UNIVERSITY OF MAINE SYSTEM
Board of Trustees
Investment Committee

December 1, 2022
Zoom

Present: Committee Members: Kelly Martin; Chair, David MacMahon, Sven Bartholomew, and Trish Riley. **Non-Voting, Non-Trustee Committee Members:** Jim Bradley. **System Staff:** Tracy Elliott and Ellen Doughty. **Others:** Kelly Regan – NEPC and Barron Schmitt – CAPTRUST.

Absent: Lisa Eames.

FY24 Endowment Spending Rate

Vice President of Finance and Controller Tracy Elliott provided information on the current Fiscal Year 2023 (FY23) endowment spending rate and the recommended FY24 Endowment Spending Rate.

The FY23 spending rate of 4.5% (which includes an internal management fee, where charged) is estimated to generate a distribution of $6.2 million for the fiscal year, including $4.9 million for endowed spending and $1.3 million for internal management fees.

The recommendation for FY24 is to continue the 4.5% spending rate, which the Chief Business Officers support. Applying this rate to the trailing twelve-quarter endowment pool market value average as of June 30, 2022, determines that an estimated $6.6 million will be distributed if the rate is approved. This amount includes $5.1 million for endowed spending, $1.3 million for internal management fees, and $265 thousand for rebuilding underwater endowments. Committee materials provide additional summary information related to the estimated annual distributions.

NEPC, who advises on the Managed Investment Pool (MIP), in which endowment funds are invested, determined that this portfolio could be expected to return in the range of 7.0% to 8.1% using 30-year expected market returns as of June 30, 2022. NEPC believes that an active management assumption of 0.5% could be added to this range. The analysis supports the return assumption of 7.25% for the portfolio and therefore the 4.5% endowment spending should be well supported by the assets recognizing there will be significant volatility around the expected return.

Underwater Endowments: The Accounting Department compared June 30, 2022 individual endowment market values to their initial investments. Nine UMS funds with initial investment values totaling $1.9 million were underwater by $265 thousand. No endowed funds were underwater last year. Included in the UMS Endowment Pool are certain fiduciary funds, of which 21 funds with initial investment values totaling $7.3 million were underwater by $249 thousand. Two fiduciary funds with initial investment values totaling $169 thousand were underwater last year by $500. To allow funds to regain market value, UMS will not distribute earnings in FY24 for those funds that were underwater as of June 30, 2022.

> On a motion by Trustee MacMahon, which was seconded by Trustee Bartholomew, and approved by a roll call vote of all Trustees present, the Board of Trustees, acting through the Investment Committee approved an endowment spending rate of 4.5% for FY24.

Defined Contribution (DC) Plans - Quarterly Review

Barry Schmitt, Senior Vice President with CAPTRUST Financial Advisors, provided a market update and an update regarding the Defined Contribution Plan for the 3rd calendar quarter ending September 30, 2022.

Administration and Industry Updates: CAPTRUST reviewed a number of industry topics including common retirement plan failures and a proposed Auto Portability solution that would be part of the Enhancing American Retirement Now (EARN) Act. The bill would allow for automatic rollovers of small (under $5,000) account balances to new employer sponsored retirement plans. CAPTRUST also reviewed proposed changes under the rules of the Investment Adviser Act of 1940 that aim to create a standardized disclosure and reporting framework for funds that market themselves as environmental, social, and governance (ESG) investments. There is no immediate impact on the plan or need for the committee to take action at this time; however, CAPTRUST anticipates further discussion in 2023.

Market Commentary: CAPTRUST provided market commentary noting that all asset classes ended the third quarter with modest losses, adding to their year-to-date woes. Stocks and bonds climbed in the first half of the quarter as concerns about inflation abated, but the Federal Reserve brought investors back to reality with its aggressive interest rate policy and messaging.

Investment Review: CAPTRUST reviewed all funds in a manner consistent with the UMS Investment Policy Statement. All funds were discussed and are in good standing with two exceptions as detailed below.

<u>Defined Contribution Plan – Emerging Markets Fund Change Recommendation</u>
CAPTRUST recommended that the Committee consider the following fund change in the Defined Contribution Plan menu.

American Century Emerging Markets R6: After posting strong relative returns in 2017, 2019 and 2020, performance has weakened for the strategy over the past twenty-four months as its growth style has fallen out of favor. This shorter-term weakness is weighing on the fund’s intermediate-term results compared to the diversified emerging markets peer group and the MSCI Emerging Markets Index with results falling below the peer median and index return over the past three, five and seven years. As of September 30, 2022, UMS participants held $20.6 million in assets in this emerging markets fund representing just 1.2% of Plan assets.

CAPTRUST conducted a thorough search and selection process to find a recommended replacement manager and provided two options and an additional strategy for consideration which was detailed in the committee’s materials.

- The two emerging market replacement options presented were Driehaus Emerging Markets Growth Instl and William Blair Emerging Mkts Ldrs R6.

- The additional strategy discussed was terminating the American Century Emerging Markets fund and mapping participant assets and contributions to the American Funds Europacific Growth fund which is an already existing foreign large blend manager in the Plan with an allocation to emerging markets (approximately 20%). UMS participants held $14 million in assets in this fund or 0.9% of the $1.66 billion Plan.

After discussion, CAPTRUST recommended terminating the American Century Emerging Markets fund and mapping the assets and contributions to the American Funds Europacific Growth fund. This Foreign Large Blend active manager, which is in good standing and ranked high by CAPTRUST, maintains an allocation to emerging markets which could fill the need for this asset class in the plan. In addition, UMS provides participants with the opportunity to use a brokerage window which provides access to thousands of mutual funds.

On a motion by Trustee Riley, which was seconded by Trustee Bartholomew, and approved by a roll call vote of all Trustees present, the Board of Trustees, acting through the Investment Committee approved the recommendation of CAPTRUST to terminate the American Century Emerging Markets fund and map the assets and contributions to the American Funds Europacific Growth fund.

Defined Contribution Plan – Medium Company Value Fund Change Recommendation
CAPTRUST Financial Advisors recommended that the Investment Committee consider the following fund change in the Defined Contribution (DC) Plan.

Virtus Ceredex Mid-Cap Value Equity R6 is a current fund in the DC Plan with returns that have underperformed the benchmark year to date (YTD) and in 2020, dragging down trailing 3 and 5-year performance. YTD performance is in the bottom decile underperforming the benchmark due to the portfolio's growth bias being out of favor as the Russell Mid Cap Growth Index underperformed the Russell Mid Cap Value Index -31.5% vs. -20.4%. YTD returns also suffered from the Portfolio Manager's 2020 shift toward growth stocks. With <15% of the portfolio invested in the value category, the strategy faced a massive stylistic headwind as value outperformed growth amid rising interest rates. CAPTRUST recommended terminating and replacing this fund.

CAPTRUST conducted a thorough search and selection process to find a replacement manager and presented two options for consideration:

- Victory Sycamore Established Value R6 and
- MFS Mid Cap Value R6.

Ultimately, CAPTRUST recommended the Victory Sycamore Established Value R6 as the replacement option.

> On a motion by Trustee MacMahon, which was seconded by Trustee Bartholomew, and approved by a roll call vote of all Trustees present, the Board of Trustees, acting through the Investment Committee approved the recommendation of CAPTRUST to terminate the Virtus Ceredex Mid-Cap Value Equity R6, replacing the fund and mapping the assets and contributions to the Victory Sycamore Established Value R6.

Defined Contribution Plan – Fiduciary Training
Barry Schmitt provided information regarding the CAPTRUST Fiduciary Training program which is provided via Brainshark technology. Committee members were encouraged to complete the approximately 20 minute training prior to the meeting. Trustee MacMahon asked who the fiduciaries are for the Plan. After discussion, Mr. Schmitt committed to working with Tracy Elliott to provide a list of fiduciaries to the Committee.

Other items discussed:

Small balance solution: Trustee Riley asked if management or CAPTRUST has heard any other comments about the recent migration of terminated participants' small balances from TIAA to Millennium Trust Company. It was noted that no additional comments have been received. The discussion included mention that CAPTRUST performs routine due diligence on auto-rollover providers. In addition, participants receive notification about their pending rollover, the process and their options.

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

Performance Reviews

Kelly Regan, Senior Consultant with NEPC, reviewed performance for all three UMS portfolios with the following highlights.

Operating Fund (OF): The Operating Fund had a market value of $320.9 million as of September 30, 2022 and a loss of -1.0%, net of fees, for the quarter. During the quarter, managers outperformed their respective benchmarks in aggregate (Composite vs. Allocation Index). The Fund also outperformed the Allocation Index over all time periods presented. NEPC also noted that at the end of the quarter, the asset allocation of the Fund was within policy ranges with the portfolio overweight cash and underweight total return assets such as equities. This is in-line with NEPC's portfolio views and is also a result of recent inflows and market movements. Ms. Regan also noted that the Fund improved in October by 0.5% and was estimated to improve another 1.5% in November given the positive markets during those months. She further commented that recent actions included termination of the Vanguard Total World Stock fund and subsequent hirings of SSgA S&P 500 index and Silchester Exclusion Trust (a fossil fuel free international equity strategy). Finally, Ms. Regan reviewed the ESG dashboard which showed an improvement in ESG integration given the move from Vanguard Total World Stock index to Silchester and SSgA equity products. NEPC also presented a fossil fuel free S&P 500 index strategy to the Committee for consideration given the decision earlier this year to divest from fossil fuels. This recommendation is discussed further below.

Defined Benefit Pension Fund: The Pension Fund had market value of $20.0 million as of September 30, 2022 and a loss of -3.6%, net of fees, for the quarter. During the quarter, manager performance was in line with the benchmarks (Composite versus Allocation Index). Over the calendar year-to-date time period, the Fund has fallen short of the Allocation Index due primarily to the Fund's growth equity manager which has underperformed during a market that has not favored growth equities. Longer-term (3 and 5 years), the Fund is more in-line with the benchmarks. At the end of the quarter, the asset allocation of the Pension was close to policy targets. Ms. Regan noted that the Fund improved in October by 1.3% and was estimated to improve another 3.5% in November given the positive markets during those months. Finally, Ms. Regan reviewed the ESG dashboard for the Pension Fund noting there was no change during the quarter as there were no manager changes.

Managed Investment Pool (MIP): The Managed Investment Pool (MIP) had a market value of $319.6 million as of September 30, 2022 and a loss of -4.0%, net of fees, for the quarter. During the quarter, managers added 60 basis points of value. The MIP ranked at the 48th percentile of the Endowments and Foundation universe during the quarter as not having an allocation to private equity benefitted the Fund. Over the long-term, the lack of private equity exposure has contributed to below median rankings. At the end of the quarter, the asset allocation of the MIP was within policy ranges. Ms. Regan noted that recent actions included termination of SSgA EAFE index and funding of Silchester Exclusion Trust (a fossil fuel free international equity strategy). She also noted that the MIP returned 3.1% in October and was estimated to improve another 5.0% in November given the positive markets during those months. Additionally, Ms. Regan mentioned the "Watch" status that NEPC has placed on JO Hambro; however, NEPC had no recommendation at this time, but will continue to monitor the strategy going forward. NEPC did bring one recommendation to the Committee for consideration which was to review a fossil fuel free S&P 500 index strategy given the Committee's decision to divest from fossil fuels, as further discussed below. Finally, Ms. Regan reviewed the ESG dashboard and noted there was no change during the quarter given that the transfer from SSgA to Silchester was an equal transfer in terms of how NEPC rates each manager from an ESG perspective.

<u>Fossil Fuel Exposure Update – Managed Investment Pool, Pension Fund and Operating Fund</u>

As noted above, NEPC provided a brief overview of the estimated fossil fuel exposure for the three portfolios for the quarter ended September 30, 2022. Ms. Regan noted that not all managers have the Carbon Underground 200 (CU200) list. For those managers without the CU200 list, managers provided either fossil fuel exposure or energy exposure.

Ms. Regan stated that for the MIP, the fossil fuel exposure remained stable at 2.0% as of September 30, 2022 compared to 1.9% the last time the exposure was measured (March 31, 2021). The total exposure to fossil fuels in dollar terms declined from $8.8 million to $6.5 million given the total portfolio's value declined due to market movements and Maine Maritime Academy's withdrawal from the portfolio.

For the Pension Fund, the fossil fuel exposure also remained stable at 1.3% as of September 30, 2022 compared to 1.1% the last time the exposure was measured (March 31, 2021). The total exposure in dollar terms to fossil fuels remained similar at roughly $250 thousand.

For the Operating Fund, the fossil fuel exposure declined to 0.8% as of September 30, 2022 down from 2.1% as of March 31, 2021, while the exposure in dollar terms declined to $2.5 million from $6.4 million. The decline is due to the hiring of Silchester Exclusion Trust and the full divestment from the IR+M portfolio.

Ms. Regan further noted that the exposures across all three portfolios may be slightly overstated given one manager's exposure was to the full energy sector which could include renewable exposure. The Committee requested that future updates include a line graph to show the fossil fuel exposure over time.

Passive Large Cap Equity Manager Recommendation – MIP & OF

Ms. Regan provided an update on the current SSgA S&P 500 index strategy in the MIP and Operating Fund. She noted that the manager would be reducing fees resulting in a savings of $15 thousand for the MIP and $10 thousand for the Operating Fund annually. The Committee requested that the fee be negotiated with SSgA retroactively to January 1, 2022. Ms. Regan agreed to follow up with the manager regarding this request.

Ms. Regan further discussed that SSgA has a fossil fuel free S&P 500 strategy (SSgA S&P 500 Fossil Fuel Reserves Free Index Strategy) available for the same cost as the S&P 500 index that the System currently invests in. She noted that the assets under management are relatively low at $200 million and that performance over time has the potential to deviate from the S&P 500 index based on the performance of the energy sector. Over the past year, this would have equated to a $1 million loss for the MIP if the System had been invested in this fossil fuel free strategy. The Committee asked what SSgA's pipeline is for future asset growth in the strategy and Ms. Regan agreed to follow up on that question as well.

> On a motion by Trustee Riley, which was seconded by Trustee MacMahon, and approved by a roll call vote of all Trustees present, the Board of Trustees, acting through the Investment Committee approved the following investment manager change resolution as amended:
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> - Terminate SSgA S&P 500 index and replace with SSgA S&P 500 Fossil Fuel Reserves Free strategy for roughly 23% of total MIP Portfolio assets.
> - Terminate SSgA S&P 500 index and replace with SSgA S&P 500 Fossil Fuel Reserves Free strategy for roughly 5% of total Operating Fund Portfolio assets.
> - To be executed on a quarterly basis, or as otherwise advised by NEPC, over a twelve month period effective today with the strategy to be reviewed by the investment committee at each meeting.

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