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UNIVERSITY OF MAINE SYSTEM

DEFINED BENEFIT PENSION FUND – ANNUAL REPORT

YEAR ENDED JUNE 30, 2009

Additional copies are available at <http://www.maine.edu/system/oft/PensionFund.php> or by contacting:

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University of Maine System

Year Ended June 30, 2009

The University of Maine System (USM) Defined Benefit Pension Plan (Pension Plan) is a closed plan, maintained for eligible employees who chose not to join the Defined Contribution Plan established for hourly employees on July 1, 1998. This plan covers a shrinking group of active employees; vested terminated employees, and pensioners.

Funded Status of the Pension Plan

The Defined Benefit Plan assets are invested in a separate fund with assets totaling \$42.4 million at June 30, 2009. On an actuarial basis, the plan was overfunded on July 1, 2007 by \$16.2 million. Valuation results for July 1, 2009 however reflect the difficult market performance during fiscal year 2009, resulting in an unfunded liability of \$2.9 million.

Oversight and Management

Portfolio and investment management is an ongoing process with the following parties meeting quarterly to provide oversight of pension plan assets:

- Board of Trustees Investment Committee
- Investment Consultant – New England Pension Consultants (NEPC) – Cambridge, MA
- Rebecca Wyke, Vice Chancellor for Finance and Administration and Treasurer, UMS
- Tracy Elliott – Director of Finance and Controller, UMS
- Peter Small – Institutional Research Analyst, UMS

Governing Guidelines

Formal guidelines, established by the Investment Committee, govern the pension plan investment process and are updated as needed. These guidelines can be found at <http://www.maine.edu/system/oft/InvestmentGuidelines.php>. They include:

- Total return and risk objectives
- Statement of goals and objectives
- Investment guidelines including
 - Asset allocation with target percentages, permissible ranges, and evaluation benchmarks, and
 - Permitted and excluded investments
- Investment manager performance standards and evaluation
- Responsibilities of all parties concerned
- Conflict of interest statement

These guidelines currently target a long-term return objective for the Pension Fund of 8.0%.

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Fiscal Year 2009 Performance

Fiscal Year 2009 saw a global recession as the economy weakened and job losses mounted, with the market experiencing extreme volatility. Deleveraging in the market, a lack of liquidity, and risk aversion fueled market corrections. This period was also marked by massive fiscal and monetary intervention by governments.

Losses in the Pension Fund reflect global economic conditions. The Pension Fund **experienced a loss of -16.2%** [-16.9% net of fees] **in FY09**. The fund placed in the 53rd percentile (i.e., 52% did better) of the total fund universe tracked by the System's investment consultant. The assets in the plan totaled \$42.4 million, decreasing \$16.5 million over the prior year-end balance as detailed below under the section Pension Plan Inflows and Outflows.

The plan's **5-year annualized return of 2.4%** [1.7% net of fees] ranks the fund in the 46th percentile of all funds, meaning the fund performed better than 54% of other funds in the universe while the risk taken during the same period was lower than the universe. This return compares to an S&P 500 return of -2.2% and the Barclays Capital Aggregate Bond Index return of 5.0% over the 5 year period.

The Defined Benefit Pension Plan funds are well diversified among a number of asset classes with allocations to ten investment managers at fiscal year-end.

Changes in Investment Managers and Holdings

Wellington

In June 2008, the Investment Committee approved a new global asset manager, Wellington Management Company. The Wellington Opportunistic Investment Fund was funded on July 31, 2008 by rebalancing the portfolio. The fund seeks to outperform 65% S&P/ 35% Barclays Aggregate by providing opportunistic exposure to a variety of non-core investment areas and new product ideas. Wellington actively rotates asset classes as opportunities change.

SSgA

The Investment Committee agreed at its February 2009 meeting to terminate State Street (SSgA) Enhanced Small Cap Index Plus Securities Lending Fund due to management changes and sub par investment performance. This action was delayed as the securities lending¹ feature of the fund caused liquidity issues brought on by this year's credit crisis.

In June 2009, UMS transferred all funds from the current SSgA actively managed product to an SSgA Small Cap Passive Index product. A permissible portion (16%) was invested in nonlending funds while the UMS continues to transfer the monthly allowable amount (4%) from securities lending to nonlending. SSgA will continue to be monitored for an appropriate time to proceed with manager termination.

¹ Securities lending is an investment management product whereby participants generate a fee for temporarily transferring client securities, in a collateralized transaction, to a borrower.

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Plan Participants

The Defined Benefit Plan is closed to new participants. New hourly employees participate in the Defined Contribution Plan.

An actuarial valuation is performed every two years. The following table presents participants in this plan as of July 1, 2007 and 2009:

	<u>July 1, 2007</u>	<u>July 1, 2009</u>
Participating Employees ²	158	106
Retirees and Beneficiaries	870	871
Deferred Vested Participants ³	<u>419</u>	<u>404</u>
Total Participants	<u>1447</u>	<u>1381</u>

Pension Plan Inflows and Outflows

	(\$ in Thousands)	
	<u>2008</u>	<u>2009</u>
Beginning Market Value - June 30	<u>\$67,307</u>	<u>\$58,865</u>
Net external outflows (e.g., benefit payments, expenses)	(\$4,567)	(\$4,613)
Outflow to fund Basic Plan costs ⁴	(2,000)	(2,000)
Interest and dividend income	5,361	772
Net gain or loss on investments	<u>(7,236)</u>	<u>(10,665)</u>
Net activity for the fiscal year	<u>(\$8,442)</u>	<u>(\$16,506)</u>
Ending Market Value – June 30	<u>\$58,865</u>	<u>\$42,359</u>

As shown above, with the approval of the Investment Committee, the System used \$2 million of the overfunded Defined Benefit Plan assets to fund Basic Plan costs. The UMS Basic Plan and this Defined Benefit Plan are administratively separate but are both part of the Retirement Plan for Classified Employees and covered by the same plan document. In accordance with Section 414(k) of the Internal Revenue Code, the System may elect to fund employer contributions to the Basic Plan and the Optional Retirement Savings Plan from excess assets in this Defined Benefit Plan.

Returns, Historical Growth, and Allocation

Attachment I reports the total returns for the fund on a net of fees basis and the fund's year end market value for the past 5 years, as well as the asset allocation for the fiscal years ended June 30, 2008 and 2009.

² Shrinking population of those employees who were over age 50 on July 1, 1998 and elected to stay in the plan. Number includes 35 participants on Long-Term Disability on 7/1/2007 and 29 participants on 7/1/2009.

³ Those who have terminated employment from UMS and are vested but not currently drawing a benefit.

⁴ Used excess assets to fund employer contributions to the Basic Plan and/or Optional Retirement Savings Plan.

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Asset Allocations, Total Returns, and Market Values

June 30, 2009

Market Value and Asset Allocation of the Defined Benefit Pension Plan Funds (\$ in thousands)

	June 30, 2008		June 30, 2009	
	Market Value	% Allocation	Market Value	% Allocation
Domestic Equities	23,083	39%	14,318	34%
International Equities	7,628	13%	5,211	12%
Fixed Income	9,045	15%	5,742	14%
Market Neutral	3,086	5%	2,163	5%
Global Asset Allocation	6,552	11%	7,134	17%
Hedge Funds	6,185	11%	5,542	13%
Core Real Estate	3,286	6%	2,250	5%
Total	58,865	100%	42,360	100%

Total returns (net of fees) for the five years ended June 30, 2009, and the market value of Plan assets at year end for the same five year period, are shown in the charts below.

