Statement of Investment Principles
for the
York University Pension Fund

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**Statement of Investment Principles**

Approved and Adopted by

York University Pension Fund
Statement of Investment Principles for the York University Pension Fund

Section 1 - Preamble

The purpose of this Statement of Investment Principles (the “Principles”) is to set forth and document the underlying principles that form the basis for the overall investment strategy, including the policy asset mix and the implementation approach of the York University Pension Fund (the “Fund”). The identification and documentation of the assumptions made in developing the investment strategy contributes to a better understanding of the core investment principles that support the investment portfolio. Together with the Statement of Investment Policies and Procedures (the “SIP&P”), the investment manager agreements and mandates, the Principles contribute towards the prudent and effective management and governance of the Fund, and forms part of the risk management framework. The Principles are solely for the internal use of York University, the Sub-Committee on Investment Performance (SCIP), the Pension Fund Board of Trustees (BoT), and the members of the York University Pension Plan.

It is intended that the Principles will constitute a working document and will be reviewed by the SCIP and confirmed or amended, as needed by the BoT on a periodic basis. This will ensure that they continue to reflect the principles that the SCIP and the BoT believes are appropriate to prudently invest the Fund. At a minimum, the Principles should be reviewed in the context of each asset mix review carried out for the Plan and should be confirmed or amended, as appropriate.

The principles are grouped into four sections: investment policy, implementation strategies, manager structure, and ongoing monitoring. Each section identifies several principles, with a statement of the principle and the underlying rationale for its adoption.

Throughout this document items in bold text are defined in the Glossary.

Financial & Risk Management Objectives and Framework

All investment decisions must be made to ensure that the Fund is appropriately invested to meet the obligations of the Plan over the long term. This fiduciary objective must always be paramount in considering whether specific approaches are optimal. Fiduciaries include the BoT, SCIP and also York University, as Plan Administrator. Maintaining full funding on a going concern valuation measure is an appropriate fiduciary objective.
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The hybrid nature of the York University Pension Plan (“the Plan”) creates investment challenges for the Fund. Unlike either a traditional defined benefit or defined contribution plan, the determination of the pension benefit levels at retirement is dependent on Fund returns, as well as factors such as salary and years of service. In addition, pensioners may receive future increases, depending on the future Fund returns.

The Fund will be appropriately diversified to manage and reduce volatility and protect returns in declining markets, and provide a stable level of investment returns for an acceptable level of risk. This investment philosophy is consistent with high quality investments, downside protection, and diversification.

This strategy requires the adoption of a long-term approach to reviewing manager performance, as both the long term result achieved over an entire market cycle and the pattern in which results are delivered within the market cycle are important factors in achieving the objectives. These risk management principles led to the development of an asset mix and other policies designed to achieve these objectives.
Section 2 – Investment Policy Principles

Policy Asset Allocation

Principle
The policy asset allocation is 40% liability-hedging assets and 60% return-seeking assets and diversified by asset class, investment managers and style. The Policy Asset Allocation will formally be reviewed every four to five years, by conducting an asset allocation study.

Rationale
The Fund is exposed to a variety of investment risks through its investment in the capital markets. It is also exposed to “mismatch risk”, which is reflected in the different manner in which the Fund and the Plan’s liabilities react to economic conditions (particularly changing interest rates). The policy asset allocation sets out the long-term strategic allocation to different asset classes that the fiduciaries believe is most likely to appropriately manage these risks and achieve the financial objectives.

In managing risk, the asset classes are categorized within two broad groups: liability-hedging assets and return-seeking assets. The proportion invested in each category and the use of different asset classes within each category attempts to best manage the risk/reward trade-offs. Some asset classes, such as Real Estate and Infrastructure, have characteristics of both liability-hedging and return-seeking assets. The following schematic provides a depiction of the thought processes involved:
Within the return-seeking category, investment risk should be managed by investing in a number of different asset classes that provide diversification in their response to different economic stimuli. The liability-hedging asset classes provide some protection against movements in interest rates and will move directionally with the liabilities as interest rates change.

Asset allocation studies review the expected future performance of the policy asset allocation under a wide variety of forward-looking economic scenarios and to determine whether a change in policy mix is likely to improve the financial performance of the Fund. In addition, qualitative discussions which incorporate items such as implementation considerations, capital markets observations and expectations, and economic trends will impact the outcome of the asset allocation study.

**Asset Mix Policy**

**Principle**
The same asset mix will be maintained for all assets of the Fund, i.e. the asset mix will be the same for active and retired members, and individuals will not be able to choose their own asset mix. The same rate will be used to credit interest for all Plan members.

**Rationale**
The Plan text does not contemplate different asset mixes for different Fund purposes (e.g., for the provision of retirement and termination benefits vs. the crediting of annual interest on member contributions, or for members of different ages or risk profiles).

**Minimum Target Allocation**

**Principle**
For any asset class in which the Fund invests, the target allocation will be at least 5%.

**Rationale**
If the allocation to an asset class is less than 5%, the return, or risk mitigation, impact on the fund is expected to be insufficient to outweigh the additional resource commitment for manager selection and monitoring. Also, for many types of investments the level of fees relative to the amount of the investment decreases as the amount of the investment increases.

**Rebalancing**

**Principle**
A disciplined rebalancing policy will be maintained to ensure asset class allocations stay within asset mix policy ranges. To the extent possible, cash flows from contributions and
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portfolio distributions will be used to assist in maintaining the asset classes within their policy ranges. Under certain extreme circumstances, rebalancing may be suspended due to liquidity constraints.

Rationale
An effective rebalancing policy ensures that the actual mix does not drift too far away from the policy benchmark, which has been set after extensive analysis of the assets and liabilities. In addition, disciplined rebalancing creates an automatic ‘buy low, sell high’ action in the Fund and so can add value and be a useful risk management tool.

Public Market Equities (Stocks)

Principle
Public market equities will be used primarily as return-seeking assets and the Fund will have a meaningful allocation to the asset class. The inclusion of a diversified portfolio of foreign equities is expected to reduce risk and the Fund will overweight foreign equities relative to Canadian equities.

Where there is a reasonable expectation of positive net of fees return relative to an appropriate benchmark, the investments will be actively managed.

Rationale
Equity investments have, in the longer term, provided a higher return than fixed income, albeit with a higher level of return volatility (risk). While history cannot be relied on to determine the level of future returns, the past relationships can be explained and represent a useful indicator of future relative performance. Therefore, since equity positions represent ownership in companies, they should, over the long term, provide a return premium over bonds, which represent lending to companies. As such, an asset mix over weighted in equities is expected to produce higher returns in the long-term, but may result in periods of poor performance in the short term.

The Canadian market is very concentrated (by both industry and company) and represents only 2-3% of the world’s equity market capitalization. The inclusion of a diversified portfolio of foreign equities is expected to reduce risk within the public market equity portfolio. In fact, modern portfolio theory asserts that there are risk reduction benefits to be gained by diversifying equities across regions. As the expectation is that skilled managers will be identified for each mandate, it is believed that the decision to invest in emerging markets should be left to the discretion of the International and Global equity managers.
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The key risks being managed in the public market equity portfolio are the absolute volatility of returns and preserving capital during equity bear markets. The public equity portfolio will be invested in a manner expected to produce strong long-term performance and provide protection during down equity markets. This objective also means that mandates should be managed actively. However, some markets are extremely efficient and active management is not expected to add value, so these markets should be passively managed.

Fixed Income (Bonds)

Principle

Fixed income investments will be used primarily for risk management purposes, and the Fund will have a meaningful policy allocation to fixed income investments. Fixed income investments will be geographically diversified, and maintain high quality at the portfolio level.

Where there is a reasonable expectation of positive net of fees return relative to an appropriate benchmark, the investments will be actively managed.

Rationale

Fixed income investments are typically the main component of the liability-hedging asset category and are used primarily for risk management purposes. Fixed income tends to have relatively low return volatility and provides diversification relative to public market equities. In addition to partially hedging the liabilities, these characteristics will help to manage the volatility of the Fund.

However, the liability-hedging characteristics of the fixed income portfolio will tend to be long-term and directional; fixed income will not exactly match the liabilities, but will decrease risk. Therefore, an allocation to foreign bonds diversifies the geographic concentration of being solely invested in Canadian fixed income while not substantively reducing the interest rate hedging benefits of the bond allocation. Diversification can be achieved through investment in developed market foreign sovereign, and corporate fixed income. In aggregate, the portfolio will maintain an average rating of investment grade; however, a small allocation to higher yield bonds and emerging market debt is expected to further diversify risk.

In order to effectively manage the risk profile of a bond portfolio, active management will be employed. However, domestic mandates that only involve government securities will be managed on a passive basis, as there is little opportunity for an active manager to either add return or create a significant difference in the risk profile of the mandate.
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Cash
Principle
Cash is not an appropriate long-term investment for the Fund, and the asset mix policy will not include an allocation to cash.

Rationale
Cash is expected to have the lowest long-term rate of return, relative to other asset classes. In addition, a cash allocation is not required from a liquidity perspective as the contributions into the Fund, and availability of assets that are easily liquidated, are sufficient to cover the required cash flows for the foreseeable future.

A small amount of residual cash will be held in the Fund to manage these cash flows. From time to time, the Fund may have more significant cash holdings, for example, cash may be used during periods of manager transition where there is a need to temporarily replicate market returns using derivative instruments. These transitional flows do not represent a policy allocation to cash.

Real Assets
Principle
There will be a policy allocation to Real Assets which are non-public market investments and include Real Estate, Infrastructure and other similar investments.

Rationale
The Fund has initially identified Real Estate and Infrastructure as the preferred investments for the Real Asset allocation as they are fundamentally different from Equities and Bonds and offer potential for risk diversification. Where historic results are available, they have demonstrated a relatively low correlation to traditional asset classes. The diversification opportunity is greater with private investment, as opposed to indirect investment through publicly traded securities which tend to have a higher correlation with equity markets.

These investments are expected to also enhance the Fund’s return and may also have a positive correlation to inflation. In addition, Real Estate and Infrastructure are expected to generate relatively predictable and sustainable cash flows.

Real assets are illiquid investments, and typically require capital to be locked-up for a long time period. In addition, it can take time to identify suitable opportunities required to develop a diverse, fully invested portfolio and build up the total exposure of these asset classes to the 5% minimum level. An allocation to Real Assets can require significant resource commitment for manager selection and performance monitoring.
The ability to increase returns with some inflation protection, generate relatively predictable and sustainable cash flows and diversify the sources of returns justifies an allocation to Real Assets despite some of these challenges.

**Absolute Return Strategies**

**Principle**
The Fund may invest in Absolute Return Strategies, provided that appropriate investment vehicles can be identified with consideration to transparency and other potential risks.

**Rationale**
Investing in Absolute Return Strategies is expected to decrease the overall risk profile of the Fund through diversification with little/no detrimental impact on the total Fund’s long-term return expectations. These skill-based strategies typically have a low correlation to traditional asset classes.

Absolute Return Strategies do, however, require more resources for due diligence and selection. As these strategies may employ derivatives, leverage and/or short selling, care must be taken to ensure that the manager’s risk controls are adequate and consideration given to the legal structure of the investment vehicle.

Many of these vehicles also limit the investor’s transparency regarding the underlying investments (i.e., the ability to examine all of the portfolio holdings at any point in time) requiring specialized monitoring to adequately assess the risks.

These strategies also have additional complexities, which may include liquidity constraints and higher fees relative to traditional equity and bond mandates. Therefore, they must be expected to generate sufficient excess net returns in order to make it worthwhile given these complexities.
Section 3 – Implementation Strategies Principles

Leverage
Principle
The Fund will not directly borrow money to make investments; however, in some cases leverage is an intrinsic part of the investment and may be used by the Fund’s investment managers providing appropriate considerations are given to the risks involved.

Investment in leveraged asset categories will only be made through vehicles where there is no possibility of losing more than the amount of the Fund’s investment in that specific vehicle.

Rationale
For certain types of investment, such as Real Estate and Infrastructure, leverage is an intrinsic characteristic of the investment, as the manager typically borrows money to finance a portion of the purchase of the investment or to cover part of the cost of improvements on an investment. Infrastructure and Real Estate investments often create leverage through the use of mortgages or similar vehicles to finance a portion of the purchase of the asset, this does not increase the total allocation at the portfolio level.

Absolute Return strategies may use leverage. Typically this is primarily through short selling or the use of derivatives. In these cases, the risk must be carefully evaluated as leverage will magnify position exposures and often introduces counterparty exposure. Thus, proper due diligence must be exercised to ensure that the manager’s risk controls are adequate and consideration must be given to the legal structure of the investment vehicles that utilize these strategies. This will form part of the overall assessment of the investment vehicle.

Short Selling
Principle
Short selling may be used by the Fund’s investment managers providing appropriate consideration is given to the risks involved.

Rationale
Allowing an investment manager with the appropriate skills to short sell securities expected to perform poorly, and to reinvest the proceeds to increase the exposure to those securities the manager expects to perform well, is expected to increase the value added generated by the manager by increasing the breadth of opportunities available to the manager.
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Short selling is a form of borrowing and thus, by its nature, creates leverage. This form of leverage may, however, decrease Fund risk. For example, market exposure may be reduced if the characteristics of the securities that are shorted are appropriately similar to the characteristics of securities that are owned.

Short selling can result in significant losses when a short position moves against you. And it does introduce counterparty exposure. Thus, proper due diligence must be exercised to ensure that the manager’s risk controls and skill at managing short positions are adequate and consideration must be given to the legal structure of the investment vehicles that utilize these strategies.

**Currency Hedging**

**Principle**

The Fund will passively hedge 100% of the foreign global Fixed Income portfolio. The Fund will passively hedge 50% of the non-domestic Real Asset exposure (Infrastructure and Real Estate). Foreign Equities will be unhedged.

Hedged mandates will be hedged at the portfolio level, not at the security level (i.e. a global US dollar denominated portfolio will hedge the US dollar exposure, and not the currency denomination of the underlying securities that comprise the fund).

**Rationale**

Over the long-term, there is expected to be no return from currencies or currency hedging. Currencies have, however, exhibited relatively high likelihoods of large movements over a short time period that can have a significant positive or negative effect on the Canadian dollar return of the foreign investments in the portfolio. These movements can directly affect the retirement income of Plan members. Since currency represents an uncompensated risk in the Fund, a thoughtful hedging strategy can reduce this risk.

The main rationale for investing in fixed income markets is to mute the volatility of the Fund returns, particularly to interest rate movements. Over the longer-term, Canadian and global fixed income yields have tended to trend in the same direction; however, currency movements can often overwhelm these interest rate shifts, particularly in the shorter term. Hedging the entire currency exposure preserves the interest rate characteristics of the global fixed income investments, which is essential to hedging the Fund’s liabilities, and eliminates the unwanted currency volatility.

The Fund has exposure to foreign Real Assets (i.e. Infrastructure and Real Estate). These assets offer the potential for risk diversification as they differ from both equities and bonds,
but also capture some characteristics of both Return Seeking and Liability Hedging Assets. The linkage between Real Assets and the Fund’s Canadian based liabilities is not as direct as fixed income; however, there are some similarities, including long-term predictable cash flows that are often inflation protected. Partially hedging these assets strengthens the linkage between the Liability Hedging characteristics of these assets and the Canadian obligations. Furthermore, investments in Real Assets are expected to be long term in nature and the Fund can tolerate some volatility from currency movement in as these investments, theoretically, will be held to maturity and should help smooth the volatility of the Return Seeking Asset portfolio. Partially hedging the Real Asset portfolio will reduce unwanted currency risk without diluting the Return Seeking characteristics of the investments.

For the Fund’s non-domestic Return Seeking assets, which are currently foreign equities, the correlation between Canadian dollar strength and the performance of global equity markets (in particular, the U.S. market) is particularly strong. Consequently, currency hedging increases the volatility of foreign equity returns for the Canadian investor, so remaining unhedged decreases the expected currency volatility.

Hedging will be done at the portfolio level. The investment managers will attempt to maximize their risk return profile in the currency in which their portfolio is measured (and often will actively manage the currency risk or invest based partially on their currency beliefs). From a Canadian perspective, currency volatility can be very large and often uncorrelated to the underlying portfolio. This risk can be reduced by hedging at the portfolio level which will reduce the currency risk, but not undermine the managers’ portfolio investment decisions.

Currency exposures can be actively managed versus a targeted hedge ratio depending on the views on the directional nature of a currency pairing. Since hedging strategies are used by the Fund fundamentally to reduce risk, and the little, if any incremental value is expected to be added from actively hedging, currency hedging will be managed passively.

The administrative issues around passive currency hedging, which include the costs of hedging and the potential for large cash flows in and out of the fund to settle currency forwards, are manageable.

**Sustainable Investing**

**Principle**

Integration of environmental, social, and governance (ESG) factors in the investment selection and evaluation process is consistent with the expectation that the Fund shall provide sustainable investment performance over the long term. The Fund will continue to
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monitor sustainable investing practices and evaluate whether an allocation or specific criteria are worthy of inclusion, considering potential return enhancement, cost, resource requirements and other relevant factors.

Rationale
Empirical studies show that there is a positive link between corporate sustainable business practices and share price performance. In addition, encouraging sustainable business practices is, in and of itself, a desirable goal. Sustainable investing is a complex area, however, requiring additional research, education, and specialized resources resulting in higher costs.

The majority of pension funds in Canada do not at this time incorporate explicit sustainable investing criteria in investment decision-making. Monitoring sustainable investing practices will help to ensure that the Fund does not diverge from common practice.

Having no explicit sustainable investing criteria does not mean that sustainable investing is ignored. Most investment managers incorporate sustainability criteria in their security selection and portfolio construction decisions in a qualitative way when evaluating the management capabilities, future growth prospects, and potential risks for companies.

Securities Lending

Principle
The Fund will not participate in a securities lending program.

Rationale
The amount of revenue that is likely to be generated from securities lending is relatively small and is not sufficient compensation for the potential risks.

Derivatives

Principle
Derivatives may be used, with proper expertise and oversight, to create positions and exposures that are consistent with these Principles.

Rationale
Derivatives are broadly used by investment managers for implementing positions and managing risk exposures. With the proper oversight, including management of counterparty exposures and liquidity risks, derivatives are an effective way for managers to implement their investment ideas and manage risk in their portfolios.
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To the extent derivatives are used, the Fiduciaries will have to be satisfied that the manager has the requisite level of expertise in the instruments they are using, are transparent in their usage, and understand the risks associated with using these investment tools.
Section 4 – Manager Structure Principles

Internal/External Fund Management

Principle
The Fund will use external money management services, and not create its own internal manager structure. The Fund will not develop nor maintain any internal fund management resources.

Rationale
The Fiduciaries believe that, given the resources available and the size of the Fund, asset classes are most effectively managed by hiring skilled external managers. The goal is to employ the most appropriate managers for each of the mandates in its investment management structure. The Fund should be managed by external investment management firms who have the necessary resources and expertise to run their respective strategies.

Practically, it is difficult to attract, retain, and adequately remunerate the best of highly qualified internal portfolio management personnel according to prevailing investment industry standards. In addition, internal management provides less flexibility, staff relations are complex and it is difficult to adequately address the career growth aspirations of its incumbents. Also, good governance for an internally managed investment organization requires an extensive internal administration structure.

For actively managed assets there are competent external managers that, net of fees, have the potential to consistently generate significant value added. It is believed that York has the resources, with assistance from external advisors, as required, to assess the skill of a manager and whether they are likely to be able to meet the desired objectives for their specific mandate.

Selection Process for Managers

Principle
The selection process will focus on a detailed assessment of qualitative factors (such as incentive structures for key investment personnel, the strength of the team and the robustness of the investment process) in selecting managers for all of the desired mandates. Detailed due diligence will be carried out, to the extent possible, at the managers’ offices, to assess these various qualitative factors before a manager is recommended to SCIP. External advisors will be used to provide detailed comparative information and facilitate the selection process and due diligence.
Rationale
A manager’s past performance is not necessarily predictive of future results. It is important to assess the qualitative factors that impact future long-term performance, such as the strength and stability of the investment personnel, consistency of reward structures with the investment approach and the efficacy of the investment process.

External advisors have extensive databases that are regularly updated, and dedicated resources for manager research and evaluation.

**Pooled vs. Segregated Vehicles**

**Principle**
For public market mandates, it is generally preferred to invest using pooled vehicles if available; however, in cases where there are specific mandate restrictions, a segregated vehicle may a reasonable choice. Direct investments in Real Assets will be accessed through limited partnership vehicles (which are by definition pooled vehicles).

**Rationale**
Pooled funds offer some potential advantages, through lower transaction costs and simpler registration requirements for foreign and emerging markets; this is particularly true when the manager uses a model portfolio construct in which all of that manager’s portfolios with unconstrained mandates are virtually identical in composition.

Segregated funds permit greater control over the mandate guidelines and the portfolio of securities and provide greater transparency on the day-to-day holdings of the manager.

Direct investments in Real Assets will be made in limited partnerships, or similar vehicles, that limit the exposure to catastrophic losses to the actual investment in a particular product.

**Active and Passive Fund Management**

**Principle**
The Fund will have an orientation toward active fund management. However, passive fund management will be used on a limited basis, in a market where there may be fewer opportunities for profitable active management (defined as positive value added relative to an appropriate benchmark on a net of fees basis) and where the benchmark itself is considered to be of adequate quality for investment.

**Rationale**
Even modest value added through active management (net of the additional fees)
has a significant effect on increasing the long-term return to the Fund. Historical analysis indicates that Canadian and International (EAFE) equities are asset classes that lend themselves well to active management for added value. On the other hand, analysis indicates that there is less potential value added from active management in US equities and Canadian bonds.

Active managers can also reduce risk, by mitigating the magnitude of negative returns from the market. The level of long-term return and the pattern in which those returns are delivered are both important aspects in achieving the Plan’s financial objectives. Thus, an equity manager who provides a return that merely matches the performance of their benchmark index over the long-term but provides that performance with significantly lower volatility and better bear market protection is helping to achieve the financial objectives. In addition, the long-term nature of the key liabilities is best matched to an active manager who utilizes a very long-term, benchmark agnostic approach to investing rather than the momentum-driven approach inherent in passive investing.

It is believed that the Fiduciaries have the ability to select active managers for most asset classes that will provide, in aggregate and over the long-term, returns that outperform their passive benchmark indices and will do so with a pattern of returns that will improve the performance. This approach is likely to result in manager portfolios that significantly deviate from the composition of the relevant benchmark index.

The existence of a market index does not, in and of itself, mean that the index is a good investment. Some market indices show a high degree of concentration (e.g., the S&P/TSX Composite Index). While these indices can be used as benchmarks, many active investment managers will operate a more diversified portfolio.

Where it is believed that an investment mandate does not provide a significant opportunity for active managers to either significantly improve long-term returns or provide a better pattern of returns, the mandate will be managed on a passive basis to minimize costs.

**Specialty Fund Management Principle**

The Fund will use primarily specialty fund management in conjunction with the maintenance of a disciplined rebalancing policy so that the asset mix does not drift.

**Rationale**

The use of specialty management rather than balanced fund management will allow the Fund to have “best in class” managers in each asset category. Managers are selected based
on their expected ability to provide the optimal level and pattern of performance within each asset class. In addition, studies in Canada and the US have shown that the median active balanced manager has tended to lose value through asset mix management.

Investment Style and Number of Managers

Principle
Where appropriate and practical, the Fund will use managers with complementary investment styles within asset classes. The Fund will have a multi-manager structure with at least one manager for each asset class in the asset mix policy, but the total number of managers will be minimized to ensure overall cost efficiency. In addition, the multi-manager structure will be such that it produces a return that promises value added relative to the asset class benchmark.

Rationale
Investment managers – particularly managers of equity investments - exhibit distinct and consistent management biases or styles. These styles can be combined, within asset sectors, in teams of managers so that value added returns are preserved, and the aggregate level of risk is lowered.

A lower number of managers, however, can result in lower manager costs and lower monitoring costs. Additionally, over diversification can dilute the aggregate value added from a multi-manager structure by moving the total asset class closer to a structure akin to the benchmark.

Fund Manager Evaluation

Principle
Qualitative and quantitative evaluation criteria will be used when choosing investment managers to fulfill a particular mandate or evaluating current managers.

Rationale
Quantitative criteria (e.g., consistency of portfolios with stated style, performance relative to suitable benchmarks, fee structure, etc.) capture past experience. Qualitative criteria (e.g., organizational strength, depth and consistency of key personnel, appropriateness of investment process and risk controls, etc.) help to evaluate the likelihood that future performance will provide value added. Both sets of criteria provide important information with respect to fund managers.
Section 5 – Ongoing Monitoring Principles

Measurement Period
Principle
For publicly traded or liquid investments, performance will be assessed over rolling four year periods, and reviewed on a quarterly basis.

Illiquid investments will be evaluated following a year’s worth of investment performance, and for periods of not less than one year.

Rationale
It is important to allow for a reasonable time horizon to measure quantitative fund and individual manager mandate performance. At the Fund level, returns achieved by different asset classes change with market cycles and it is necessary to have an appropriate time period to prove the success of the strategy. At the mandate level, studies have shown that style has a strong impact on a manager’s returns. As styles move in and out of favor, it is important to allow the manager a sufficient time period to prove the success of the strategy.

In hiring each manager, it is important to clearly understand the types of market conditions during which the manager should be expected to underperform and outperform. Shorter term performance assessment should focus on understanding what has been driving the benchmark over the recent period and determining whether the manager’s performance is in accordance with expectations. Thus, a manager’s underperformance during a period during which underperformance would normally have been expected should not be viewed in a negative context. Conversely, outperformance during a period during which the manager was expected to underperform could be a cause for concern.

For portfolios that are not benchmark focused it will be necessary to evaluate manager performance against objectives over a longer time period. Benchmark agnostic portfolios can display very different performance patterns than their benchmark and can underperform or outperform for considerable periods. The key measurement period for assessing performance for individual managers will be a full market cycle – for ease of tracking, a market cycle will be assumed to span a four year period (although it is recognized that any particular cycle is likely to be either shorter or longer than this). During interim periods, the monitoring will focus on patterns of performance specific to the individual manager’s mandate (i.e., whether the return over a specific period is consistent with expectations given the factors that drove the markets included in their mandate).
Prolonged periods of manager underperformance can, however, be costly for the Fund, and the reality is that very few decision-makers have tolerance for prolonged underperformance. A four-year time period provides a reasonable compromise between:
(a) the requirement for sufficient time to prove success; and
(b) a realistic time frame within which fiduciaries will tolerate underperformance.

Illiquid assets will only be evaluated following a full year’s worth of performance as the J-curve effect that is present earlier in investment period can dramatically obscure the actual success of a manager, particularly in the early days of an allocation.

**Benchmarks**

**Principle**
Benchmark-related targets will be the primary basis of assessment for the Fund’s managers. A benchmark-related target, along with the real rate of return target will be the primary tools for assessment at the total Fund level. Appropriate benchmarks will be identified for the Fund and for each asset class and manager mandate. **Peer group** comparisons will be used sparingly.

**Rationale**
Benchmarks based on market indices reflect the primary investment opportunity set for a given asset class. Market index returns can be replicated using low cost index management, and therefore provide an objective hurdle for active management. Constituents of benchmarks are transparent and (generally) unbiased and specified in advance.

Even where a relevant market index does not exist, a benchmark still needs to be selected to assess whether the investment manager or strategy is providing returns in line with the expectation when the manager/strategy was selected. Some examples of possible benchmarks include a return in excess of cash or an absolute return target.

Peer groups, on the other hand, while useful to a point, have certain inherent characteristics that render them less valid as performance targets. Peer group comparisons do not always recognize differing mandates or investment restrictions placed on managers. Also, survivor bias may be inherent in peer groups. Finally, the median or top-quartile manager within a peer group cannot be specified in advance, and it is difficult to effectively manage against a target that is constantly changing.

**Value Added Targets for Active Mandates**

**Principle**
Realistic value added targets will be adopted for all active management mandates. Over a
full cycle, the magnitude of each value added target will reflect the historical evidence of active management success in that asset class, the level of active risk inherent in the manager’s strategy, the level of management fees, and the prospects for incremental return in the future. As a result, differing mandates/asset classes may have different value added targets.

Rationale
Realistic value added targets are essential for effectively measuring the success of each individual manager’s mandate and eliminating unnecessary manager turnover. A target that is too high may result in performance expectations that are excessive, and lead to the unjustified termination of a manager. On the other hand, a target that is too low may result in a mediocre manager being retained within the Fund. Value added targets will be higher for managers who invest in more concentrated portfolios and for managers who are permitted to invest significantly in securities that are not included in their benchmark, since the more discretion provided to the manager to make decisions, the higher the value added target should be.

Mandate Compliance
Principle
All fund managers will be monitored against the parameters established for them in their mandates. A formal mandate will be maintained for every manager, and the monitoring of it will be part of ongoing due diligence.

Rationale
A “drift” by any manager from the processes and controls specified in its manager mandate may result in the Fund being exposed to unintended biases, or to risks that are specifically prohibited with respect to the Fund.

Transparency and Reporting of Leverage
Principle
The amount of the Fund’s capital allocated to each asset class, investment manager and product (i.e., an investment product may include one or more strategies) shall be disclosed at least quarterly.

The Fund will only invest in products which provide timely transparency of the underlying investments and the level of leverage employed. Any products that employ leverage to increase exposures shall be noted, along with the amount of leverage being used. Disclosure of underlying holdings in all investments is preferred; it is sufficient, however, to receive only summary descriptions of the exposures within the portfolio from the investment

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manager provided the risk exposure can be evaluated.

Rationale
There are numerous products available in the industry and a lack of standardization of nomenclature. Leverage may be used and not inherently visible. Thus, additional reporting may be necessary to clarify the exposure and the nature of the investments.

It may not be practical to receive disclosure of all underlying holdings, as these positions are often considered proprietary to the investment manager. Thus the transparency principle has not been extended to the underlying holdings.

Qualitative Manager Monitoring
Principle
Fund managers will also be monitored from a qualitative perspective and periodic due diligence reviews will be conducted as required.

Rationale
Qualitative criteria (e.g., organizational strength, depth and consistency of key personnel, appropriateness of investment process and risk controls, etc.) help to evaluate the likelihood of future out performance, and to ensure that the factors that led to the manager being hired originally remain in place.
Appendix A – Glossary of Terms

Absolute Return Strategies: Primarily skill-based strategies expected to generate positive returns that have no/low correlation to the stock or fixed income markets. These strategies may employ derivatives, leverage and short selling. Absolute Return Strategies have various names, including “equity market neutral” and “hedge funds”. There are usually no appropriate market indices for Absolute Return Strategies, so benchmarks for performance monitoring are often based on an absolute return target or a return in excess of cash.

Active Fund Management: Approach to investment management where the aim is to outperform a particular market index or benchmark through asset allocation and/or stock selection and/or currency decisions. (Also see Passive Fund Management).

Active Position(s): Difference between the actual level of investment made in a particular stock or asset class and the benchmark allocation or weighting of that investment.

Asset Class: A segment of the investment opportunity set, such as cash, bonds, equities, real estate, infrastructure, and commodities.

Asset Mix (Asset Allocation): Distribution of investments across categories of assets, such as cash, equities and bonds. Asset allocation affects both risk and return and is a central concept in financial planning and investment management.

Balanced Fund Management: Refers to the use of a single manager for both stocks and fixed income. The manager may or may not have discretion to make asset mix shifts.

Benchmark: Measure against which a portfolio's performance is assessed. The benchmark may be a market index for portfolios focusing on a particular market e.g. MSCI World Equity Index, or a combination of market indices. Where a relevant market index does not exist (e.g., for some Real Assets and Absolute Return Strategies), the benchmark may be based on cash, inflation, a market index which has some relationship to the investment, or an absolute return target.

Bond: Certificate of debt issued by a government or company, promising regular payments on a specified date or range of dates, usually with final capital payment at redemption.

Commodities: A tangible substance, such as food, grains, metals, oil and gas, etc., which investors buy or sell through futures contracts.
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**Correlation:** Reference to the Correlation Coefficient, which is a statistical measure of the degree to which the movements of two variables are related. A correlation of 1.0 indicates that the two variables move perfectly in tandem. A correlation of 0.0 indicates a random relationship between the variables, and a correlation of -1.0 indicates perfect negative correlation (perfect tandem but in opposite directions). Combining assets in a portfolio with negative correlations or with positive correlations less than 1.0 will reduce total portfolio volatility.

**Currency Hedging:** Strategy designed to reduce (partial hedge) or eliminate (100% hedge) exchange rate risk in a portfolio of non-domestic assets, through the use of currency futures/forwards or by the purchase, sale or borrowing of the exposed currency.

**Defined Benefit (DB):** Pension arrangement where the benefits payable to members are clearly specified, usually as a percentage of salary at, or near, retirement. The contributions that are required to ensure that this commitment can be met will vary depending on the plan's investment and demographic experience and the benefits to be provided. The employer bears the investment risk in such an arrangement.

**Defined Contribution (DC):** Pension or savings arrangement where the rate of contribution paid by the employer and/or the employee is defined (usually a percentage of salary). The benefits paid to members will depend on the contributions paid into the plan on behalf of the member, the investment return earned on those contributions and the terms available at retirement for converting the fund into a pension. The employee bears the investment risk in such an arrangement. Also known as money purchase or capital accumulation.

**Derivatives:** Financial instruments whose value is derived from the value of another investment, typically a stock, bond, currency or commodity. Can be used for reducing exposure (hedging) or gaining exposure with no or little capital employed. Some examples of derivatives are futures, swaps and options.

**EAFE:** Europe, Australasia and Far East. Typically used in the context of the MSCI EAFE Index which tracks the stocks of 21 developed countries.

**Equity:** Investment or ownership interest possessed by shareholders in a corporation -- stock as opposed to bond.

**Fiduciary:** Person or entity, who acts for the benefit and on behalf of another person or group of persons. A fiduciary holds a legally enforceable position of trust.
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**Fixed Income:** (See Bond)

**Foreign Equity:** A non-domestic *Equity.* (Also see *Equity*)

**Hedge (Hedging):** Action taken to protect the value of a portfolio against a change in market prices. It is usually used to reduce or eliminate risk, although similar techniques can also be used to speculate in a market.

**Hybrid:** Refers to a pension plan that combines certain characteristics of defined benefit plans with certain characteristics of defined contribution plans.

**Infrastructure:** Physical structures and networks that provide essential services to society, including oil and gas pipelines, electric transmission and distribution facilities, water distribution facilities, toll roads, airports, prisons, hospitals and so on.

**Investment Policy:** The particular asset classes selected and the target allocation of assets in a portfolio to these asset classes.

**Investment Style:** Approach followed by an active investment manager in selecting stocks. Example: A growth investment style is employed by investment managers who invest in companies that have superior growth prospects. Generally, these companies have higher price to earnings and price to book ratios and lower dividend yields. A value investment style is an approach to investment which places emphasis on identifying shares which are believed to be underpriced (on the basis of indicators such as P/E ratio, P/B ratio, and dividend yield) by the market. A core investment approach is not dominated by a particular style of investing such as value or growth.

**Leverage:** The use of a small amount of capital to gain a much higher exposure to an investment or asset class, typically through derivatives or by borrowing capital.

**Liability-Hedging Assets:** These assets partially hedge the Plan liabilities. In general, they have similar characteristics to the Plan’s liabilities and will respond to movements in interest rates and inflation in directionally the same manner as the liabilities.

**Modern Portfolio Theory:** Theory of portfolio optimization that seeks to construct an optimal portfolio by considering the relationship between risk and return.

**Passive Fund Management:** Approach to investment management which aims to replicate a particular market index or benchmark fund and does not attempt to actively manage the
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portfolio. (Also see *Active Management*).

**Peer Group**: Term sometimes used to describe the total number of operators or competitors in a particular field (for example, a group of equity investment managers), or the number of available stocks from which a portfolio is selected. Investment manager performance surveys are also referred to in this way.

**Real Assets**: Physical assets available for investment by institutional investors, including real estate, infrastructure and commodities.

**Real Estate**: Property in land, building or housing, as distinct from personal property (e.g. cars); also known as physical property to distinguish itself from Property Trusts.

**Real Return**: Inflation-adjusted return.

**Rebalancing**: Making adjustments to a portfolio to counteract the fact that different assets have performed differently over a period, and thus comprise different percentages of the portfolio than originally intended. Timing (how often to rebalance), ranges (how far the asset mix can drift before rebalancing), and targets (to rebalance back to) are important aspects of rebalancing.

**Return-Seeking Assets**: These assets are used to improve the funded ratio of the Plan. These assets may react differently than the underlying liabilities to different economic stimuli, and over a market cycle are expected to generate positive returns for the Fund, and add value relative to a relevant benchmark.

**Risk**: Risk can have many different meanings, depending on the context it is used in. Unless otherwise specified, risk refers to the volatility of returns.

**Risk Management**: Control or mitigation of volatility.

**Specialty Fund Management**: Specialty fund management refers to the use of separate mandates (and potentially different managers) for each asset class, with no discretion given to the managers to make asset mix shifts.

**Short Selling**: Selling a security that is not currently owned, but borrowed from a third party (e.g., from pension funds and other institutional investors through their securities lending programs) to execute settlement with the buyer. The seller therefore has a negative exposure to the security, creating a profit if it goes down in value and a loss if it goes up in
value. Can be used to add value, for hedging, or to provide a temporary source of funds with which to make additional investments beyond those afforded by the original capital (i.e., to leverage the original capital).

**Standard Deviation:** A measure of the dispersion of a set of numbers around the average. In a regression analysis (which assumes a normal distribution), 68% of the data points fall between 1 standard deviation below the average and 1 standard deviation above. Standard deviation is frequently used as a measure of risk.

**Stock:** See *Equity*.

**Sustainable Investing:** Incorporating environmental and social criteria in the investment decision-making process in order to enhance return and/or reduce risk. Sustainable investing makes no judgment as to the ethics or morality of any investment and does not change the Fund objectives.

**Volatility:** The variability of the price of a security, portfolio, or investment returns. Typically quantified as standard deviation. (Also see *Standard Deviation*).