UNIVERSITY OF MAINE SYSTEM
Board of Trustees

Investment Committee

December 8, 2016
University of Maine System – Executive Offices
Rudman Conference Room, 253 Etabrooke Hall, Orono

Present: Committee Members: Karl Turner, Chair (at USM) and Shawn Moody (at USM). **Non-Voting Committee Members**: Robert Blackwood (at USM) and Eric Hayward (at USM). **Staff:** Tracy Bigney, Tracy Elliott (at USM), Laurie Gardner (UMF) and Ryan Low. **Others:** Kelly Regan – NEPC (at USM), Jay Roney – NEPC (at USM), Mike Pratico - CAPTRUST (at USM), and Barry Schmitt – CAPTRUST (at USM)

Absent: Committee Members: James Donnelly, Mark Gardner, Sam Collins and Gregory Johnson

Trustee Turner, Chair, called the meeting to order.

Defined Contribution Plan Update. Mr. Barry Schmitt and Mr. Mike Pratico with CAPTRUST Financial Advisors provided the following updates.

CAPTRUST provided an update regarding the Department of Labor (DOL) Fiduciary Investment Advice Rule as it relates to the University of Maine System (UMS) retirement plan. This new rule becomes effective April 10, 2017, and defines "advice" as many of the activities TIAA has historically provided to plan participants as education and guidance. TIAA is largely operating under the new guidelines today via their Ibbotson Advice program and will continue to be able to support client's employees in a similar capacity going forward with little to no impact to the plan sponsor. TIAA has not formally communicated their position on the new rule but more information will follow.

CAPTRUST then briefly reviewed recent 403b ERISA lawsuits noting that most of the lawsuits focus on following a proper process when monitoring plan expenses and investments. CAPTRUST expressed their belief that the UMS follows a proven prudent process.

CAPTRUST went on to provide a brief Market Commentary stating that asset classes continue to march higher. Three quarters into calendar year 2016, investment returns have been strong, especially in light of subdued expectations heading into the year. Most global equity indexes rose while fixed income categories were mixed. The third quarter was unusually quiet in terms of macroeconomic news. With equity markets delivering their worst start to a year in history and the Brexit calamity in the second quarter, investors welcomed the relative calm.

The Committee and CAPTRUST reviewed all Defined Contribution Plan funds in a manner consistent with the Investment Policy Statement. CAPTRUST noted that all funds are in good standing and emphasized the following:

> Harbor Capital Appreciation – The recent market swing from growth to value has hurt Harbor in the short term. Additionally, nearly 50% technology holdings, underweight industrials and overweight consumer defensive sector positions have provided headwinds. CAPTRUST continues to recommend this fund.

CREF Inflation Linked Bond – Volatility and recent manager changes have hurt the fund's score but performance remains sound.

<u>Defined Contribution Plan – Updated Investment Policy Statement</u>. CAPTRUST discussed amendments to the Defined Contribution Plan Investment Policy Statement. Those changes reflected the recent revisions of certain benchmark indices and peer universe categories by Morningstar. Lacking a quorum, staff will make the policy changes consistent with its fiduciary responsibilities, and seek Board approval at its January meeting.

Action for January Board Meeting:
That the Board of Trustees approves the update to the Investment Policy Statement for the Defined Contribution Plan.

<u>Defined Contribution Plan – Education Meetings Update</u>. CAPTRUST mentioned the Retirement Preparation seminars, which they conducted in September. These presentations were held in Portland and Orono and offered via Polycom to all campuses and were well attended by UMS employees. The meetings focused on savings and allocation as well as the TIAA Traditional product.

<u>Retirement Plan for Classified Staff – Actuarial Results</u>. Tracy Elliott, Director of Finance and Controller reviewed the actuarial report for the Retirement Plan for Classified Staff, also known as the Defined Benefit Plan, for June 30, 2016. This report was prepared by KMS Actuaries, LLC., and is a roll forward of the July 1, 2015 Actuarial Valuation with financial reporting and disclosure information as of June 30, 2016.

By way of background, the Classified Plan is a closed Plan for eligible participants as of June 30, 1998 who chose to remain in the Plan rather than roll the value of their accrued benefit into the Defined Contribution Plan.

The actuarial report provides financial reporting and disclosures under Governmental Accounting Standards Board (GASB) 67 & 68. These standards require projected benefit payments be discounted to their actuarial present value using the single rate that reflects:

1. A long-term expected rate of return on pension plan investments:
    - to the extent that the pension plan's assets are sufficient to pay benefits and
    - pension plan assets are expected to be invested using a strategy to achieve that return and
2. A tax-exempt, high-quality municipal bond rate:
    - to the extent that the conditions for use of the long-term expected rate of return are not met.

As UMS has an annual funding strategy that is structured so that plan assets will never be depleted, the long-term rate of return is used as the discount rate for the actuarial report.

The fiscal year 2016 (FY16) report included the following assumption changes:
- A $20,000 decrease in estimated annual administrative costs.
- A 50 basis point decline in the discount rate - from 6.75% in FY15 to 6.25% in FY16.

The Pension Expense for fiscal year 2016 (FY16) was $2.8 million as compared to $864 thousand in FY15. During FY16, the change in the discount rate negatively impacted expense by $1.4 million while the amortization of the difference in 2015 and 2016 investment projections compared to actuals added another $940 thousand to expense.

The Fiduciary Net Position at June 30, 2016 was $33 million with a Total Pension Liability of nearly $43 million, resulting in a Net Pension Liability of $10 million. The Plan was 76% funded at June 30, 2016 compared with 85% in the prior year. The major drivers contributing to the decreased funding status were the 50 basis point decline in the discount rate and investment performance.

Ms. Elliott then reviewed the sensitivity of the Net Pension Liability. The Net Position Liability of $10 million, determined using a discount rate of 6.25%, would increase by $3.2 million if the discount rate dropped by 1% and would decrease by $2.8 million if the discount rate increased by 1%.

NEPC Performance Reviews. Kelly Regan and Jay Roney, with NEPC, reviewed performance for all 3 UMS portfolios with the following highlights.

Managed Investment Pool (MIP). The Managed Investment Pool (MIP) returned 3.6% fiscal year-to-date as of September 30th. This return ranked in the 61st percentile in the InvestorForce Endowments and Foundation $100-500 million universe. Managers detracted 20 basis points of value during this time period with an international equity manager and emerging market equity managers detracting the most value relative to benchmarks. On a trailing one year ending September 30th, the MIP returned 8.4% ranking in the 41st percentile.

Defined Benefit Pension Fund Performance Review. The Pension returned 2.4% fiscal year-to-date as of September 30th. This return ranked in the 76th percentile in the InvestorForce Total Fund Universe due to the conservative asset allocation. Managers detracted 40 basis points of value during this time period with international equity and emerging market equity managers detracting the most value relative to benchmarks. On a trailing one year ending September 30th, the Pension returned 7.2% ranking in the 73rd percentile.

Operating Fund. The Operating Fund returned 1.4% fiscal year-to-date as of September 30th. The Operating Fund had the lowest return compared to the other 2 portfolios given the very conservative risk profile of the Fund. Managers added 20 basis points of value during this time period as most managers were ahead or in-line with stated benchmarks. On a trailing one year ending September 30th, the Operating Fund returned 3.9%.

Operating Fund Manager Recommendation – PIMCO Floating Income. On November 8, 2016, PIMCO announced that effective January 23, 2017, the PIMCO Floating Income Fund would be renamed the PIMCO Low Duration Income Fund. In addition to the name change, the investment guidelines and principal investment strategy will be altered.

The PIMCO Floating Income Fund is a duration-hedged product that invests in a variety of credit sectors such as investment grade credit, below investment grade and emerging market debt. Over the past year, PIMCO has been speaking to clients in the Floating Income Fund and decided to change the strategy to increase the duration band, reduce credit exposure and increase the quality of the fund. As such, the new fund will be renamed to the PIMCO Low Duration Income Fund and will be a higher quality, lower duration version of the PIMCO Floating Income Fund. The new fund will be managed by the same team as the Floating Income Fund. The upcoming changes to the PIMCO Floating Income Fund represent not only a name change, but a change to the fund's investment strategy. While current investors may choose to roll their investment into the new PIMCO Low Duration Income Fund, the strategy is different than what was initially approved by UMS.

Given the above, NEPC recommended that the roughly $12.7 million (4.5%) in Operating Funds, invested in this Fund, be re-allocated to current managers in the Income Pool with similar exposures as the Floating Income Fund. This re-allocation will be 1/3 to each a short-term bond manager, unconstrained bond manager and a bank loan manager to achieve a similar asset class exposure, yield and duration as the PIMCO Floating Income strategy.

This recommendation was supported by Investment Committee members present at that meeting. Staff will take appropriate action to begin implementation of the recommendation and the action will be presented to the Board for approval at its January meeting.

Action for January Board Meeting:
That the Board of Trustees approves the reallocation of the PIMCO Floating Income funds (approximately $12.7 million) equally across the following current managers:

- Income Research & Management: Short Term Aggregate Exposure
- Blackrock Strategic Income Opportunities: Diversified credit exposure with allocations to Emerging Market Debt
- Loomis Sayles: Below investment grade exposure

Investment Manager Discussion – Permal. NEPC issued a "Hold" status for Permal Fixed Income Holdings (PFIH) in February 2016 due to the Entrust Permal merger. At the September 2016 Committee meeting, NEPC recommended maintaining the investments with EntrustPermal Fixed Income Holdings while continuing to monitor the firm and strategy going forward. Holdings with this manager as of September 30, 2016 were:

Managed Investment Pool	$16.0 million
Pension	1.7 million
Operating Funds	6.1 million
Total	$23.8 million

The Committee met with EntrustPermal representatives at its December 8^{th} meeting to get a better understanding of the merger. Committee members present at the meeting supported retaining this manager. This item will be presented for approval at the January Board meeting.

Action for January Board Meeting:
That the Board of Trustees approves retention of investments with Permal Fixed Income Holdings, in the Managed Investment Pool, Pension, and Operating Funds.

Adjournment

Submitted by
Tracy Elliott for
Tracy B. Bigney, Clerk