively minimal management and a very low cost. As the dollars in the trust fund have grown, BIT has decided to pursue an “active” strategy in which managers actively pursue various investment types including exposure to top tier firms. An active investment approach necessarily incurs higher investment management fees with the intent of securing returns that outperform the passive benchmark, net of fees.

Salary and Benefit Charges

In total, the Executive’s FY14 recommended operating budget includes \$2,035,800 in salary and benefit costs for the management of the Employees’ Retirement System, the Retirement Savings Plan, the Deferred Compensation Plan, and the Retiree Health Benefits Trust. The FY14 recommended salary and benefits costs (combined for the four plans) represent a \$31,800 increase (1.6%) above FY13 approved costs.

Non-Departmental Account

The Executive’s FY14 Recommended Operating Budget includes a new non-departmental account (NDA) for the Montgomery County Employee Retirement Plans (MCERP). As noted the Recommended Budget, expenditures associated with this program are funded from the ERS, RSP trust funds and from the General Fund on behalf of the DCP trust fund (see © 1). As such, the NDA does not show any appropriation amounts. The NDA entry in Recommended Budget displays MCERP performance measures relating to ERS rate of return as well and RCP and DCP offering rankings and fees. A copy of the MCERP program performance measures appears on © 2.

Attachments
Executive’s Recommended FY14 Operating Budget, Page 8-9
Executive’s Recommended FY14 Operating Budget, Page 66-11

PROPOSED OPERATING BUDGET DEFERRED COMPENSATION MANAGEMENT							
ITEM	FY12 APPR	FY12 ACT	FY13 APPR	FY13 EST	FY14 REC	FY14 vs. FY13 Appr.	
						\$ Change	% Change
EXPENSES							
Salaries and Benefits	77,340	101,283	91,873	109,300	125,700	33,827	36.8%
Professional Services	5,500	55,694	5,500	23,500	5,000	(500)	(9.1%)
Due Diligence/Education	1,000	1,735	1,000	1,500	2,000	1,000	100.0%
Office Management	5,510	3,845	5,310	5,300	6,700	1,390	26.2%
Investment Management	10,000	8,370	9,000	8,400	9,000	0	0.0%
TOTAL EXPENSES	99,350	\$170,927	\$112,683	\$148,000	\$148,400	\$35,717	31.7%

Amounts shown above are not charged to the Deferred Compensation Plan Trust but are instead appropriated and charged to the General Fund Compensation and Employee Benefits Adjustments Non-Departmental Account.

PROPOSED OPERATING BUDGET RETIREE HEALTH BENEFIT TRUST							
ITEM	FY12 APPR	FY12 ACT	FY13 APPR	FY13 EST	FY14 REC	FY14 vs. FY13 Appr.	
						\$ Change	% Change
EXPENSES							
Salaries and Benefits	66,960	45,000	52,500	52,500	170,000	117,500	223.8%
Professional Services	75,000	0	0	0	0	0	0.0%
Due Diligence/Education	0	0	6,000	20,000	48,000	42,000	700.0%
Office Management	1,500	1,100	1,200	3,000	9,400	8,200	683.3%
Investment Management	70,000	99,343	308,000	250,000	1,500,000	1,192,000	387.0%
TOTAL EXPENSES	\$213,460	\$145,443	\$367,700	\$325,500	\$1,727,400	\$1,359,700	369.8%

The chart illustrates MCERP expenditures only.

PROPOSED OPERATING BUDGET EMPLOYEES' RETIREMENT SYSTEM							
ITEM	FY12 APPR	FY12 ACT	FY13 APPR	FY13 EST	FY14 REC	FY14 vs. FY13 Appr.	
						\$	%
REVENUE							
Contributions	146,500,000	130,688,905	139,600,000	151,700,000	146,400,000	6,800,000	4.9%
Investment Income	212,000,000	134,103,217	227,000,000	296,000,000	241,000,000	14,000,000	6.2%
Miscellaneous Income	700,000	1,174,289	735,000	1,000,000	950,000	215,000	29.3%
TOTAL REVENUE	359,200,000	265,966,411	367,335,000	448,700,000	388,350,000	21,015,000	5.7%
EXPENSES							
OPERATING EXPENSES							
Retirement Benefits	204,500,000	205,268,948	226,000,000	226,400,000	245,000,000	19,000,000	8.4%
Investment Management	19,300,000	17,585,825	21,200,000	21,200,000	23,000,000	1,800,000	8.5%
SUBTOTAL	223,800,000	222,854,773	247,200,000	247,600,000	268,000,000	20,800,000	8.4%
ADMINISTRATIVE EXPENSES							
Salaries and Benefits	1,775,920	1,742,539	1,654,200	1,669,600	1,582,700	(71,500)	(4.3%)
Professional Services	833,930	635,946	813,933	1,003,600	895,900	81,967	10.1%
Benefit Processing	375,000	1,059,818	375,000	375,000	130,000	(245,000)	(65.3%)
Due Diligence/Education	53,500	26,684	55,500	60,400	64,700	9,200	16.6%
Office Management	241,887	80,667	240,887	92,500	99,300	(141,587)	(58.8%)
SUBTOTAL	3,280,237	3,545,654	3,139,520	2,956,100	2,772,600	(366,920)	(11.7%)
TOTAL EXPENSES	\$227,080,237	\$226,400,427	\$250,339,520	\$250,556,100	\$270,772,600	20,433,080	8.2%
NET REVENUE	\$132,119,763	\$39,565,984	\$116,995,480	\$198,143,900	\$117,577,400	581,920	0.5%

PROPOSED OPERATING BUDGET RETIREMENT SAVINGS PLAN							
ITEM	FY12 APPR	FY12 ACT	FY13 APPR	FY13 EST	FY14 REC	FY14 vs. FY13 Appr.	
						\$	%
REVENUE							
Investment Income	6,250	2	1,500	10	20	(1,480)	(98.7%)
Miscellaneous Income	500,000	252,634	240,000	90,000	90,000	(150,000)	(62.5%)
TOTAL REVENUE	506,250	252,636	241,500	90,010	90,020	(151,480)	(62.7%)
EXPENSES							
OPERATING EXPENSES							
Investment Management	10,000	8,370	9,000	8,400	9,000	0	0.0%
SUBTOTAL	10,000	8,370	9,000	8,400	9,000	0	0.0%
ADMINISTRATIVE EXPENSES							
Salaries and Benefits	162,390	190,420	205,460	140,800	157,400	(48,060)	(23.4%)
Professional Services	73,500	100,679	89,500	104,500	89,200	(300)	(0.3%)
Due Diligence/Education	2,000	1,735	2,000	1,500	2,000	0	0.0%
Office Management	23,630	12,002	23,430	5,300	6,700	(16,730)	(71.4%)
SUBTOTAL	261,520	304,836	320,390	252,100	255,300	(65,090)	(20.3%)
TOTAL EXPENSES	\$271,520	\$313,206	\$329,390	\$292,410	\$292,410	(36,980)	(11.2%)

Source: Montgomery County Employee Retirement Plans.

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FY14 Recommended Changes	Expenditures	FTEs
FY13 Approved	580,000	0.00
Increase Cost: Operating expenses	15,592	0.00
Increase Cost: FY14 Compensation Adjustment	4,408	0.00
Shift: Funding shifted between operating and personnel costs for chargeback to this NDA	0	2.00
Decrease Cost: Elimination of One-Time Items Approved in FY13	-200,000	0.00
FY14 CE Recommended	400,000	2.00

Montgomery Coalition for Adult English Literacy (MCAEL)

This NDA provides funding for the Montgomery Coalition for Adult English Literacy (MCAEL). MCAEL's mission is to strengthen the countywide adult English literacy community of providers' network with resources, training, collaborations, and advocacy to support a thriving community and an optimal workforce. Funding for MCAEL supports program grants to organizations that provide adult English literacy services; technical assistance, training, and networking opportunities that improve program quality and coordination; information resources for the community; and operating expenses to administer the grants and provide the support services. The County's contribution is implemented by a contract between the Department of Public Libraries and MCAEL.

FY14 Recommended Changes	Expenditures	FTEs
FY13 Approved	716,058	0.00
Enhance: Additional Capacity Building for MCAEL	76,001	0.00
Enhance: MCAEL FY14 Community Grant Request	23,999	0.00
FY14 CE Recommended	816,058	0.00

Montgomery County Employee Retirement Plans

The mission of this NDA is to manage prudent investment programs for the members of the Employee Retirement Plans and their beneficiaries. Expenditures associated with this program are funded from the Employees' Retirement System (ERS), Retirement Savings Plan (RSP), and the General Fund on behalf of the Montgomery County Deferred Compensation Plan (DCP) trust funds and are, therefore, not appropriated here. This NDA manages the assets of the ERS through its investment managers in accordance with the Board's asset allocation strategy and investment guidelines. The Board also administers the investment programs for the RSP and DCP. The Board consists of 13 trustees including the Directors of Human Resources, Finance, Management and Budget, and the Council Staff; one member recommended by each employee organization; one active employee not represented by an employee organization; one retired employee; two members of the public recommended by the County Council; and two members of the general public.

Program Performance Measures	Actual FY11	Actual FY12	Estimated FY13	Target FY14	Target FY15
ERS - Rate of return - used to compare to the 7.5% Actuarial Assumed Return ¹	21.77%	5.30%	13.07%	N/A	N/A
ERS - Return in excess of the total fund benchmark (passive indices) ²	1.81%	(.08)%	2.19%	2.00%	2.00%
RSP & DCP - Percentage of funds offered that are ranked at or above over a market cycle	81%	80%	N/A	N/A	N/A
RCP & DCP - Fees for fund offerings are at or below the median fees charged	97%	98%	N/A	N/A	N/A

¹ The FY13 estimated figure is as of 1/31/13.

² The FY13 estimated figure is as of 1/31/13.

FY14 Recommended Changes	Expenditures	FTEs
FY13 Approved	0	0.00
FY14 CE Recommended	0	0.00

Motor Pool Fund Contribution

This NDA funds the acquisition of new, additional Motor Pool fleet vehicles, as opposed to replacement vehicles, which are financed through an established chargeback mechanism.

FY14 Recommended Changes	Expenditures	FTEs
FY13 Approved	1,466,225	0.00
Enhance: Public Safety: 30 Marked, 6 Unmarked, 1 Van for Police	2,100,085	0.00
Enhance: Public Safety: Corrections Work team vans	84,106	0.00
Decrease Cost: Elimination of One-Time Items Approved in FY13	-1,466,225	0.00
FY14 CE Recommended	2,184,191	0.00