UNIVERSITY OF MAINE SYSTEM
Board of Trustees

Investment Committee

February 22, 2016
UMS, Rudman Board Room

Present: Committee Members: Karl Turner, Chair (at USM), James Geary (by phone), Erik Hayward (at USM), Gregory Johnson (by phone), Marjorie Medd (at USM), Jack Moore (at USM) and Shawn Moody (at USM). **Presidents:** John Murphy (at UMFK). **Staff:** Tracy Bigney, Tracy Elliott (at USM), Ryan Low and Rebecca Wyke (by phone). **Others:** George Campbell (at USM), Karen Pelletier (at USM), Jay Roney – NEPC (at USM), Kelly Regan – NEPC (by phone), Barry Schmitt CAPTRUST (by phone) and Michael Pratico – CAPTRUST (at USM).

Absent: Committee Members: Samuel Collins, James Donnelly, and Mark Gardner.

Trustee Turner, Chair, called the meeting to order.

USM Management Fee on Endowments. Mr. George Campbell, University of Southern Maine (USM) Vice President of Advancement and President and CEO of the USM Foundation, presented information about significantly expanding their fund raising efforts and requested an increase in the management fee on USM endowments held by the System from 25 basis points to 125 basis points. The Investment Committee approved a similar management fee for the University of Maine (UM) at their May 1, 2015 meeting to support investment in the UM's fundraising efforts.

Aggressive fund raising efforts are underway at USM with those efforts currently shared by both USM and the USM Foundation. Mr. Campbell noted their fundraising goals range from $50 million to $125 million, along with goals for increasing alumni participation rates from 1.46% to 10%. While enhanced fund raising is progressing, discussions have begun at USM regarding the USM Foundation assuming the primary fund raising role for USM similar to the UM model.

With regard to the requested management fee, USM will adhere to the following:

- The fee increase will pay for advancement efforts.
- The fee will be disclosed in advance of being charged; an opportunity to "opt out" shall be presented to current endowment donors, their heirs or representatives; and a policy for exceptions to this fee will be established based upon best practices nationwide.
- The fee will be implemented, as of July 1, 2016, or later and will be up to 1.25% calculated by the System methodology which currently uses the 3-year market value average of USM endowments held by the System.
- The fee will be taken from the annually determined endowment payover and will replace the current annual management fee of .25%.
- Should donors opt out of the management fee increase, their endowment will not be charged the increase.

On a motion by Trustee Moody, which was seconded by Trustee Medd, the Investment Committee approved USM's assessment, as of July 1, 2016 or later, of an annual management fee of up to 1.25% of the market value of USM's endowments held by the University of Maine System. The fee will be taken from the annually determined endowment payover and will replace the current annual management fee of 0.25%.

FY2017 Endowment Distribution Rate Per Share. Ms. Tracy Elliott, UMS Controller, provided an overview of the UMS FY2017 endowment distribution rates and estimated spending. Ms. Elliott noted that the campus Chief Business Officers affirmed their support for using a 4.5% spending rate to calculate the FY2017 endowment distribution rate per share. This 4.5% is consistent with prior years and other higher education institutions. The distribution rate applies to UMS universities only. Other entities in the managed investment pool determine their own distribution rates.

A 4.5% endowment spending rate equates to a rate per share of $14.78338. Using this rate, an estimated $4.3 million will be distributed for endowed spending and $1.1 million for management costs, depending on the timing and acceptance by donors of the increased rates.

On a motion by Trustee Moody, which was seconded by Trustee Medd, the Investment Committee approved an endowment distribution rate of $14.78338 per share for FY2017.

Defined Contribution Plan Update.

Money Market Funds

Mr. Barry Schmitt, Senior Vice President with CAPTRUST, provided an overview of money market regulatory changes and the impact on the UMS defined contribution plan with TIAA-CREF. On July 23, 2014, the Securities and Exchange Commission (SEC) announced new rules related to money market funds that will take effect in October 2016. Plan sponsors need to take action prior to that deadline to ensure appropriate capital safety and liquidity for participants.

As a result of money market regulatory changes, TIAA-CREF will designate all of its money market funds as "government" money market funds (TIAA-CREF Money Market Fund, TIAA-CREF Life Money Market Fund, and CREF Money Market Account), meaning they will be exempt from any floating Net Asset Value (NAV) and/or liquidity gate and fee requirements. Currently the funds are classified as prime money market funds. UMS offers the CREF Money Market R3 fund to participants and, as of December 31, 2015, participants had nearly $18 million (1.4% of the plan) invested in money market funds.

In December 2015, TIAA-CREF announced that in conjunction with designating all of their money market funds as 'government' funds that they would be ending their fee waivers on the CREF Money Market Account by April 14, 2017. The waivers, common across the money market industry, have been used to prevent negative returns since administrative costs have generally outweighed money market returns since 2009. Note that the elimination of fee waivers will only apply to the CREF Money Market Account and not to any of TIAA's mutual fund offerings. TIAA came to this decision after discussions with their fund boards and the New York state insurance regulator.

With the increase in rates in the 4th quarter, TIAA took action to eliminate the waivers on only the R3 fee class of the CREF Money Market Account effective immediately. Their reasoning for this is that the R3 class (the cheapest) had started to exhibit returns greater than the fees being waived. If interest rates increase before the April 14, 2017 deadline, CAPTRUST anticipates TIAA removing the waiver early for the R2 and R1 classes as well. Along with removal of the fee waivers, TIAA will also begin recouping lost expenses, which cannot exceed 25% of the positive return on a daily basis. The recoupment is subject to a three year lookback period, with the clock already started for the R3 shares. The latest date recoupment would be in place for any share class would be April 14, 2020.

Since UMS participants have individual contracts at TIAA and those contracts require that participants have access to the CREF Money Market Account in the plan menu, UMS cannot eliminate the CREF Money Market Account from the plan menu options. UMS can however add additional capital preservation options to the plan. The Investment Committee decided that adding an additional money market fund is prudent and would best serve the individual participants. CAPTRUST will bring money market options for consideration to the Committee at a future meeting.

Quarterly Review of Funds:
Mr. Mike Pratico, Senior Vice President with CAPTRUST, reviewed the Defined Contribution Plan holdings. The Committee commented on the high percentage of assets in the TIAA Traditional Account as well as the percentage directed to the account via the Ibbotson Model Portfolios (asset allocator advice tool). CAPTRUST believes the asset allocations within the portfolios to be appropriate and that Ibbotson Associates is an appropriate company to assemble and review the model portfolios. A discussion followed regarding the percentage of assets directed to the TIAA Traditional as well as liquidity issues of the TIAA Traditional. When CAPTRUST and staff reviewed this area in June 2015, there were 845 UMS participants advised within the Ibbotson model representing $262 million in assets (20% of current assets).

The TIAA Traditional Annuity is a guaranteed annuity account (group annuity contract) that is backed by the financial strength and claims-paying ability of TIAA and TIAA has excellent financial strength ratings. CAPTRUST believes that the TIAA Traditional continues to be an appropriate investment for the UMS plan.

CAPTRUST continued with their quarterly review of funds providing an overview about the plan investments consistent with the standards and approach defined in the Investment Policy Statement. As described below, two funds, the Goldman Sachs Mid Cap Growth and Ridgeworth Mid Cap Value are marked for review, though no change recommendations are being made. All other funds are currently in good standing.

Ridgeworth Mid Cap Value – The fund closed out 2015 in the 61st percentile following a strong 2014. The strategy has exhibited inconsistent performance since 2011, alternating between top and bottom quartile results each year. The strategy faced stylistic headwinds as the market has rewarded higher growth firms while the manager looks for companies with low analyst expectations. The team had some missteps in individual positions where their investment thesis did not unfold as expected. Poor stock selection in consumer discretionary, technology, and utilities has been a primary driver of recent underperformance. CAPTRUST continues to recommend the strategy, however the fund is on watch as we look for more consistent results going forward.

Goldman Sachs Growth Opportunities - The strategy's fourth quarter 2015 performance lagged its benchmark and was in the bottom half of its peer group. Likewise, full-year results significantly lagged the benchmark and landed in the bottom quartile of its peer group. Poor stock selection in the consumer discretionary and consumer staples sectors was the main driver of fourth quarter underperformance. CAPTRUST continues to recommend this strategy although it remains on the watch list due to concerns about significant personnel changes in recent years. Given the disappointing 2015 results, improved performance is needed in the coming quarters in order to maintain conviction in the strategy.

Several other highlights of the discussion include:

- Several Vanguard funds converted to institutional share classes in 2015.
- The CREF Stock fund is difficult to benchmark given its exposure to multiple equity asset classes. The fund currently meets the guidelines set forth by CAPTRUST for distinct investments in the Investment Policy Statement.
- The TIAA Real Estate Account is similar in its benchmarking challenges given its direct investment in Real Estate holdings unlike a typical Real Estate Investment Trust (REIT) fund. Performance of the TIAA Real Estate fund was strong in 2015 closing up over 8% for the year.

CAPTRUST will work on the following items prior to the next meeting:

- Request a demographic report from TIAA addressing TIAA Traditional participation in detail.
- Review TIAA pricing.

Asset Allocation Study and Recommendations.
New England Pension Consultants (NEPC) led a discussion of asset allocation options for the UMS Managed Investment Pool, Defined Benefit Pension, and Operating Fund.

Managed Investment Pool (MIP)
NEPC and the Investment Committee reviewed the asset allocation option (Mix A) which included:

- Global Asset Allocation (GAA) changes:
  - Reducing the GAA allocation by 5% from 25% to 20%,
  - Removing PIMCO All Asset from the line-up, and
  - Equal weighting the allocation to the other two GAA managers: GMO Global Asset Allocation Return and Wellington Opportunistic Investment.
- Allocating 3% to a new Treasury Inflation Protected Securities (TIPS) strategy and to a new manager, the Vanguard Inflation-Protected Securities Fund.
- Allocating 2% to U.S. Equity – 1% each to large cap and small/mid cap equity.
- Removing dedicated commodity hedge fund exposure by terminating Blenheim and allocating proceeds to hedge fund of fund managers.
- Initiating a search to consider a possible replacement for Permal Fixed Income Holdings (Hedge Fund of Fund). This was specifically due to changes in Permal’s management and investment structure.

The Committee discussed Mix A and supported the recommendations but wants to get a better understanding of the GMO strategy, perhaps by inviting the manager to present at an Investment Committee Meeting in the future. The allocation changes are expected to maintain expected returns while slightly reducing risk.

Pension Fund
NEPC and the Investment Committee reviewed the asset allocation option (Mix A) which included:

- Global Asset Allocation (GAA) changes:
  - Reducing the GAA allocation by 5% from 30% to 25%,
  - Removing PIMCO All Asset from the line-up, and
  - Hiring GMO Benchmark Free Allocation Strategy and allocating the 25% GAA allocation equally to GMO and Wellington Opportunistic Investment.
- Allocating 3% to Core Real Estate through current manager Principal.
- Allocating 2% to U.S. Equity – 1% each to large cap and small/mid cap equity.
- Initiating a search to evaluate Permal Fixed Income Holdings (Hedge Fund of Fund).

The Committee discussed the above rebalancing recommendations. The adjustment to the asset allocation strategy increases the expected return of the portfolio while reducing risk. NEPC recommended replacing PIMCO with the GMO Benchmark Free Allocation Strategy; however, the Committee requested that NEPC deliver a search book outlining a variety of replacement options that would include best in class managers. In conjunction with the MIP, NEPC will conduct a search to consider a possible replacement for Permal.

Operating Fund

NEPC and the Investment Committee reviewed the following asset allocation options (Mix A and Mix B):

Mix A

- Reduce GAA by 5% from 15% to 10%
- Allocate 2.5% to Hedge Fund of Funds
- Allocate 2.5% to Global Equity
- Initiate a search to evaluate Permal Fixed Income Holdings (Hedge Fund of Fund)

Mix B

- Reduce GAA by 5% from 15% to 10%
- Allocate 5.0% to Global Equity
- Initiate a search to evaluate Permal Fixed Income Holdings (Hedge Fund of Fund)

The Committee discussed the above rebalancing recommendations and approved rebalancing to Mix A. The goal is to improve the implementation of the current strategy.

On a motion by Trustee Moody, which was seconded by Trustee Medd, the Investment Committee approved asset allocation option Mix A for the Managed Investment Pool (MIP), Mix A for the Pension Fund with the exception that the Committee will review a Global Asset Allocation manager search book to replace the PIMCO All Asset fund, and Mix A for the Operating Cash Fund along with specific manager recommendations provided for each Portfolio's respective mixes as described in the meeting minutes.

Operating Fund – Money Market Funds

The Committee discussed the upcoming SEC money market fund rules scheduled to take effect in October 2016. The Operating Fund currently has capital in two prime money market funds managed by Dreyfus and Federated. As discussed early in the meeting, based on SEC regulations, prime money market funds will be subject to floating NAVs, liquidity fees, and redemption fees. At the next Investment Committee meeting NEPC will recommend government money market fund options that will be exempt from the new SEC money market rules.

NEPC Performance Reviews

Managed Investment Pool (MIP)
Markets performed well during the quarter ended December 31, 2015 resulting in the MIP returning 2.7%; however, results for the fiscal year to date (YTD) are a disappointing -3.9%. During these time periods the MIP ranked in the top 30th and 58th percentiles within NEPC's Endowments and Foundations universe. Performance on a fiscal year to date basis lagged due to disappointing performance within the GAA and Hedge Fund space:

- GMO Global Absolute Return (-4.0% vs. -0.8% for the blended index)
- PIMCO All Asset Fund (-8.6% vs. -0.8% for the blended index)
- Permal (-5.0% vs.-3.0% for the HFRI Fund of Funds Index)
- Blenheim (-6.1% vs. -23.5% for the Bloomberg Commodity Index)

Under-performance for the strategies listed above was due to overweight allocation to International and Emerging Markets Equity, Credit, and a variety of Real Assets.

Defined Benefit Pension Plan
The Pension Plan returned 1.2% during the quarter ended December 31, 2015 and -2.8% during the fiscal year to date time period. During these time periods the Plan ranked in the 78% percentile and the 56th percentile of the NEPC's universe. Observations include:

- Lower allocations to equity drove the below median performance posted during the quarter.
- Strong manager performance was delivered by Lighthouse and Principal Real Estate.
- Disappointing performance was posted by the PIMCO All Asset Fund and Permal.

Operating Fund
The Fund returned 0.1% for the quarter and -1.7% for the FYTD time period. During the fiscal year time period, the Total Return Pool has been the source of negative performance. Global Equity and Fixed Income, as well as commodities, negatively impacted returns during this time period. Although the Total Return Pool's returns have been problematic during the past year, the allocation has added significant value over intermediate and longer term time periods.

Adjournment.

Submitted by
Tracy Elliott for
Tracy B. Bigney, Clerk