

UNIVERSITY OF MAINE SYSTEM

Board of Trustees

**Investment Committee**

September 7, 2016

48 Stodder Hall, UM - Orono

**Present: Committee Members:** Karl Turner, Chair (at USM), James Donnelly (by phone), Mark Gardner (at USM), Sarah Newell (by phone), and James Geary, **Staff:** Tracy Bigney, Tracy Elliott (at USM), Ryan Low (by phone), Rebecca Wyke (by phone). **Others:** Robert Blackwood - USM Foundation (at USM), Katherine Greenleaf – MMA (at USM), Kelly Regan – NEPC (at USM), Mike Pratico - CAPTRUST (at USM).

**Absent: Committee Members:** Shawn Moody, Sam Collins and Gregory Johnson

Trustee Turner, Chair, called the meeting to order.

**Non-Voting, Non-Trustee Member Approval.**

Trustee Turner, Chair of the Investment Committee, recommended the appointment of Robert S. Blackwood as a non-voting, non-trustee member of the Investment Committee. Mr. Blackwood is a retired commercial lender from Maine's banking community. He has a long record of service to the University of Southern Maine (USM) including serving on the Alumni Association Board and the Board of Visitors. Currently Mr. Blackwood serves on the USM Foundation Board as Treasurer and is active in fundraising.

**Action Taken**

On a motion by Trustee Gardner, which was seconded by Trustee Donnelly, the Investment Committee approves the appointment of Mr. Robert S. Blackwood to a three-year term as a non-voting, non-trustee member of the Investment Committee effective September 7, 2016.

**Non-Voting, Non-Trustee Member Recognition.**

Mr. James Geary has served as a member of the Investment Committee since September 25, 2013 and will be completing his term effective November 25, 2016. The University of Maine System (UMS) and the Investment Committee extends its sincere gratitude to Mr. Geary for his years of dedicated service and for the expertise he has brought to the Investment Committee.

**Action Taken**

On a motion by Trustee Gardner, which was seconded by Trustee Donnelly, the Investment Committee acknowledges James Geary for his dedication and service as a non-voting, non-trustee member.

**Investment Committee FY2017 Work Plan and Duties & Responsibilities.**

The Investment Committees reviewed its fiscal year 2017 Work Plan and Committee Duties & Responsibilities. Both documents will be included in the September 18-19, 2016 Board of Trustees meeting materials.

**Defined Contribution Plan – Quarterly Review and Update.**

Mr. Mike Pratico from CAPTRUST provided brief market commentary noting that halfway through 2016, returns have been strong, especially in light of the news that shape them. The April-June

timeframe saw most U.S. equity and fixed income categories rise, while international markets were mixed.

Mr. Pratico also briefly noted the recent increase in law suits related to Employee Retirement Income Security Act (ERISA) related plans. Claims vary but issues range from fees, to performance, to investment options.

Mr. Pratico went on to note that Morningstar recently changed several investment peer group names. CAPTRUST will update such references in the UMS Defined Contribution Plan's Investment Policy Statement for the Committee to approve at a future meeting.

TIAA recently announced the opening of their new office in Portland at Four City Center. As of June 30, 2016 there were \$1.3 billion in total plan assets including \$1.9 million in transfers from deselected vendors for the quarter. The Vanguard Target Date fund assets continue to increase and now represent approximately 5% of the assets within the 403b Plan. TIAA Traditional – Group Retirement Annuity holds the largest allocation of assets at 38% or \$505 million while CREF Stock comes in second with participants investing \$213 million or 16% of assets in this investment.

#### **TIAA Traditional Due Diligence Update & Fiduciary Rules**

Following the May 26, 2016 Committee discussion about the TIAA Traditional Account and the appropriateness of the investment for UMS employees, several conference calls were held to continue the education and discussion about this product. Calls were held on July 20<sup>th</sup> and August 18<sup>th</sup>, 2016 to discuss the TIAA Traditional product as part of an overall asset allocation strategy and the underlying composition of the TIAA General Account respectively. CAPTRUST continues to feel comfortable with the TIAA Traditional product as a choice within the UMS retirement plan. CAPTRUST also believes that the percentage of assets allocated to TIAA Traditional via the Ibbotson models is appropriate. The Committee requested additional educational sessions be made available for UMS participants. CAPTRUST and UMS staff will begin planning for such sessions this fall.

Mr. Pratico spoke briefly about the new Department of Labor fiduciary rules that go into effect on April 10, 2017 which are intended to ensure financial advisers are keeping the best interests of clients in the forefront when offering guidance. TIAA is still working on analyzing the requirements and how TIAA's operations and procedures may need to change to comply with the rules.

Jack Moore urged Mr. Pratico to keep the Committee informed as TIAA determines how the fiduciary rules impact its business and what changes may impact UMS plans and participants. He further urged that such updates include any changes related to allocation recommendations made by the Ibbotson model particularly related to the TIAA Traditional product.

Trustee Turner noted a recent 60 minutes segment titled "Not Paid" which raised concerns about the insurance industry's procedures related to ensuring payout of life insurance and retirement assets to beneficiaries and estates upon a participant's death. Concerns included those around escheatment procedures whereby property is supposed to be turned over to States as required under abandoned property laws. One of the key areas mentioned was the lack of procedures where an insurance company would learn of an annuitant's death, would stop disbursements, but then fail to notify the related insurance arm of the company to stop charging premiums for life insurance. Such payments were sometimes taken from the cash value of the policy until nothing was left.

### **Plan Expense Summary**

Mr. Pratico provided an overview of plan expenses. The weighted average expense ratio of the plan is 0.44%, noting that participants have the ability to structure much lower cost portfolios by utilizing either the Vanguard Target Date series or selecting from the Vanguard Index fund options. TIAA's target for record keeping expenses is to capture .09% (or \$1.2 million) of revenue which CAPTRUST considers reasonable.

### **Quarterly Review of Investments**

The Committee reviewed all funds in a manner consistent with the Investment Policy Statement. All funds were discussed with emphasis on the following. No changes are recommended at this time. CAPTRUST placed Ridgeworth Mid Cap Value on watch in 2015 due to inconsistent performance. The strategy has faced stylistic headwinds similar to its peers, but poor stock selection and its benchmark agnostic approach magnified the underperformance. Based on valuation concerns, the strategy is underweight Real Estate Investment Trusts (REITs) and utilities which comprise nearly 30% of the index and have benefitted from the low rate backdrop. The market has rewarded higher growth firms, while the team looks for firms with low analyst expectations. The team also had some missteps in individual positions where their thesis did not unfold as expected. Based on the CAPTRUST scoring methodology, the fund has recently climbed back into good standing and near term performance has been sound. The fund has been in the top third of its peer group through early September 2016 and the top quartile over the last year.

### **NEPC Performance Reviews.**

Kelly Regan from NEPC reviewed market performance reminding the Committee that, for the most part, 2015 was a difficult year for diversified portfolios as large cap equities and core fixed income were the best places to be. On the other hand, 2016 calendar year-to-date has been good to diversified asset classes such as Emerging Market Equities and Bonds.

### **Managed Investment Pool (MIP)**

The MIP returned -2.0% for the fiscal year ending 2016. This return ranked in the 51<sup>st</sup> percentile in the InvestorForce Endowments and Foundation universe. Managers detracted value during this time period with small cap, multi-sector fixed income and global asset allocation managers detracting the most value relative to benchmarks. The MIP performed well in July 2016 as asset classes rallied and the portfolio was up 3.1% for the month.

The Committee asked NEPC to provide an update on Loomis Sayles (MIP's multi-sector fixed income manager) at the next meeting given the manager's higher risk profile compared to traditional fixed income and their lackluster performance. They returned 1.9% for FY16 compared to the benchmark of 8.9% following -6% in FY15 compared to the benchmark of -3.2%.

The Committee discussed the MIP annualized returns as of July 31, 2016 for the trailing 3 year (returning 4.2%) and 5 year (returning 5.3%) time frames and observed that the Portfolio has not generated enough investment gains to offset inflation and the 4.5% endowment distribution rate. NEPC commented on the difficult time period for diversified portfolios along with expectations going forward. Ms. Regan reminded the Committee that NEPC's minimum long term return assumption is 7.5% recognizing that volatility will persist. Mr. Moore commented that it's worth the Committee revisiting the payout rate as the markets might be in for several years of depressed returns.

### **Defined Benefit Pension Fund Performance Review**

The Pension fund returned 0.5% for the fiscal year ending 2016. This return ranked in the 46th percentile in the InvestorForce Total Fund Universe. Managers detracted value during this time period with global asset allocation managers detracting the most value relative to benchmarks. The Pension performed well in July 2016 as asset classes rallied, however the return was muted at 2.0% compared to the MIP as the Pension has a more conservative profile.

The Committee discussed the cash outflows of the Pension Fund for benefit payments and asked about the funding level from an actuarial perspective. Tracy Elliott commented that she expects the actuarial report by the end of the week and will provide an update at the next meeting. Early results indicate an increase in the annual funding requirement given last year's lower than expected returns and given the decline in NEPC's minimum long-term return assumption declining from 6.75% to 6.25%. Further, the Pension's funded status will have declined for the same reasons.

### **Operating Fund**

The Operating Fund returned 0.7% for the fiscal year ending 2016. The Operating Fund had the highest return compared to the other 2 portfolios given the very conservative risk profile as the Fund is invested 50% in Fixed Income strategies and 25% in money markets and the State Pool. Managers detracted value during this time period with global asset allocation managers detracting the most value relative to benchmarks. The Operating Fund performed well in July 2016, returning 1.0% for the month.

### **Environmental Social and Governance Investing and MSCI Reporting Discussion.**

Trustee Turner provided a brief history of its discussions with the Divest UMaine including a meeting held this past April and how Environmental, Social and Governance (ESG) investing presents a common ground for consideration. Divest UMaine representatives viewed this alternative as a responsible approach to responding to climate change in the investment arena.

An increasing number of investment strategies are integrating ESG factors into their investment process. Investment managers who have adopted an ESG model rate companies on their Environmental actions, Social responsiveness, and their Governance structure. ESG focused managers will typically have less exposure to fossil fuels, but may not eliminate the exposure entirely. ESG investing is one of positive rather than negative screening and such managers generally take a "best in class" approach.

Ms. Regan provided an educational overview of ESG investing along with a sample report from MSCI which rates a portfolio on different E, S and G factors. She commented that ESG investing focuses on increased financial returns by providing a context for research and security selection. The Committee discussed a 5 year plan for considering ESG when looking at managers going forward. The Committee will start with asset classes with high ESG consideration and give other areas time to develop. Ms. Regan commented that this is a growing strategy with \$4 trillion invested in ESG strategies in 2006 compared with \$59 trillion today. Similarly, the number of ESG managers has grown from 201 in 2005 to 925 today. When we interview managers we will need to gain an understanding of how integrated ESG is in their process. For example, is there a dedicated team or just a consideration of ESG factors? MSCI helps organizations by rating companies on ESG factors and scoring the portfolio. The results will assist the Committee in understanding its progress

in ESG investing over time. About 60-80% of the MIP could be rated on ESG factors. The MIP will incur a charge of \$4,000 a year for the MSCI Reporting.

Mr. Moore suggested that the MIP IPS include a proxy policy statement or that UMS draft a letter to managers encouraging them to express sustainability in investing. Ms. Regan said she would look into options in this area.

Trustee Gardner commented that the ESG considerations are fundamentally the pillars of how a good business is run. He cautioned the Committee to be aware that there are no global standards for the ESG criteria. A company in an emerging market economy would have different standards than in developed markets and a company is rated from the perspective of where that company is located globally.

### **Updated Investment Policy Statements.**

NEPC and staff have reviewed and updated the Investment Policy Statements (IPS) for the MIP, Defined Benefit Pension Plan and Operating Fund. Ms. Regan briefed the Committee on the changes including those related to asset allocations, minimum long term return assumptions, endowment distribution rates, and consideration of environmental, social and governance factors. Specifically, the MIP goals were expanded to include recognition that companies which include ESG factors into their decision making process may benefit from improved long term value creation. As a result, the Committee will consider ESG principles and incorporate ESG analysis into investment decisions such as asset allocation and manager selection. Further, investment manager responsibilities were expanded to require those investment managers who incorporate ESG into their investment process to provide annual updates to the Committee regarding their process and impact. Investment managers that have a responsible investment policy and Principles for Responsible Investment (PRI) transparency report should provide the documents to the Committee. Additional ESG specific reports may also be required and requested by the Committee.

Trustee Gardener again cautioned the Committee that there are global differences about what ESG means and how managers view the various factors. Such differences can remove a company from consideration when they may in fact be a very good company. This area will surely evolve but we need to be aware of the nuances. Mr. Robert Blackwood agreed and commented that the way the IPS is written allows us the flexibility to consider such companies while this area develops.

### **Action Taken**

On a motion by Trustee Gardner, which was seconded by Trustee Donnelly, the Investment Committee approves the updated Investment Policy Statements for the Managed Investment Pool, Defined Benefit Pension Fund and the Operating Fund.

### **Investment Manger Discussions: Windhaven and Permal.**

The Operating Fund has a 5% target allocation to Windhaven with \$15 million invested as of the end of July. NEPC placed Windhaven on "Client Review" in July 2016 as Windhaven announced several personnel changes and a reorganization in the oversight of their investment products. In addition, Windhaven's short and long term performance has been disappointing versus their benchmark. As such, NEPC recommends replacing Windhaven Diversified Conservative with Newton Global Real Return, a manager which the Committee hired for the MIP and Pension funds in May 2016.

NEPC issued a "Hold" status for Permal Fixed Income Holdings (PFIH) in February 2016 due to the Entrust Permal merger. NEPC recommends maintaining the investments with Permal Fixed

Income Holdings while continuing to monitor the firm and strategy going forward. The University of Maine System currently has a \$23.4 million allocation to PFIH as of June 30, 2016, as follows:

- MIP: \$15.7 million
- Pension: \$1.7 million
- Operating: \$6.0 million

Mr. Moore cautioned that Permal is not the firm the UMS hired and asked what percentage of senior and junior people are still with the firm. Ms. Regan will inquire and respond back to the Committee. Mr. Moore asked that NEPC make the Committee aware of any further developments and revisit the conversation in the future.

**Action Taken**

On a motion by Trustee Gardner, which was seconded by Trustee Newell, the Investment Committee approves:

1. replacing Windhaven Diversified Conservative with Newton Global Real Return in the Operating Fund and
2. maintaining its investments with Permal Fixed Income Holdings, in the MIP, Pension, and Operating Funds.

**Money Market Funds Selection.**

NEPC previously briefed the Committee about changes to occur in October 2016, when the Security and Exchange Commission's new money fund rules will go into effect. These new rules will have varying effects on different types of funds (government, prime or municipal/tax exempt) and investor types (institutional or retail). The rules will impact UMS's Operating Fund investments with Dreyfus and Federated as they are Prime Funds that will be subject to Floating NAV, liquidity fees and redemption gates. The MIP and Pension Fund currently also utilize a prime money market fund in the BNY Mellon cash account/sweep vehicle. Given the money market reform that goes into effect October 2016, BNY Mellon will no longer offer the current option utilized by UMS. Ms. Regan reviewed a money market fund presentation and discussed options for investing.

**Action Taken**

On a motion by Trustee Gardner, which was seconded by Trustee Donnelly, the Investment Committee approves the selection of Federated, JP Morgan and Dreyfus Government Money Market Funds as follows:

- 1) In the Operating Fund, utilize Federated Government Obligations (GOFXX) and JP Morgan US Gov't MM (OGVXX) to replace Dreyfus Inst'l Cash Advantage (DADXX) and Federated Prime Cash Obligations (PCOXX).
- 2) In the MIP and Pension sweep accounts at BNY Mellon, utilize Dreyfus Government Cash Management (DGCXX) in lieu of the Dreyfus Cash Management Institutional Fund (DICXX)

Adjournment

Submitted by  
Tracy Elliott for  
Tracy B. Bigney, Clerk