



Department of Legislative Services Office of Legislative Audits

Fraud Hotline

Presentation to
Maryland General Assembly
Joint Audit Committee

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Department of Legislative Services Office of Legislative Audits

Hotline History

- August 2002 – JAC instructed OLA to implement the hotline and web referral process.
- February 2003 – OLA's hotline and web referral process were launched.
- Ongoing – OLA's hotline and web referral process are marketed to State employees through a variety of methods.



Department of Legislative Services
Office of Legislative Audits

Fraud Hotline

**Report Fraud or Abuse
In State Government**



1-877-FRAUD-11

www.ola.state.md.us



Department of Legislative Services Office of Legislative Audits

Hotline Calls

- Calls are answered by audit professionals during business hours and handled in accordance with established procedures.
- Callers are assured that the information provided is considered confidential.
- Callers are provided with information about the State's "whistleblower" laws, if reassurance is needed.
- Calls are assessed for credibility and due diligence is performed before field investigations are initiated.

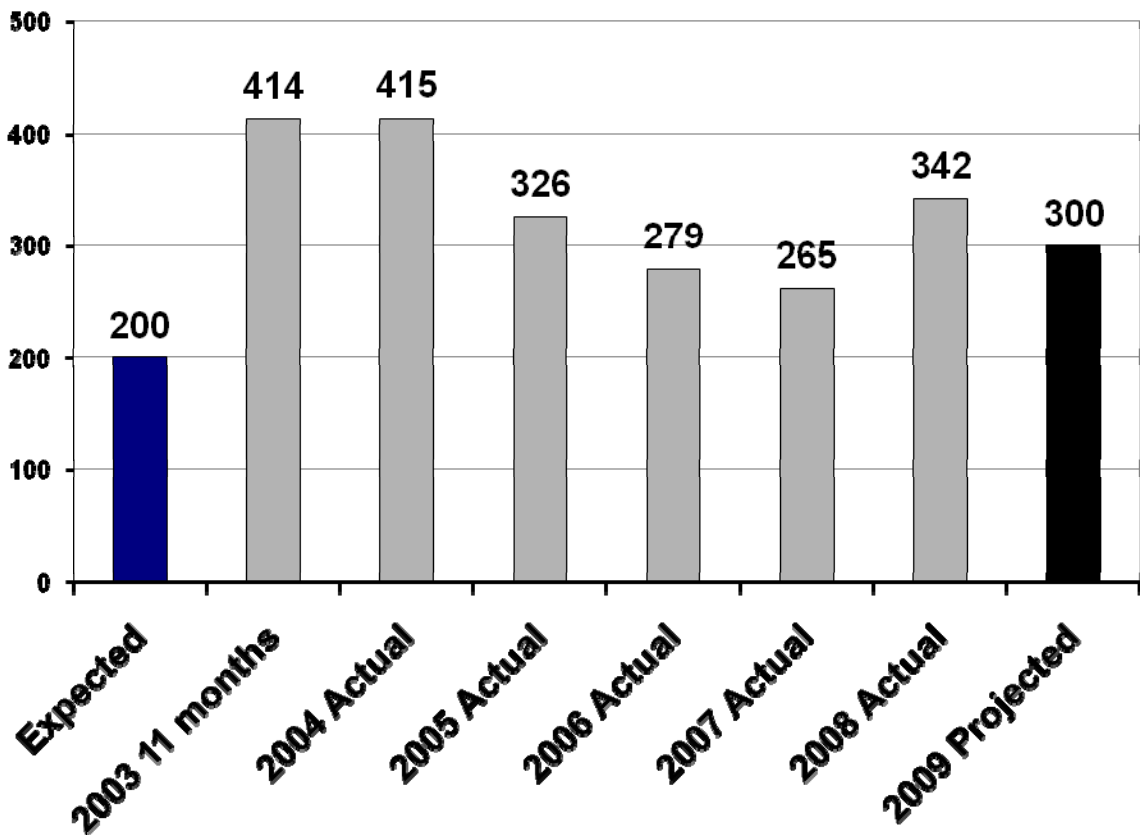


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Hotline Activity

Call volume has continued to exceed expectations

**Annual Call Volume
(Calendar Year Basis)**





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Hotline Cases

Hotline Case Disposition (February 2003 through October 2009)	
Investigations in Process or Completed by OLA	22%
Referred to a Future OLA Audit or Investigation	3%
Referred to Other Agencies with Investigative Units	33%
Not Pursued with a Letter to the State Agency	5%
Not Pursued	37%



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Hotline Investigations

OLA will brief the Committee on the following report issued in connection with a hotline call

- Board of Trustees of the Maryland Teachers and State Employees Supplemental Retirement Plans - Investment Contract Pool (Special Review). Report dated October 9, 2009.



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Supplemental Retirement Plans – Investment Contract Pool

Original Hotline Allegation: possible lack of disclosure of losses incurred in the Investment Contract Pool (ICP)

Background

- The Board of Trustees (Board) of the Maryland Teachers and State Employees Supplemental Retirement Plans (MSRP) is responsible for implementing, maintaining, and administering the State's voluntary tax sheltered income deferral plans for State employees and others.
 - These plans are permitted under various sections of the Internal Revenue Code. The ICP is available as an investment option in the 401(a), 401(k), and 457 Plans. Plan assets are held in trust for the plan participants.
 - The ICP's objective is to preserve principal and provide a stable, competitive return for participants.
 - A number of consultants have been hired to advise and assist the Board in managing the ICP.
 - MSRP's investment manager reported that the 12/31/08 book value of ICP investments totaled \$729 million for 27,163 employees in the ICP, making the ICP the single most popular investment option offered by MSRP based on amounts invested. In total, \$1.9 billion was invested in all plans as of 12/31/08 (38% of that was in the ICP).
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Supplemental Retirement Plans

– Investment Contract Pool (continued)

Key Findings:

➤ Inadequate Disclosure of Unrealized Losses

- MSRP did not adequately disclose unrealized losses of the ICP investments (the aggregate market values were less than purchase prices) in financial reports made available to existing and prospective plan participants (see page 11 for example).
- The unrealized losses were not disclosed in MSRP's 2007 audited financial statements. As of 12/31/08, unrealized ICP losses totaled approximately \$48 million.
- MSRP did not confirm the existence of ICP investments with the custodian bank.

➤ Lack of Independent Verifications

- Documentation was not available to substantiate that the market value of ICP investments had been independently verified.
 - MSRP did not independently verify the accuracy of the interest rate calculated by the investment manager that was used to credit earnings to participant accounts.
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Supplemental Retirement Plans

– Investment Contract Pool (continued)

Key Findings: (continued)

- **Protection Afforded by Wrapper Agreements Unclear**
 - Wrapper agreements executed with financial institutions to cover ICP investment losses were highly complex and ambiguous.
 - MSRP personnel and the investment manager were unable to clearly explain how the agreements preserved the investment portfolio.
 - Certain agreements were apparently not signed until after we requested them during this review.

- **Lack of Documentation of Monitoring:**
 - MSRP management and the MSRP Board did not adequately document their monitoring of the performance of the investment manager and the sub-managers. Performance reports prepared by MSRP's investment consultant indicated the ICP was outperformed by comparable investment plans for the 3-year and 5-year periods ending 12/31/08.



Investment Contract Pool

Separate Account Report as of September 30, 2008



Objective

The MSRP Investment Contract Pool ("ICP") seeks to preserve principal value and provide a relatively stable rate of return comparable to intermediate fixed-income yields over two to five years.

Investment Overview

The ICP invests in a diversified portfolio of stable value contracts issued by banks, insurance companies, and other financial institutions, and a variety of fixed income instruments including U.S. Government and agency securities, mortgage-backed securities, asset-backed securities, and corporate bonds. Investors earn the average return received under all contracts in effect at any point in time. The ICP's return is affected by the general level of interest rates as well as by cash flows, including those from employer and employee contributions, withdrawals, and transfers into and out of the ICP. The average duration of the ICP's investments will be approximately two to four years. The average credit quality of the ICP's investments will generally be AA (or its equivalent), although individual securities or contracts purchased for the ICP may have a lower credit quality rating.

Risks

Like all investments, the ICP has risks. There is a possibility that the ICP may not achieve its investment objectives. If an issuer of a contract or a fixed income security defaults on its obligations, the ICP may not maintain its principal value. To minimize this risk, the ICP's investment managers regularly monitor credit ratings and financial strength of the issuers of contracts and fixed income securities.

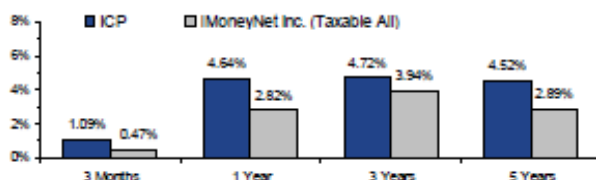
ICP Characteristics

Assets	\$691 million USD
Average Credit Quality (See Credit Profile) ¹	AA+
Average Duration	3.20
Previous quarterly crediting rate (annualized)	4.39%
Upcoming quarterly crediting rate (annualized)	4.40%
Inception Date	1987
Investment Manager	DB Advisors ²

Sector Allocation³

Agency	6.6%	A-1	5.9%
Asset Backed	5.1%	AAA	66.1%
CMBS ⁴	6.7%	AA+	0.7%
Corporate	19.7%	AA	10.3%
Mortgage Backed	33.4%	AA-	0.6%
STIF & Cash Equivalent	6.6%	A+	0.7%
US Treasury	12.3%	A	5.2%
General Account GICs	4.4%	A-	1.8%
Wrapper Exposure ⁵	5.3%	BBB+	2.9%
		BBB	4.9%
		BBB-	0.9%
		BB+ & Below	0.1%

Performance⁶



¹ Represents the weighted average credit quality.

² Prior to July 2006 ING Stable Value Product Group, a division of ING Life Insurance and Annuity Company provided management services.

³ Allocations shown are not necessarily indicative of future allocations. Figures may not sum to 100% due to rounding.

⁴ As rated by Standard & Poor's or equivalent by any other rating services.

⁵ Commercial Mortgage Backed Securities

⁶ Wrapper exposure represents the difference between the book value of the wrapper contracts and the market value of the underlying fixed income securities as a percentage of the book value of the entire Fund. A positive wrapper exposure denotes that the Fund's book value exceeds the market value of the underlying assets and the Issuer of the wrapper contract has a

potential liability to the Fund. A negative wrapper exposure means that the market value of the underlying assets exceeds the book value of the wrapper and the Fund may have a potential liability to the contract issuer.

⁶ Performance shown is net of Investment Management fees. Past performance is not indicative of future results. Figures greater than one year are annualized. The returns herein are not necessarily indicative of the returns that may be achieved over the longer term. There is no assurance that comparable returns will be achieved in the future or that the ICP's investment objective will be achieved. The results portrayed reflect the reinvestment of dividends and other earnings. The iMoneyNet Inc. Money Fund Report Averages is a service of iMoneyNet Inc. (formerly the IBC Financial Data Inc.) and are averages for categories of similar money market funds. Investors cannot invest in an average.



Investment Contract Pool

Separate Account Report as of September 30, 2008



Strategy Overview

Assets in the Investment Contract Pool are held in trust for the benefit of participants of the MSRP. Participant investments made in the ICP are credited with a daily blended interest rate. Each quarter an anticipated, but not guaranteed, rate is declared. This quoted rate is net of all fees and expenses directly related to the ICP. This average annual expense fee will vary, but typically is approximately 0.35%, annualized. This fee does not include the monthly asset fee assessed on all participants by the Maryland Board of Trustees ("Board") and Nationwide Retirement Solutions, which will total 0.19%, annualized.

The ICP typically invests in the following investments:

(1) Short term cash investments that are primarily available for participant daily liquidity needs; (2) Stable value pooled funds, which are stable value commingled bank trusts; (3) General Account Investment Contracts ("GICs" or "BICs"), which are issued by insurance companies or banks and maintain a constant principal valuation while earning interest; and (4) Synthetic GICs, which also allow for principal stability while earning interest. The key difference is that Synthetic GICs are the result of fixed income portfolios owned by the ICP and managed by independent fixed income managers, which generate investment income to pay interest, combined with wrapper contracts issued by insurance companies, banks, and other high-quality financial institutions, which help maintain the principal stability of the ICP.

ICP Investment Policy

The ICP is managed according to a detailed investment policy established by the Board, which is available upon request.

Further Information

For information about the Maryland Supplemental Retirement Plans, investment option booklets, and other general information or to arrange educational seminars, please go to the MSRP website at www.msrp.state.md.us. For additional information about the Plans, financial planning calculators, performance information, mutual fund prospectuses, Plan forms, and to enroll or access an account, please log on to the Nationwide Retirement Solutions MSRP participant website at www.MarylandDC.com.

You may also call the MSRP at 410-767-8740 / 1-800-543-5605 (office hours: Monday thru Friday, 8:30 a.m. to 5:00 p.m.) or e-mail us at info@msrp.state.md.us. Or you may call the Nationwide Retirement Solutions Team MSRP Customer Service Center at 1-800-545-4730.

⁷ Ratings are Moody's Investor Services, Standard and Poor's Ratings Service, and Fitch, or its equivalent as determined by the manager, respectively.

⁸ Allocations shown are not necessarily indicative of future allocations. Figures may not sum to 100% due to rounding.

⁹ Fixed income portfolios managed by these fixed income advisors are combined with benefit responsive wrapper contracts to form Synthetic GICs.

ICP Investments^{7,8}

Short Term Investment Funds (STIF)

Bank of New York Government STIF	A-1	4.6%
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General Account GICs

Jackson National Life Ins. Co.	A1/AA/AA	2.9%
Prudential Insurance Co.	Aa3/AA/AA	1.5%

Synthetic GICs / Wrapper Issuers

Bank of America, N.A.	Aaa/AA+/AA-	24.2%
Natixis Financial Products Inc.	Aa3/AA-/A+	28.7%
Royal Bank of Canada	Aaa/AA-/AA	24.2%
Monumental Life Insurance Co.	Aa3/AA/AA+	13.9%

Fixed income portfolios within Synthetic GICs^{8,9}

Aberdeen Asset Management	17.2%
The Hartford Investment Management Company	22.5%
Goode Investment Management, Co.	10.2%
Pacific Investment Management Company	18.9%
Western Asset Management Company	17.0%

The MSRP Investment Contract Pool is not a mutual fund, therefore there is no prospectus. It is a separately managed account, which may utilize collective investment trusts as part of its investment strategy. Unit price, yield, and return may vary.

The comments, opinions and estimates contained herein are based on or derived from publicly available information from sources that we believe to be reliable. We do not guarantee their accuracy. This material is for informational purposes only and sets forth our views as of this date. The underlying assumptions and these views are subject to change without notice.

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Conclusion

Efforts Devoted to OLA's Hotline Have Been Worthwhile

- Significant efforts have been made to build awareness of the hotline.
- Hotline activity has continued to exceed initial expectations.
- OLA has identified and reported on a number of significant findings based on hotline calls and certain investigations are either underway or planned for the future.