



NON-CONTRIBUTORY RETIREMENT FUND
ANNUAL REPORT
YEAR ENDED JUNE 30, 2015

Report is available at:

<http://www.maine.edu/about-the-system/system-office/finances/pension-fund-annual-reports/>

Office of Finance and Administration, University of Maine System

Non-Contributory Retirement Fund – Annual Report

University of Maine System Year Ended June 30, 2015

The University of Maine System (UMS) Non-Contributory Retirement Fund (Pension Plan or 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.¹

Funded Status of the Pension Plan

The Plan assets are invested in a separate fund (Pension Fund or Fund) with the market value of assets totaling \$36.6 million at June 30, 2015 compared to \$40.2 million at June 30, 2014. UMS obtains an actuarial valuation every other year. The most recent valuation, completed by KMS Actuaries, was as of July 1, 2015 and showed a Total Pension Liability (TPL) of \$43.3 million for a funded status of 85%. The difference between the assets and TPL is a Net Pension Liability (NPL) of \$6.7 million. This compares with an NPL of \$6 million on June 30, 2014 when the Plan had a funded status of 87%.²

Oversight and Management

Portfolio and investment management is an ongoing process with the following parties meeting routinely to provide oversight of the Fund:

- UMS Board of Trustees Investment Committee
- Investment Consultant – New England Pension Consultants (NEPC)
- Vice Chancellor for Finance and Administration and Treasurer, UMS
- Director of Finance and Controller, UMS

Governing Investment Guidelines and Objectives

Investment guidelines, last updated May 27, 2015, govern the investment process and may be found at <http://www.maine.edu/about-the-system/system-office/finances/investment-guidelines-2/>.

Guidance includes:

- Minimum long-term return assumption
- Risk tolerance
- Statement of goals and objectives
- Investment guidelines including:
 - Asset allocation with target percentages, permissible ranges, and evaluation benchmarks, and
 - Permitted and excluded investments

¹ For a more detailed description and actuarial status of this defined benefit plan, see the UMS Annual Financial Report at <http://www.maine.edu/about-the-system/system-office/finances/annual-financial-reports/>

² The UMS retroactively implemented Governmental Accounting Standards Board (GASB) Statement #68 for its fiscal year 2015 (FY15) financial statements. As a result, certain changes were made to presentation, disclosure, and Required Supplemental Information. For further information about this accounting change, see the UMS's FY15 Annual Financial Report.

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- Investment manager performance standards and evaluation
- Responsibilities of all parties
- Conflict of interest
- Statements about implementation and amendments

Long-Term Return Objective

With the implementation of a more conservative asset allocation strategy, approved by the Investment Committee in February 2014, the long-term return assumption was reduced from 7.25% to 6.75% which is reflected in the current investment guidelines. Reducing the discount rate, increases the actuarially determined liability for this factor.

Fiscal Year 2015 Performance

The Pension Fund **experienced a return of 0.1%** net of fees for fiscal year 2015 (FY15), placing the Fund in the 84th percentile of the total fund universe tracked by NEPC. Performance is impacted by financial market conditions, asset allocation and the investment managers utilized. As a point of reference, the S&P 500 return was 7.4% and the Barclays Capital Aggregate Bond Index return was 1.9% over the same 1 year period. On June 30, 2015, the Fund totaled \$36.6 million, decreasing \$3.6 million from the prior year-end balance as detailed on the next page.

5-Year Annualized Return

The Fund's **5-year annualized return as of June 30, 2015 was 8.5%** net of fees ranking the Fund in the 65th percentile of the total fund universe tracked by NEPC while the risk taken, in terms of volatility of returns, was at the 66th percentile. The S&P 500 return was 17.3% and the Barclays Capital Aggregate Bond Index return was 3.3% over the same 5 year period.

The Fund is well diversified among a number of asset classes with allocations to twelve investment managers or index funds at fiscal year-end.

Changes in Portfolio Allocation and Investment Managers

Fixed Income Managers

At its May 2014 meeting, the Investment Committee discussed diversifying the Core Fixed Income allocation given the recently approved target allocation increase, from 13% to 27%, for this asset class. At its September 2014 meeting, the Investment Committee approved the addition of the J.P. Morgan Core Bond Fund (R6 Class Shares) for an approximate 13.5% allocation which was funded by a transfer from PIMCO Total Return in October 2014.

At its December 2014 meeting, the Investment Committee approved the termination of the PIMCO Total Return fund given the abrupt departure of PIMCO Total Return's lead fund manager, founder and chief investment officer, Bill Gross, along with several other key factors. The Committee approved replacing this product with the Vanguard Total Bond Market Index Fund (VBTIX) which was funded in December 2014.

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Hedge Fund Managers

At its May 1, 2015 meeting, the Investment Committee approved the redemption of the Cube Global Multi-Strategy Fund and the commencement of a search for a replacement manager. At its May 27th meeting, the Investment Committee selected Lighthouse Partners for this mandate. Initial funding began on August 1, 2015 following receipt of partial proceeds from Cube.

Portfolio Allocation Review

At its February 2015 meeting, the Investment Committee reviewed the asset allocation for this Plan and made no changes.

Plan Participants

The Plan is closed to new participants. Eligible employees who were hired before July 1, 1998 and who were age 50 or older on June 30, 1998 could elect to roll their accrued defined benefit to the Defined Contribution Program or remain in the Defined Benefit Pension Plan. Hourly employees hired July 1, 1998 or later participate in the Defined Contribution Program.

An actuarial valuation is performed every other year for the Defined Benefit Pension Plan and participant information as of the last two valuations is shown here:

	<u>July 1, 2013</u>	<u>July 1, 2015</u>
Participating Employees ³	25	12
Retired Participants and Beneficiaries	856	809
Terminated Vested Participants ⁴	<u>363</u>	<u>345</u>
Total Participants	<u>1,244</u>	<u>1,166</u>

Pension Fund Inflows and Outflows

(\$ in Thousands)

	<u>FY14</u>	<u>FY15</u>
Beginning Market Value – July 1	<u>\$39,188</u>	<u>\$40,201</u>
Contributions from the University of Maine System	\$550	\$1,100
Benefit payments	(4,742)	(4,693)
Investment Results Net of Fees	5,290	27
Other Professional Services	<u>(85)</u>	<u>(7)</u>
Net Activity for the Fiscal Year	<u>\$1,013</u>	<u>(\$3,573)</u>
Ending Market Value – June 30	<u>\$40,201</u>	<u>\$36,628</u>

³ Shrinking population of those employees who were over age 50 on July 1, 1998 and elected to stay in the Pension Plan. Participating employees includes 7 participants accruing benefits on long-term disability on 7/1/2015 and 12 participants on 7/1/2013.

⁴ Those who have terminated employment from UMS and are vested but not currently drawing a benefit.

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Pension Funding

The actuarial valuation as of July 1, 2015 reports that the Defined Benefit Pension Plan was 85% funded with a Net Pension Liability of \$6.7 million. During fiscal year 2014, the UMS adopted a funding strategy for this Plan to smooth the impact of financial markets on contributions over a long time period and to minimize the impact on Operating Fund cash flows. The amount UMS is required to contribute will be re-determined with each actuarial valuation. The contribution amounts will vary based on market performance, the supported long-term return objective and other assumptions used in the actuarial valuation. The UMS contributed \$1.1 million to the Pension Fund in FY15 and \$550 thousand in FY14.

This funding strategy is designed such that the Plan's assets will never be depleted and allows UMS to use its investment consultant's approved long-term return objective as the discount rate for its actuarial valuations. Otherwise, UMS would be required to use a governmental bond rate for actuarial calculations related to the unfunded portion of the liability, resulting in a greater calculated pension liability.

Returns, Market Values and Portfolio Allocation

Attachment I reports the total returns for the Pension Fund on a net of fees basis and the year-end market values for the past 5 years, as well as the asset allocation on June 30, 2014 and 2015.

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Market Values, Asset Allocations, and Total Returns
June 30, 2015

Market Value and Asset Allocation of the Defined Benefit Pension Fund (\$ in Thousands)						
	June 30, 2014			June 30, 2015		
	<u>Market Value</u>	<u>% Allocation</u>	<u>Target %</u>	<u>Market Value</u>	<u>% Allocation</u>	<u>Target %</u>
Domestic Equities	\$4,205	11%	10%	\$3,594	10%	10%
International Equities	4,552	11%	10%	3,676	10%	10%
Fixed Income	13,109	33%	32%	11,805	32%	32%
Global Asset Allocation	12,207	30%	30%	11,466	31%	30%
Alternative Investments	3,322	8%	10%	3,453	10%	10%
Core Real Estate	1,968	5%	5%	2,003	5%	5%
Cash	838	2%	3%	631	2%	3%
Total	\$40,201	100%	100%	\$36,628	100%	100%

Total returns (net of fees) and the market value of the Pension Fund for the five years ended June 30, 2015 are:

