# Université de Moncton
# Endowment Fund

# Investment Policy

**Last revision adopted by the Board of Governors**

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**Table of Contents**

## Preamble

The Université de Moncton, an institution of higher education abiding by generally accepted moral values, expects its manager(s) (the "Manager") to respect the deontology and ethics of these values in the management of the Endowment Fund (the “Fund”). The Manager commits in good faith to act accordingly, but cannot guaranty that he or she will be aware of all of the issuer’s transactions.

## Chapter 1 – Objective

The Université de Moncton Board of Governors (the "Board") is responsible for the management of the Fund’s assets. It is incumbent upon the Board to provide sound and prudent management. The adoption of the Investment Policy (the "Policy") stated herein is included within the responsibilities of the Board.

The Investment Committee (the "Committee") is responsible for the implementation and oversight of the Investment Policy.

The objectives of the Fund are:

a) to generate maximum annual revenues while keeping the volatility of returns to a low level;

b) to ensure a constant annual income in order to meet the commitments of the Endowment Fund;

c) to ensure the Fund grows at a rate that is equal to the annual increase in the Consumer Price Index (CPI); and

d) to ensure the Fund generates, in the medium term, a real rate of return sufficient to sustain the rate of disbursement established herein.

The responsibilities that are assigned or may be assigned to the various parties are as follows:

The Board must:

- adopt the Policy;
- appoint the Manager of the Fund;
- approve the custodian of the Fund's assets;
- determine and periodically review the Fund's annual rate of disbursement in its specific context and through its evolution.

The Committee must:

- develop the Investment Policy and monitor its application;
- on a yearly basis, review the Policy and reassess such factors as the expected return, the acceptable risk and the Fund's long-term asset mix;
- recommend to the Board the Manager of the Fund and, as required, select an investment management coordinator and any other expert advisors;
- select the Custodian of the assets;
- conduct quarterly monitoring of the Fund's asset mix and apply the rebalancing mechanism to the assets;
- at least once yearly, review and evaluate the Manager's investment performance based on quantitative and qualitative standards;
- conduct any other reviews or analysis deemed useful or necessary for the purpose of decision-making.

The Manager is charged with the responsibilities to:

- fulfil the mandate assigned by the Committee, as described herein, with due consideration to applicable legislation and additional guidelines transmitted in writing by the Committee;

- provide the Committee with a written quarterly report of its decisions and a summary of investment performance, forecasted returns by asset classes and investment strategy recommendations for the next period;
- provide the Committee with a quarterly compliance certificate;
- notify the Committee, in a timely manner, of any element of the Policy that may hinder the performance of the Fund or adversely affect the attainment of the stated objectives;
- explain the characteristics of the new asset classes and their potential contribution to the attainment of the Fund's objectives;
- in the case of pooled funds,
  - provide the Committee with a written statement of investment policies and objectives for each pooled fund,
  - provide the Committee with a quarterly compliance certificate regarding the Investment Policy of the said Fund,
  - ensure that policies are in compliance with existing legislation, and
  - immediately inform the Committee of any amendment to the above statement;
- meet with the Committee at least once a year.

The Custodian is charged with the responsibility to:

- provide monthly financial statements with respect to all assets, transactions related to the Fund's assets and the distribution of these assets (market value).

All of the above responsibilities may be delegated to one or several parties as directed by the Board.

## Chapter 3 – Committee's Statement of Investment Beliefs

The Committee's Statement of Investment Beliefs is as follows:

a) A balanced approach for the management of the Fund is preferred, as much as possible, in order to limit the complexity of the investment structure and reduce costs. A more complex investment structure can, however, be justified by risk management or by value-added considerations in the long term, after having taken into account direct and indirect costs.

b) Active management has the potential to add value to the market returns, net of management fees, for all asset classes.

c) Core equity mandates or the combination of complementary styles are expected to generate long-term returns adjusted for risk similar to those of growth or value styles. Consequently, strong style biases should be limited in order to protect the Fund against periods of relative underperformance.

d) The Canadian equity market is more concentrated and less diversified than the main foreign equity markets and exposure to foreign markets allows improvement to the diversification of a portfolio.

e) With globalization, markets are more and more integrated, and the industry or sector in which a company operates is more important than its country of origin. Consequently, exposure to foreign markets through an integrated approach offers a superior return and diversification potential while being more efficient at the tactical asset allocation level, and with regards to fees.

f) Exposure to currencies does not have a long-term effect on the total risk in a significant way. Currency hedging has a cost and consequently, currencies should not be hedged (except in the case of a mandate where the objective is to generate an absolute return).

g) The Committee believes that environmental, social and governance factors (ESG) can be important for long-term returns for businesses, sectors, regions, and asset classes. The Committee believes that the analysis of investments should integrate ESG factors insofar as they have an impact on the return and the risk. As for investments, the Committee gives the Manager every latitude for the evaluation of risks and opportunities in regards to responsible investment. The Committee will take into account the level of consideration for the ESG factors and of their integration into the investment process during the selection of a Manager.

## Chapter 4 – Investment objective, benchmark portfolio, expected return and risk

### Return Objective

The long-term return objective of the Fund (e.g. for a period of 10 years) is to yield an annualized rate of return that is at least equal to the expenditure rate to which the CPI rate of increase is added.

### Benchmark Portfolio

The benchmark portfolio represents the long-term targeted asset allocation that should enable the Fund to reach its return objective with an acceptable level of risk.

| **Benchmark portfolio** | | |
|---|---|---|
| **Asset class** | **Weighted average** | **Market index** |
| Short term | 1.0% | FTSE TMX Canada 91-day Treasury Bills Index |
| Fixed income | | |
| Canadian | 24.0% | FTSE TMX Canada Universe Bond Index |
| Unconstrained | 10.0% | CDOR 3 months Index + 4% |
| Equity | | |
| Canadian | 16.5% | S&P/TSX Capped Composite Index |
| Foreign (developed) | 14.0% | MSCI World Index (CAD$) |
| Foreign (all countries) | 14.5% | MSCI All Country World Index (CAD$) |
| Emerging markets | 5.0% | MSCI Emerging Markets Index (CAD$) |
| Hedge funds | 15,0% | CDOR 3 months Index + 5% |

**Expected return and risk**

An analysis was conducted to assess the risk-return profile of the benchmark portfolio, assuming passive portfolio management (index management). The analysis indicated that the benchmark portfolio should yield a median annual real rate of return of approximately 4.4% for the majority of the rolling 10-year periods. However, it is possible that, during one given year, the annual real rate of return significantly deviates from the median (upwards or downwards).

Annualized returns and probabilities were estimated based on long-term return and risk assumptions for the selected asset classes. These are listed in Schedule I. Projections are based on lognormal probability distributions.

The use of different probability distributions and assumptions may result in variations of the estimated rates of return and levels of risk. However, the Committee believes the assumptions used are appropriate for this Policy.

The Committee thus believes that with an asset mix reflective of the benchmark portfolio, the Fund should reach the target investment objective with a long-term level of risk that is both tolerable and controlled.

## Chapter 5 – Limits of permitted investments and rebalancing mechanism

Because of performance difference in each of the Fund's asset classes, its composition can move away from its target allocation on a long-term basis.

### Limits of permitted investments

| Asset class | Minimum threshold | Target | Maximum threshold |
|---|---|---|---|
| Short term | 0.0% | 1.0% | 3.0% |
| Fixed income | | | |
| Canadian | 21.0% | 24.0% | 27.0% |
| Unconstrained | 7.0% | 10.0% | 13.0% |
| Equity | | | |
| Canadian | 13.5% | 16.5% | 19.5% |
| Foreign (developed) | 12.5% | 14.0% | 15.5% |
| Foreign (all countries) | 13.0% | 14.5% | 16.0% |
| Emerging markets | 3.0% | 5.0% | 7.0% |
| Hedge funds | 12.0% | 15.0% | 18.0% |

### Rebalancing mechanism

The application of the rebalancing mechanism is the Committee's responsibility. The underlying principles of this mechanism are the following:

a) The Fund's asset allocation between the different mandates is reviewed at the end of each quarter during preparation of investment activity follow-up reports.

b) If the proportion of the Fund allocated to a specific mandate is superior to the maximum threshold, assets are liquidated and transferred to re-establish the allocation halfway between the target and maximum threshold. Liquidated assets are allocated to the mandate with the allocation closest to the minimum threshold until the halfway mark between the target and the minimum threshold of this mandate is reached. If the desired weighting is achieved, the remaining assets are transferred to the next mandate with the allocation closest to the minimum threshold and so on until the allocation of the mandate with an allocation superior to the maximum threshold is re-established.

c) If the proportion of the Fund allocated to a given mandate is inferior to the minimum threshold, a similar procedure is applied.

d) The allocations per mandate are evaluated with the help of market values supplied by the Custodian.

e) The rebalancing mechanism must be applied as soon as possible after the end of a quarter all while taking into account the liquidation constraints of various funds used.

| | |
|---|---|
| Short Term: | Cash, demand deposits, Treasury bills, short-term instruments, bankers' acceptances, term deposits, guaranteed investment certificates and insurance-backed securities. |
| Fixed Income: | Bonds, debentures, asset-backed securities, mortgages, mortgage-backed securities, insurance contracts, indexed mortgage loans, term deposits, guaranteed investment certificates and pooled funds. |
| Equity: | Common stock, income trusts, installment receipts, warrants and securities convertible into common stock and pooled funds. |

Income trusts are permitted provided that their legal status limits the trustees' rights of recourse and indemnification to the assets of the trust, or that terms limiting liability have been included in the provincial legislation governing the trust before its activation.

Investments that are not explicitly authorized herein are not permitted unless they are used through a pooled fund which the Investment Policy would permit.

Derivative instruments, private placements, real estate as well as closed-end funds are permitted with prior written Committee approval, but are not to be used under any circumstances for speculative purposes. However, this constraint does not apply to the unconstrained fixed income and hedge funds mandates.

## Investment structure

The investment structure retained by the Committee for the Fund is composed of various mandates managed by specialists. Insofar as possible, and in line with the Committee's belief in regards to a balanced approach to investment, certain mandates have been given to the same manager.

## Value-added objectives

| Asset class | Reference index | Value-added objective (annualized) |
|---|---|---|
| Total portfolio | Reference portfolio | +0.8% over 4 years |
| Fixed income | | |
| Canadian | FTSE TMX Canada Universe Bond Index | +0.3% over 4 years |
| Unconstrained | CDOR 3 months Index | +4.0% over 4 years |
| Equity | | |
| Canadian | S&P/TSX Capped Composite Index | +1.5% over 4 years |
| Foreign (developed) | MSCI World Index (CAD$) | +1.5% over 4 years |
| Foreign (all countries) | MSCI All Country World Index (CAD$) | +1.5% over 4 years |
| Emerging markets | MSCI Emerging Markets Index (CAD$) | +2.0% over 4 years |
| Hedge funds | CDOR 3 months Index | +5.0% over 4 years |

**Investment constraints**

Pooled funds are used for all mandates. The investment constraints for these mandates are those outlined in the Investment Policy relating to each of the specific pooled funds used. In the case of a discrepancy between the content of this Policy and that of the pooled fund used, the latter will prevail.

**Other constraints**

a) No loan shall be contracted on behalf of the Fund. However, temporary overdrafts resulting from purchase or sale transactions made by the Custodian as well as the purchase of installment receipts are permitted.

b) Purchases on margin are not permitted.

c) Short sales are not permitted.

d) Options and futures are not permitted.

e) All investments must comply with applicable legislation and with CFA Institute standards.

f) The Manager must have adopted the CFA Institute's code of conduct, or a similar code.

With the exception of e) and f), the restrictions enumerated above do not apply to the unconstrained fixed income and hedge funds mandates.

## Conflict of Interest and Disclosure Policy

The following persons are required to comply with these guidelines:

a) members of the Board;

b) members of the Committee;

c) the Manager;

d) the Custodian; and

e) the employees or agents retained by the Committee or any of the foregoing to provide services related to the Fund's management.

Those subjected to the conflict of interest guidelines shall disclose any direct or indirect interest, association or participation of importance related to their role in the investments that will or may result in a conflict of interest.

Without limiting the general terms of the above, should be disclosed any important benefit derived from one of the Fund's assets, any significant ownership of such assets, membership on boards of other companies or any existing or anticipated contract.

Those subjected to these guidelines shall, immediately upon becoming aware of the situation, disclose in writing to the Committee the nature and extent of any actual or potential conflict, or request that the matter be recorded in Committee meeting minutes.

The party disclosing the conflict of interest may only continue his or her activities related to the object of the conflict with the Committee's consent.

## Securities lending

Securities lending in relation to the Fund is not permitted.

## Delegation of voting rights

Voting rights acquired through investments are delegated to the Manager who discharges this responsibility in due respect of the objectives stated herein. The Manager shall, however, inform the Committee as soon as possible each time there is a vote on a special matter.

## Valuation of investments not traded on a regulated market

In accordance with the Policy, all securities held by the Fund shall be traded on a regulated market and assessed at their market value.

In the event that the Fund should hold securities that are not traded on a regulated market, these securities shall be valued at least yearly by the Custodian. Using a discount rate based on a projection of the risk-free rate of return, the forecasted inflation rate and a risk premium commensurate to the uncertainty of future revenues derived from the investment.

Alternatively, a valuation of the investment may be obtained at least yearly from a qualified independent evaluator.

## Pooled Funds

In the case of pooled funds, the conflict of interest and disclosure guidelines as well as the constraints concerning securities lending, delegation of voting rights and valuation of investments not traded on a regulated market, will be subject to the Investment Policy of the specific pooled fund.

### Expenditure rate

The expenditure rate, including management and administration fees, is set at 4.5% of the average of the Fund’s market value as of December 31 of the three years preceding the current year. This expenditure rate reflects the expected real rate of return on the Fund’s assets. This calculation determines the total expenditure permitted for the coming year.

Of this total allowable expenditure, management and administrative fees must be subtracted. The remainder is then distributed proportionally to all individual donation funds of the Fund. These amounts become the sums authorized to be spent during the year and are transferred to the unrestricted fund account of the donors.

### Capitalization of donations received

Donations received (or the capital) will be deposited in the donor’s fund and will be kept in perpetuity. Only the investment revenue will be used to ends specified by the donor. In order to preserve the real value of the donation, an amount equal to the increase of the Consumer Price Index will be added annually to each fund of the donor (or the capitalization fund) from investment revenues from the current year.

### Donor fund deficit

The Fund’s Disbursement Policy anticipates that the donor’s funds will be allowed to accumulate a surplus in order to be allowed to disburse when returns are weak. The accumulated surplus (or the restricted fund balance) represents the cumulative total of investment revenues less the amounts capitalized and less the sums authorized for disbursements. During consecutive years of weak stock market returns, it is possible that a donor fund goes into deficit.

A donor fund is in deficit when the restricted fund balance amount is inferior to the amount authorized to be disbursed for the coming year. In this situation, in order to avoid encroaching on the initial donation of the donor, the authorized amount to be disbursed for the next fiscal year will be limited to the lesser of A or B which follows:

A – the amount authorized to be disbursed; and
B – the balances of the restricted fund account and the capitalization fund.

**Balance from previous years**

In a normal situation, the available balance from previous years which is available to be disbursed is the accumulated balance of the unrestricted fund account. The accumulated balance of the unrestricted fund account represents the total amounts authorized to be disbursed over the years less the total of real expenditures. When the donor’s fund is in deficit (see the above definition), expenditures of the balance from previous years can be limited in order to avoid encroaching on the initial donation of the donor. In such a situation, the balance from previous years available to be disbursed will be the lesser of A or B:

A – the balance of the unrestricted fund account; and
B – the higher of C and D:
C – 0
D – the sum of the balance of unrestricted and restricted fund accounts and of the capitalization fund.

All situations are unique. Finance department personnel will be required to discuss the matter with the person responsible for the fund in question in order to arrive at a balance, which is suitable depending on the situation.

## Schedule I – Assumptions for asset classes comprising the benchmark portfolio

**EXPECTED RETURN AND RISK**

| | **Long-term return** | **Annual volatility** |
|---|---|---|
| **Short term** | 1.9% | 1.5% |
| **Bonds (Universe)** | 3.0% | 5.4% |
| **Foreign bonds** | 2.7% | 8.6% |
| **Emerging markets debt** | 7.2% | 12.0% |
| **Canadian equities** | 7.5% | 19.5% |
| **Foreign equities** | 7.5% | 16.3% |
| **Emerging markets equities** | 9.6% | 25.0% |
| **Hedge funds** | 5.8% | 11.0% |

**CORRELATIONS**

| | **A** | **B** | **C** | **D** | **E** | **F** | **G** | **H** |
|---|---|---|---|---|---|---|---|---|
| **A – Short term** | 1.00 | | | | | | | |
| **B – Bonds (Universe)** | (0.02) | 1.00 | | | | | | |
| **C – Foreign bonds** | 0.18 | 0.63 | 1.00 | | | | | |
| **D – Emerging markets debt** | 0.11 | 0.31 | 0.42 | 1.00 | | | | |
| **E - Canadian equities** | (0.12) | (0.31) | (0.70) | 0.15 | 1.00 | | | |
| **F – Foreign equities** | (0.17) | (0.16) | (0.32) | 0.48 | 0.74 | 1.00 | | |
| **G – Emerging markets equities** | (0.04) | (0.06) | (0.43) | 0.38 | 0.87 | 0.79 | 1.00 | |
| **H – Hedge funds** | 0.10 | 0.19 | 0.49 | 0.52 | (0.09) | 0.14 | 0.11 | 1.00 |

All numbers were calculated by Mercer as of April 30, 2014. The Mercer method of calculation was used to estimate expected returns, standard deviations, correlation factors and probabilities.

Expected returns for short-term securities and bonds were estimated using data from the real yield and equilibrium ratio curves. Expected returns for stocks were calculated based on ratio projections such as growth in Gross Domestic Product (GDP), inflation, price earnings ratio, income growth, anticipated dividend rate, etc. The expected performance of non-traditional asset classes was calculated to reflect the nature of the assets, historical data and previous factors.

Standard deviations for short-term securities and bonds were estimated based on 10-year historical data adjusted using a duration model approach (duration and standard deviation being influenced by interest rates). Standard deviations of stocks were estimated based on 10-year historical data and adjusted to obtain Capital Action Pricing Model (CAPM) variables coherent with the assumptions.

Correlations between asset classes were estimated based on 10-year historical data and adjusted for consistency.

It is assumed that the annual return of the benchmark portfolio will follow a lognormal distribution curve. With expected return, standard deviation and correlation assumptions differing from the ones indicated herein, the performance and risk factors of the benchmark portfolio would change.