

# Board Responsibilities – Investment Policy for Defined Benefit Plans

## 2.1 – Investment Policy Statement

Date Adopted: June 9, 2016

Date Amended: New

---

### Policy

The Board of Trustees of the Maine Public Employees Retirement System is authorized and responsible for administering defined benefit retirement programs at the State and local levels. The Board carries out this responsibility by adopting investment objectives and establishing an investment program through which the policy is implemented. In the case of conflicts, this policy statement supersedes previous policies and actions by the Board.

This policy covers the investment management of the assets of the following defined benefit programs administered by the Board:

- Legislative Retirement Program;
- Judicial Retirement Program;
- State Employee and Teacher Retirement Program, which includes State employees and public school members; and
- Participating Local District Retirement Program, which includes retirement plans of withdrawn participating local districts and the Consolidated Plan for Participating Local Districts.

Collectively, the assets of these programs are referred to as the DB Plan Assets. Statutes allow for the pooling of the DB Plan Assets for the purpose of investment. Pooling provides significant efficiencies. Because the relevant characteristics of the DB plans are sufficiently similar, all the DB Plan Assets are pooled for investment.

### Statutory/Legal Provisions

- Me. Const. art. IX, § 18.
- 5 M.R.S. §§ 17102, 17103, 17435; 18-B M.R.S. § 801, et seq. (Maine Uniform Trust Code); 18-B M.R.S. § 901, et seq. (Maine Uniform Prudent Investor Act).
- 5 M.R.S. §§ 17153(4).
- Restatement (Third) of Trusts § 78(1) (2007) (the “sole interest rule”).
- Restatement (Third) of Trusts formally permits, and in some cases requires, the delegation of investment decisions from trustees to internal staff or external agents with the necessary skills and knowledge.
- The Employee Retirement Income Security Act (“ERISA”), codified at 29 U.S.C. § 1002, et seq., provides a description of the standard of care that applies to trustees of private

## **Governance Manual**

MainePERS Board of Trustees

sector retirement plans. Although the System as a public retirement plan is not specifically governed by the fiduciary duty standard set forth in ERISA, courts will often consider the standard set forth in ERISA when addressing public pension plan issues. Under ERISA, a fiduciary must act with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person (expert) acting in a like capacity would act. This statutory standard is derived from the common law of trusts, which is applicable in the State of Maine.

## **Resources**

The Board of Trustees implements this investment policy in coordination with:

- in-house investment professionals (the “Investment Team”), with experience, authority and responsibility to implement the investment policy and administer investment operations;
- consultants, with appropriate expertise, to assist the Board and the Investment Team;
- investment managers, selected individually and collectively to reflect and implement the investment policy, having full discretion within policy and contractual limits to manage assets allocated to them;
- custodians qualified to carry out recordkeeping, reporting, measurement and custodial functions; and
- other advisors that the Board deems appropriate and necessary

## **Investment Objectives**

MainePERS’ investment objectives balance the System’s twin goals of generating investment returns (to ensure growth of the trust funds) and minimizing investment risks (loss of capital and cash flow shortfalls). The Board recognizes and accepts that these goals are in opposition, and that a trade-off exists between expected risk and return. The Board balances these goals by seeking to optimize portfolio returns consistent with an established targeted portfolio risk level. Additionally, by optimizing investment returns on trust assets, rather than attempting to maximize them, the Board seeks to maintain contribution rate and funding level volatility at acceptable levels.

## **Strategic Asset Allocation and Rebalancing**

The Investment Team and Board consultants shall annually review long-term capital market expectations and existing asset class allocations with Trustees. The Board shall review, and when strategically appropriate, approve recommended changes to the existing strategic asset classes, target weights, and ranges for implementation by the Investment Team. (See Appendix 1)

The specified policy weight ranges define minimum and maximum acceptable weights for each asset class. (See Appendix 2) The Investment Team shall maintain asset class weights within

## **Governance Manual**

MainePERS Board of Trustees

target ranges, subject to considerations such as transactions costs and the unique characteristics of private market investments, by reallocating capital within existing strategies and investments. The Investment Team will provide Trustees with reports showing the fund's current asset allocation at least monthly, and report on rebalancing activity quarterly.

### **Portfolio Risk Management**

The primary method of controlling risk shall be the selection of the strategic asset allocation and asset class target weights within the allocation. (See Appendix 1) Combined with long term capital market expectations, these policy weights define a portfolio with a specific level of risk.

The Chief Investment Officer shall develop a risk strategy for managing assets within the Board approved strategic asset allocation. The risk strategy will specify practices and procedures for the measurement and management of portfolio risk, including the provision of a portfolio risk report to the Board at least quarterly. (See Appendix 3)

Nothing in the risk strategy shall override the Asset Classes, Policy Weights and Ranges described in Appendix 1.

### **Performance Objectives and Benchmarks**

The Board acknowledges that benchmarks provide insight into fund and asset class performance, but are not necessarily guides for changing asset allocations or fund managers. The rate of return earned by fund assets will be measured against a policy benchmark comprised of the asset class benchmarks. (See Appendix 4) Returns earned by individual managers will be compared with a benchmark index appropriate to each manager's investment approach.

For performance evaluation purposes, all rates of return will be measured net of the deduction of investment management fees.

During a period of transition from one asset allocation to another, certain transitional allocations to appropriate benchmarks are permitted.

### **Investment Implementation**

The Investment Team shall implement the investment policy, subject to Board guidelines:

- Exposure to publicly traded equity securities is expected to be obtained passively and with weightings substantially similar to those of the benchmarks specified in Appendix 4. Any exceptions must be approved by the Board.
- Investments within each Asset Class should be consistent with the Asset Class definitions provided in Appendix 1.

### **Investment Manager Selection and Allocation Process**

MainePERS invests through external investment managers, who are charged to act as fiduciaries, and allocates fund assets among them in accordance with the strategic asset allocation. The Investment Team identifies, performs due diligence on, and recommends investment managers and allocations to the Board. The Investment Team also monitors performance and recommends retention and termination decisions to the Board. The Board retains final authority for manager selection, retention and termination decisions.

Managers are selected and retained on the basis of an evaluation that establishes sufficient confidence that the manager will improve the return and risk of the investment program. If and when the Investment Team and/or consultant(s) identify an investment manager that they believe will improve the investment program, the Investment Team will make a recommendation to the Board of Trustees that the manager be hired. This recommendation will be accompanied by an opinion by the investment consultant on this recommendation. The Board retains the final authority to accept or reject such recommendations.

The Investment Team will prepare and present to the Board of Trustees selection criteria they deem pertinent for each manager search and recommendation to hire. The Investment Team will provide the Board with all the necessary information and analysis to enable an informed decision. The Board may choose to interview the recommended manager or they may rely on the Investment Team to conduct interviews.

### **Derivatives/Leverage**

In general, the use of derivatives is permitted provided that the purpose of the derivative is to achieve an investment objective at lower cost and/or risk than would be the case with direct investments in the underlying securities. Derivatives are not to be used as a means of obtaining leverage. The use of leverage in any strategy must be disclosed to the Board prior to the Board's approval of an investment in the strategy.

The Board has reviewed the benefits and risks associated with foreign currency exposures. As a general rule the Board has chosen not to hedge currency at the portfolio level. Unless otherwise directed asset managers will have discretion to hedge investments under their management as they deem most beneficial to their mandate.

### **Transaction Costs and Brokerage**

The Board of Trustees expects investment managers, in their capacity as fiduciaries, to manage transaction costs in the best interests of the System as an investor. To enable the managers to fulfill this fiduciary duty, it is the Board's policy not to be party to directed brokerage programs.

## **Governance Manual**

MainePERS Board of Trustees

### **Securities Lending**

The System may participate in a securities lending program either directly through its separately managed portfolios or indirectly through its investments in pooled vehicles. In each case, the securities lending program must focus on low risk, as opposed to maximization of returns. All DB Plan Assets are available for securities lending.

### **Monitoring**

The Board relies on the Investment Team and the investment consultant(s) to continuously monitor the investment program and to report to the Board as outlined below.

- the Investment Team and investment consultant(s) provide comprehensive periodic reports on the entire investment program, including asset allocation, performance of each component relative to benchmarks, attribution analysis, and commentary.
- the Investment Team and investment consultant(s) monitor changes and developments at investment managers and at custodian(s) on an ongoing basis and report significant changes or events with recommended actions as needed.

### **Emergency Measures**

Immediate action may be taken beyond the bounds of this policy under extraordinary circumstances and in order to preserve the best interests of the plans' participants by unanimous decision of the following:

- The Chair, or in the Chair's absence, Vice Chair of the Board
- The Executive Director, or in the Executive Director's absence, the General Counsel
- The Chief Investment Officer, or in the Chief Investment Officer's absence, Deputy Chief Investment Officer

Any such action must be reported to the Board of Trustees at the earliest opportunity.

## Board Responsibilities – Investment Policy

### Appendix 1: Asset Classes, Policy Weights and Ranges

Date Adopted: June 9, 2016

Date Amended: New

The System’s assets are invested across nine Asset Classes that play four distinct Roles in the overall Fund. The Trustees define these Roles and Asset Classes and set target policy weights and ranges below.

	Weights		
	Minimum	Policy	Maximum
<b>GROWTH</b>	40%	50%	60%
Public Equity	25%	35%	45%
Private Equity	5%	15%	20%
<b>DIVERSIFIERS</b>	0%	0%	10%
<b>HARD ASSETS</b>	15%	25%	35%
Real Estate	5%	10%	15%
Infrastructure	5%	10%	15%
Natural Resources	0%	5%	10%
<b>CREDIT</b>	5%	15%	20%
Traditional Credit	5%	10%	20%
Alternative Credit	0%	5%	10%
<b>MONETARY HEDGE</b>	5%	10%	20%
US Government Securities	5%	10%	20%
Cash	0%	0%	10%

### Asset Class Definitions

The below Asset Class definitions are simplified and are intended to convey the general characteristics of investments held within each class. Some investment strategies involve assets and securities that span multiple asset classes.

#### Public Equity

Investments in publicly-traded shares of companies. May include different classes of common stock, shares of REITs, and MLPs.

#### Private Equity

Investments in non-publicly traded shares of companies. Investments are typically made via private limited partnerships, and may include both equity and debt securities.

## **Governance Manual**

MainePERS Board of Trustees

### *Real Estate*

Investments providing direct exposure Real Estate, including investments through private funds.

### *Infrastructure*

Investments typically made through private funds that generally invest in assets that meet most or all of the following criteria: provide essential public services, possess monopoly-like characteristics, provide long term contracted cash flows, and bear limited volumetric and price risk.

### *Natural Resources*

Investments in private funds that generally invest in businesses focused on natural resources such as timberland, agriculture, and mining. Private energy investments will generally be included in Private Equity, rather than Natural Resources.

### *Traditional Credit*

Investments in investment-grade debt instruments that are not issued by the U.S. Government. Such debt may or may not be registered for sale to the general public.

### *Alternative Credit*

Investments in debt instruments issued by non-investment grade and unrated entities. This may include, but is not limited to high yield debt, bank loans, structured debt, and asset-backed debt. Alternative credit investments are expected to pay or accrue periodic interest and to return principal at maturity. Distressed debt and other debt or yield-oriented securities that include equity-like exposures are considered Private Equity, not Alternative Credit.

### *Monetary Hedges*

Investments in debt instruments issued by the U.S. Government, including nominal Treasury securities and Treasury Inflation Protected Securities (TIPS).

## **Roles in the overall fund**

Each of the above asset classes fills a specific Role in the overall portfolio. These Roles are defined below.

### **Growth Assets**

Growth Assets are intended to reduce the system's funding needs in the long term by appreciating in value. Growth Assets possess inherently higher expected returns than other

## Governance Manual

MainePERS Board of Trustees

asset classes. Growth Assets also have higher expected volatility than other asset classes, and are expected to increase funding volatility in the short run.

### Diversifying Assets

Diversifying Assets are investments that primarily derive their return from alpha (or active manager skill) as opposed to market directionality.

### Hard Assets

Investments in the Hard Assets category provide exposure to long-lived “real” assets, such as real estate, timber, agricultural, and infrastructure assets. Expected return levels of Hard Assets are lower than those of Growth Assets, and a substantial portion of such returns is expected to come from ongoing cash flows. Hard Assets are expected to provide inflation protection, to have low correlation with Growth Assets, and to provide diversification benefits.

### Credit Assets

Credit investments provide capital to end-users via loans and the purchase of debt securities. Such investments provide for contractual returns (interest) and repayment of principal. Credit investments possess lower risk and expected returns than equity investments, but have higher risk and expected returns than monetary hedges. Credit investments are expected to provide diversification away from Growth Assets.

### Monetary Hedges

The role of Monetary Hedges in the portfolio is to provide liquidity and a safe harbor in times of turbulence. These investments are cash and obligations of the U.S. Government, and are considered to be free of default risk.

## Governance Manual

MainePERS Board of Trustees

### Board Responsibilities – Investment Policy

#### Appendix 2: Rebalancing

Date Adopted: June 9, 2016

Date Amended: New

The Board has set target weights for each Asset Class and Role in Portfolio category in Appendix 1, and delegates the management of asset class allocation to the Investment Team. The Investment Team is expected to maintain asset class weights near target, subject to considerations such as transactions costs and the unique funding and liquidity characteristics of private market investments.

To this end, the Team is permitted to reallocate capital within existing strategies and investments for rebalancing purposes. The Team will provide Trustees with reports showing the Fund's current asset allocation at least monthly, and report on rebalancing activity at least quarterly.

## **Governance Manual**

MainePERS Board of Trustees

### **Board Responsibilities – Investment Policy**

#### **Appendix 3: Risk Strategy**

Date Adopted: June 9, 2016

Date Amended: New

While this Risk Strategy is in development the Chief Investment Officer shall rely on the Strategic Asset Allocation and Rebalancing provisions of this policy to manage the Fund's risk.

The Investment Team and the Board believe that this approach will deliver an appropriate expected return with commensurate risk over a long term horizon. However they also recognize that the portfolio's realized risk will vary over time which may result in periods during which the fund bears substantially higher risk than the System initially targeted.

In an effort to achieve more stable (less volatile) returns, the Investment Team will seek to develop management tools and practices that they believe will be better able to keep the fund's risk in an acceptable range.

This Risk Strategy shall be updated from time to time by the Trustees to reflect recommendations developed by the Chief Investment Officer.

Nothing in the Risk Strategy shall override the Asset Classes, Policy Weights and Ranges described in Appendix 1.

## **Board Responsibilities – Investment Policy**

### **Appendix 4: Policy Benchmarks**

Date Adopted: June 9, 2016

Date Amended: New

<b>Asset</b>	<b>Benchmark</b>	<b>Weight</b>
Total Public Equity	Russell 3000 & MSCI ACWI ex-USA, based on ACWI weights	35%
Private Equity	Russell 3000 + 3%	15%
Diversifiers	0.3 Beta MSCI ACWI	0%
Real Estate	NCREIF Property (lagged one quarter)	10%
Infrastructure	CA Infrastructure Median	10%
Natural Resources	CA Natural Resources Median	5%
Traditional Credit	Barclays US Aggregate, ex Treasury	10%
Alternative Credit	50% BAML US HY II + 50% S&P/LSTA US Leveraged Loan Index	5%
U.S. Government Securities	Custom Fixed Income Benchmark	10%