

UNIVERSITY OF MAINE SYSTEM
Board of Trustees
Investment Committee

March 3, 2022
Zoom

Present: Committee Members: Kelly Martin; Chair, David MacMahon, Sven Bartholomew, James Donnelly, and Mark Gardner. **Other Trustees:** Peggy Rotundo and Trish Riley. **Non-Voting, Non-Trustee Committee Members:** Jim Bradley, and Matthew Skaves. **System Staff:** Tracy Elliott, Ellen Doughty, and Ryan Low. **Others:** Kelly Regan – NEPC, Barron Schmitt – CAPTRUST, Michael Pratico – CAPTRUST.

Absent: None.

Opening Comments

Trustee Martin, Chair, called the meeting to order and welcomed everyone. The Clerk performed a roll call of the Committee members present. Chair Martin then provided a brief update regarding a February 9th education session where trustees, staff, and NEPC had a good discussion regarding sustainable investing. Chair Martin extended her thanks to those who have provided input as the Committee considers its investment policies.

UMS Vice President of Finance and Controller, Tracy Elliott, noted that Maine Maritime Academy has participated in the Managed Investment Pool (MIP) for the last 14 years. Recently, their Wealth Management Selection Committee conducted a routine due diligence review and voted to terminate their investment agreement with the University as soon as prudently possible. UMS anticipates beginning distribution of proceeds on April 1st and completing the liquidation process by fiscal year end after receiving all liquidation proceeds, final valuations, and a final assessment of fees.

FY2023 Endowment Spending Rate

UMS Vice President of Finance and Controller, Tracy Elliott provided information regarding the FY2023 endowment spending rate. At its December meeting, the Investment Committee approved a spending rate of **4.5%**. Since that time, budgets have been calculated and provided to the campuses. The estimated distribution is approximately \$6.2 million, increasing \$300 thousand (or 4.8%) over the prior year which supports nearly \$5 million in endowed spending plus a \$1.3 million total management fee (charged by UM, USM, & GUS)

Defined Contribution (DC) Plans - Quarterly Review

Michael Pratico, Senior Vice President, and Barry Schmitt, Principal, with CAPTRUST Financial Advisors, provided a quarterly update regarding the Defined Contribution Plan.

Industry Updates: Mr. Pratico mentioned the Secure Act, noting that the House of Representatives released *Securing a Strong Retirement Act of 2021*, and the Senate released the *Retirement Security and Savings Act*. These bills contain many overlapping provisions and likely will be combined in 2022 to create *SECURE 2.0*. A potential impactful element of *SECURE 2.0* is the proposed allowability of Collective Investment Trust (CIT) vehicles in 403(b) plans. CITs are in some ways similar to mutual funds and are often viewed as a lower-cost option for participants. However, CITs may also pose challenges including limited transparency to participants. CAPTRUST will monitor closely and report back to UMS as appropriate.

CAPTRUST also suggested that retirement plan fiduciaries should be mindful of the following in the new year:

- a new auditing standard known as Statement on Auditing Standard No. 136 (SAS 136) *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, and
- the lifetime income disclosure rule, which requires lifetime income illustrations on retirement plan participant statements.

In addition, CAPTRUST updated the committee on the recent ERISA lawsuit filed against Northwestern University that went all the way to the Supreme Court. The suit, similar to many other suits filed under ERISA, focused on the plan sponsors offering too many choices, expensive retail share class funds, and having no process in place. CAPTRUST noted that, while not subject to ERISA, UMS follows ERISA guidelines as a best practice and has a thorough prudent fiduciary process in place.

Market Commentary: CAPTRUST provided market commentary noting that despite bouts of volatility fueled by virus and policy uncertainty, supply chain woes, and inflation worries, most asset classes posted solid returns in 2021, led by economically sensitive sectors that benefitted from reopening trends. Emerging markets stocks were roiled by China policy and growth concerns, and core bonds moved sideways as bond yields ticked modestly higher.

Investment Review: The committee and its advisor reviewed the plans' funds consistent with the process outlined in the Investment Policy Statement. All funds are currently "in good standing" based on the CAPTRUST scoring methodology. CAPTRUST emphasized the following:

- **PGIM Total Return:** The fund underperformed its peers in 2021. The driver of underperformance has been the strategy's higher duration, or interest rate sensitivity. The fund bounced back in the 2nd quarter of calendar year 2021 as interest rates settled back down but 2021 performance still lagged and is off to a poor start in 2022 in a challenging interest rate environment for bond fund managers. CAPTRUST continues to recommend holding the fund but is monitoring performance closely.
- **Vanguard Target Date:** While the performance of the Vanguard series struggled in the 4th quarter of calendar year 2021, long term performance remains sound. The series' asset allocation was the primary driver to the peer and benchmark relative lagging performance. Vanguard's portfolio construction approach is driven by an emphasis on global diversification, as the firm believes that this will create more resilient portfolios. This detracted in the 4th quarter.

Defined Contribution (DC) Plans – Limited Scope Request for Proposal Recommendation

Mr. Schmitt led the group through CAPTRUST's report on the results of the record-keeping Request for Proposal (RFP) conducted in the first quarter of 2022. The report highlighted the evaluation process, criteria for prospective recordkeeping candidates, and vendor responses. CAPTRUST performed a qualitative and quantitative evaluation of the landscape of potential record-keepers for the University of Maine System's plans. The group discussed various topics and the "levers" used in pricing the plans including "legacy" assets that would remain at TIAA if a new vendor were chosen. CAPTRUST recommended that the committee accept TIAA's offer to lower the recordkeeping/administrative fees from 4.3 basis points to 3.3 basis points which will result in cost savings to participants of approximately \$198,000/year.

On a motion by Trustee Gardner, which was seconded by Trustee Donnelly, and approved by a roll call vote of all Trustees present, the Board of Trustees acting through the Investment

Committee, accepted TIAA's proposal which reduces recordkeeping/administrative fees to 3.3 basis points.

NEPC Managed Investment Pool (MIP), Pension, and Operating Funds

Market Update

Kelly Regan with NEPC provided a review of the fourth quarter 2021 market environment. She noted that 2021 was a great year for risk assets. U.S. large cap equities returned 28.7% and international developed equity returned 11.3%. The one area of equity underperformance was emerging market equities which declined 2.5% in 2021 as increasing regulations in China put pressure on Chinese equities which make up roughly 35% of the MSCI EM index. Treasury rates increased during the 2021 calendar year and the Barclays Aggregate declined -1.5%. While Treasury rates increased, credit spreads narrowed resulting in positive performance for credit focused investments. For reference, the Barclays US High Yield index returned 5.3%.

Ms. Regan also provided an update on the calendar 2022 to date market environment which has experienced negative equity and fixed income returns. She noted higher inflation, potential for the Federal Reserve to increase short-term interest rates and the Russia-Ukraine conflict adding volatility to markets. Looking forward, NEPC has added a new theme to their outlook, Economic Crossroads. Ms. Regan discussed the theme and noted NEPC's belief is that the pendulum is swinging from Fed policy as the dominant input for capital markets to growth and inflation forces driving market dynamics. She noted that there is a lot of uncertainty around this theme and stated that the strategic asset allocation outlook over the near-term is to maintain current equity targets, to overweight emerging markets (versus the MSCI ACWI index) and to maintain portfolio liquidity through fixed income (core bonds and TIPS).

Asset Allocation

Ms. Regan reviewed the three UMS portfolios and noted there were no asset allocation recommendations. All three portfolios are positioned to meet their long-term return objectives, over the next 30 years, of 7.25% for the MIP, 4.0% for the Operating Fund and 6.25% for the Pension Fund.

Performance Reviews

Ms. Regan reviewed performance for all three UMS portfolios with the following highlights.

Operating Fund: The Operating Fund returned 0.7% during the quarter ended December 31, 2021 and 2.8% over the trailing 12 months, net of fees. The Fund's total market value was \$307.8 million as of December 31st representing a decrease of \$31.6 million quarter over quarter due to negative cash flows out of the Fund. During the quarter, managers were in-line with their respective benchmarks in aggregate (Composite vs. Allocation Index). At the end of the calendar year, the asset allocation of the Fund was within policy ranges.

Defined Benefit Pension Fund: The Pension Fund returned 3.8% during the quarter ended December 31, 2021 and 8.9% over the trailing 12 months, net of fees. The Pension's total market value was \$25.2 million as of December 31st representing no change quarter over quarter. During the quarter, managers added 40 basis points of value. At the end of the calendar year, the asset allocation of the Pension was close to policy targets.

Managed Investment Pool (MIP): The Managed Investment Pool (MIP) returned 4.1% during the quarter ended December 31, 2021 and was positive 11.5% over the trailing 12 months, net of fees. The MIP's total market value was \$460.8 million as of the calendar year end representing an increase of \$18.5 million quarter over quarter. During the 4th quarter, managers detracted 10 basis points of value.

International equity managers contributed the most to the underperformance as further discussed later in the meeting. The MIP ranked at the 38th percentile of the Endowments and Foundation universe during the 4th quarter. NEPC noted that longer term ranks have fallen short of the median in part because the MIP does not have an allocation to private equity, while most peers do, and because of manager underperformance. At the end of the calendar year, the asset allocation of the MIP was close to policy targets.

International Equity Manager Recommendations – Managed Investment Pool

Ms. Regan provided the Committee with a recommendation to terminate two MIP managers - Morgan Stanley International Equity and Kabouter International Opportunities due to poor long-term performance and other factors. She discussed the performance of the two managers, reasons for underperformance and other concerns specifically with Kabouter's higher than usual holdings turnover limiting the ESG capabilities. A recommendation was made to replace Morgan Stanley with the SSgA EAFE Index Fund Non-Lending. NEPC prefers passive management in efficient asset classes such as International Large Cap equity and the hiring of SSGA would reduce investment manager fees by \$190 thousand annually. Ms. Regan detailed all of the managers included in the passive International Equity search and recommended SSgA due to low fees and consistent performance compared to the MSCI EAFE index. Ms. Regan then recommended replacing Kabouter with the Axiom International Small Cap Equity fund. She cited consistent performance, strong ESG investment process, lower fees and reasonable risk statistics.

On a motion by Trustee Bartholomew, which was seconded by Trustee Donnelly, and approved by a roll call vote of all Trustees present, the Board of Trustees acting through the Investment Committee, approved the following international equity manager changes:

- Terminate Kabouter International Opportunities and replace with Axiom International Small Cap Equity for approximately 3% of total Portfolio assets.
- Terminate Morgan Stanley International Equity and replace with SSgA MSCI EAFE Index Non-Lending for approximately 5% of total Portfolio assets.

EXECUTIVE SESSION

On a motion by Trustee Gardner, which was seconded by Trustee Donnelly, and approved by a roll call vote of all Trustees present, the Investment Committee meeting went into Executive Session under the following provisions:

- 1 MRSA Section 405 6-C to discuss the condition, acquisition or disposition of real property or economic development if premature disclosure of the information would prejudice the competitive or bargaining position of the UMS.

On a motion by Trustee Donnelly, which was seconded by Trustee Gardner, and approved by a roll call vote of all Trustees present, the Committee concluded the Executive Session.

Additional information about the meeting can be found on the Board of Trustees website:

<https://www.maine.edu/board-of-trustees/meeting-agendas-materials/investment-committee/>

Adjournment

Tracy Elliott for

Ellen N. Doughty, Clerk