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UNIVERSITY OF MAINE SYSTEM

DEFINED BENEFIT PENSION FUND – ANNUAL REPORT

YEAR ENDED JUNE 30, 2010

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

Office of Finance and Treasurer
16 Central Street
Bangor, ME 04401-5106

Defined Benefit Pension Fund – Annual Report

University of Maine System Year Ended June 30, 2010

The University of Maine System (UMS) 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.¹

Funded Status of the Pension Plan

The Defined Benefit Plan assets are invested in a separate fund with assets totaling \$42.1 million at June 30, 2010 compared to \$42.4 million at June 30, 2009. UMS obtains an actuarial valuation once every two years. The last valuation, completed as of July 1, 2009, showed an unfunded liability of \$2.9 million (or a funded status of 94%). This compares with \$16.2 million overfunding on July 1, 2007.

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. These guidelines, last updated November 2009, may be found at <http://www.maine.edu/system/oft/InvestmentGuidelines.php>. They include:

- Total risk and return 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
- Conflict of interest statement

These guidelines currently target a long-term return objective of 8.0% with low to moderate risk.

¹ For a more detailed history, description, and actuarial status of this Plan, see the University of Maine System Annual Financial Report for the Year Ended June 30, 2009, page 48, note #13 on Pension Plans. The financial statements are at <http://www.maine.edu/pdf/2009AnnualFinancialReport.pdf>

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Fiscal Year 2010 Performance

The market rallied for most of fiscal year 2010 (FY10) allowing the fund to regain some of the losses experienced in the prior fiscal year. Nonetheless, the economic recovery is weak with continued high unemployment, high governmental debt levels, general market uncertainty, and a recovery largely based on governmental actions.

The Pension fund **experienced a return of 10.8%** [10.1% net of fees] in FY10, placing the fund in the 75th percentile (i.e., 75% performed better) of the total fund universe tracked by the System's investment consultant (NEPC). Performance is a function of the conservative approach to both asset allocation and the investment managers utilized, in addition to some managers having a higher quality bias which dragged down performance in a low quality rally. Importantly, at 10.8%, the fund did exceed the 8.0% discount rate used in the Plan's actuarial valuation. On June 30, 2010, the Plan assets totaled \$42.1 million, decreasing \$0.3 million from the prior year as detailed below under the section Pension Plan Inflows and Outflows.

The Pension fund's **5-year annualized return was 2.4%** [1.7% net of fees] ranking the fund in the 69th percentile of all funds (i.e., 69% performed better) while the risk taken by the fund was lower than the universe. The UMS' 2.4% return compares to the S&P 500 return of -0.8% and the Barclays Capital Aggregate Bond Index return of 5.5% over the same 5 year period.

The Pension fund is well diversified among a number of asset classes with allocations to eleven investment managers at fiscal year end.

Changes in Investment Managers and Holdings

Small Cap Manager - Terminate SSgA Enhanced Small Cap Index Plus Securities Lending Fund moving funds to SSgA Small Cap Passive Index product

At its February 2009 meeting, the Investment Committee voted 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 lending² feature of the fund caused liquidity restrictions brought on by the 2009 credit crisis.

In June 2009, UMS transferred all funds from the SSgA actively managed product to an SSgA Small Cap Passive Index product with 84% going to the lending product and 16% to the nonlending product. UMS continued to transfer money from securities lending to nonlending in accordance with SSgA's liquidation schedule. The final transfer will occur on August 31, 2010.

SSgA will continue to be monitored for an appropriate time to proceed with manager termination.

² 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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Large Cap Growth Manager - Rainier Investment Management, Inc. Replaces Chase Investment Counsel

At its February 23, 2010 meeting, the Investment Committee voted to terminate Chase Investment Counsel due to personnel changes at the firm. At the same meeting, the Investment Committee interviewed other Large Cap Growth managers and voted to hire Rainier Investment Management, Inc. The change in managers occurred in April 2010.

Rainier has been managing Large Cap Growth since 1989. Rainier's Large Cap Growth fund holds approximately 80 to 120 companies and is constructed to hold securities of companies with above average earnings per share and to sell at reasonable values. While the portfolio does well in most market environments, the benefit of the fund is downside capture, with good performance being a challenge in speculative markets and periods of little to no growth.

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 as of the last two valuations:

	<u>July 1, 2007</u>	<u>July 1, 2009</u>
Participating Employees ³	158	106
Retirees and Beneficiaries	870	871
Deferred Vested Participants ⁴	<u>419</u>	<u>404</u>
Total Participants	<u>1,447</u>	<u>1,381</u>

Pension Plan Inflows and Outflows

	(\$ in Thousands)	
	<u>FY09</u>	<u>FY10</u>
Beginning Market Value	<u>\$58,865</u>	<u>\$42,359</u>
Net External Outflows (e.g., benefit payments, expenses)	(\$4,613)	(\$4,775)
Outflow to Fund Basic Plan Costs ⁵	(2,000)	0
Interest and Dividend Income	772	761
Net Gain or (Loss) on Investments	<u>(10,665)</u>	<u>3,803</u>
Net Activity for the Fiscal Year	<u>(\$16,506)</u>	<u>(\$211)</u>
Ending Market Value – June 30, 2009 and 2010	<u>\$42,359</u>	<u>\$42,148</u>

Returns, Historical Growth, and Allocation

Attachment I reports the total returns for the Pension fund on a net of fees basis and the year end market value for the past 5 years, as well as the asset allocation for the fiscal years ended June 30, 2009 and 2010.

³ 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.

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

⁵ Used 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

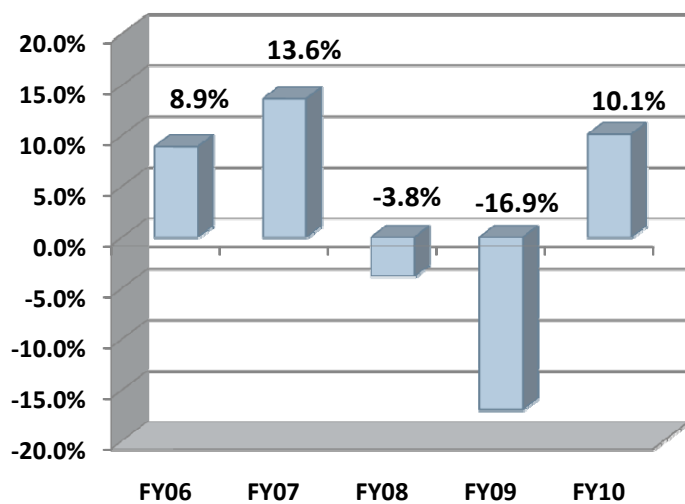
June 30, 2010

Market Value and Asset Allocation of the Defined Benefit Pension Fund (\$ in Thousands)

	June 30, 2009		June 30, 2010	
	Market Value	% Allocation	Market Value	% Allocation
Domestic Equities	\$14,318	34%	\$13,860	33%
International Equities	5,210	12%	5,060	12%
Fixed Income	5,742	14%	7,064	16%
Market Neutral	2,163	5%	1,667	4%
Global Asset Allocation	7,134	17%	6,646	16%
Hedge Funds	5,542	13%	5,803	14%
Core Real Estate	2,250	5%	2,048	5%
Total	\$42,359	100%	\$42,148	100%

Total returns (net of fees) for the five years ended June 30, 2010 and the market value of the Pension fund, at year end for the same five year period, are shown in the charts below.

Total Returns (Net of Fees)



Market Value (\$ in Millions)

