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**Statement of Investment Policies and Objectives –
Investment Pool**

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McMaster University

Statement of Investment Policies and Objectives

Investment Pool

**Planning and Resources
Committee – APPROVED
May 25, 2017**

**Board of Governors - APPROVED
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Section 1 – Preamble

As of May 1, 1998, the General Trust and Endowment Funds (as defined below) and the Capital Fund were pooled and unitized for investment purposes. This larger investment pool benefits from economies of scale, offers more options to optimize future returns and provides more administrative efficiencies. Although other funds have been added to the Investment Pool, the investment policies and objectives of the Investment Pool mainly reflect the needs of the General Trust and Endowment Funds.

Donations to the University from private sources for specific or designated purposes are placed in “trust funds”, and those for unrestricted use in “endowment funds”. Donations may take the form of cash, securities in-kind, gifts in-kind, bequests or planned gifts among others.

While some gifts and legacies are free from restrictions as to the preservation of the capital, it is the policy of the University to maintain the original capital of the funds in “real dollar” terms, and to provide a relatively stable annual expenditure rate through investment in long-term securities.

Section 2 – Definitions

The “*Total Rate of Return*” is the time-weighted rate of return based on the change in market value of the Fund over a measured period of time, calculated in conformity with the standards established by the CFA Institute.

A “*Fund Manager*” is an external investment manager who invests a segment of the Fund according to guidelines specified in this policy and the mandate given by the University.

The “*Trust Fund Administrator*” is a University officer who is responsible for administering the fund in accordance with specifications made by the donor and in accordance with the ‘Operational Policy and Procedures for Trust and Endowment Fund Management’, the ‘Expenditure Policy External Restricted Endowments’ and ‘Expenditure Policy Internal Restricted Endowments’.

The “*Fund*” is the assets of the Investment Pool.

“*Real Assets*” includes both real estate and infrastructure investments.

Section 3 – Trust Funds

Specific purpose, or designated, donations are placed in trust funds and, in doing so, the University agrees to the terms and conditions for the use of the funds as established by the donor and the University and/or legal requirements. Trust funds are classified as externally restricted endowments in the University’s audited financial statements.

General Trust Funds are either:

- Perpetual Trusts – funds from which only the income earned on the capital may be expended; or,
- Long-Term Trusts – funds from which both the income and capital may be expended. Any capital to be spent from long-term trusts must be defined as expendable.

Specific Trust Funds are short term, and are funds received which are to spend in the current year for some express purpose. These funds are invested in the Cash and Short Term Investment Portfolio.

Trust funds are combined for investment purposes in the Investment Pool which is invested by external Fund Managers under this policy. Some trust funds may consist of securities received with the stipulation that they be retained and that the income be used for specific purposes.

Section 4 – Endowment Funds

Internally Restricted Endowment funds have been established by the Board of Governors. The Board can approve borrowings and/or permanent reductions from the funds through its annual budget process and in accordance with the ‘Expenditure Policy for Internally Restricted Endowments’.

General Endowment Fund

- Proceeds from bequests and insurance policies and other donations received by the University, the use of which has not been designated by the donor, are pooled in a fund designated the “General Endowment Fund”.
- The income of this fund is used to support scholarship and bursary programs of the University and such other purposes as approved by the Board of Governors during the University’s budgeting process.

H. L. Hooker Endowment Fund

- A legacy from Dr. H. L. Hooker, the use of which is not designated by the donor, is held in the “H. L. Hooker Endowment Fund”.
- The use of the income from this fund is approved by the Board of Governors during the University’s budgeting process, but the programs supported by this fund must enrich the academic achievements of the University and must provide a suitable memorial to Dr. Hooker.

Pension Surplus Fund

- In 2003, the University's portion of the Salaried Pension Plan's excess surplus was transferred to an internally restricted endowment. The income from the Pension Surplus Fund is used to support general operating purposes as approved by the Board of Governors during the annual budget approval process.

Endowment funds are combined for investment purposes in the Investment Pool which is invested by external Fund Managers.

Section 5 – Financial Objectives

The following are the financial objectives of the University for the Investment Pool.

- To achieve a Total Rate of Return sufficient to support stable and growing expenditures for University purposes.
- To preserve the original capital in “real” terms.
- To provide capital growth.

Section 6 – Fund Governance

The University is the administrator of the Investment Pool and the Board of Governors is responsible for the overall management. The Board of Governors has delegated certain duties and responsibilities (including the power to sub-delegate) to the Planning and Resources Committee which, in turn, has delegated certain duties and responsibilities to the Investment Pool Committee and the Treasury Operations Department and to various agents it has retained to assist in carrying out its duties in respect to the Investment Pool.

Section 7 – Investment Objectives, Beliefs and Mandates

In order to achieve the financial objectives, the Fund Managers are expected to maximize the Total Rate of Return within their defined mandates and policy constraints with respect to diversification, quality of securities and liquidity.

Investment Objectives:

The University expects the Fund to earn an annualized 5.0% (4% payout + 1% administration fee) real rate of return, after investment management fees, over the longer term. In any one year, however, the annual return may be significantly above or below the 5.0% real return. Investment strategies at the asset class and Fund Manager level will have specific objectives that when combined are expected to earn the total Fund level objective of 5%.

Investment Beliefs:

- The University has from time to time reviewed and confirmed its investment beliefs. A summary of the major beliefs is outlined below. Currently, the University believes:
 - the bias of the fund is towards being substantially fully invested over time;
 - that equity investments will provide greater long-term returns than fixed income investments, although with greater short-term volatility;
 - that it is prudent to diversify the Fund across the major asset classes;
 - that a meaningful allocation to foreign equities will increase portfolio diversification and, thereby, decrease portfolio risk while at the same time providing the potential for enhanced long-term returns;
 - the University will employ a rebalancing policy, to be implemented by the Treasury Operations Department, within prescribed ranges around the long-term asset mix policy;
 - that it is appropriate to employ specialist, external investment managers to invest the Fund in an efficient and effective manner;
 - that investment managers with active mandates can reduce portfolio risk below market risk and potentially add value through security selection strategies, and that a substantial portion of the Fund should be allocated to such active mandates;
 - that a component of passive management can be appropriate in certain asset classes, and that a portion of the Fund may be invested in passive mandates;
 - that it is appropriate to hedge a minimum 20% of foreign equities back to the Canadian dollar;
 - that it is appropriate to retain more than one investment manager, given the size of the Fund, provided that such managers offer asset class or style diversification;
 - that investment in hedge funds and private equity are not appropriate investments; and,
 - the University recognizes that, environmental, social and corporate governance (ESG) issues, including government/public policy and disclosure concerns can affect the performance of companies in which the Fund invest and consideration should be given to how managers analyze and integrate ESG factors into their investment process when selecting Fund Managers.

Benchmark Portfolio:

- The University believes that a portfolio invested in the following asset mix (based on market value) can, over the long term, achieve the stated investment objectives.

Asset Class	Benchmark Index	% Allocation
Canadian Equities	S&P/TSX Composite Index	20%
U.S. Equities		
- U.S. Large Cap	Russell 1000 Index (Cdn. \$)	6%
- U.S. Large Cap	Russell 1000 Index (Hedged)	10%
- U.S. Small Cap	Russell 2000 Index (Cdn. \$)	4%
Non-North American Equities	MSCI EAFE Index (Net)	20%
Bonds	FTSE TMX Universe Bond Index	35%
Real Assets	CPI + 4%	5%

For the purpose of measuring performance against the benchmark asset allocation guidelines of Section 7, any use of cash or other short-term investments as part of a strategy shall be considered either an equity or bond allocation, not a cash or short-term allocation.

The actual asset mix may vary at any time since a large percentage of the Fund is actively managed and asset classes provide different returns. Section 8 defines the limit for such deviations.

Expectations from Active Management

The long-term overall quantitative performance of the Fund from active management shall be considered satisfactory if the total annualized returns earned by the Fund exceed by 50 basis points (see Appendix 1 for calculation) the returns that could be earned on a passive basis.

For the purpose of measuring the Fund's and each Fund Manager's total rate of return, all returns shall be measured before investment management fees, but after transaction costs, and over four-year rolling periods. All index returns shall be total returns, and all foreign index returns shall be Canadian dollar returns.

Performance Objectives:

The following table outlines the value-added expectations for the active component of each asset class. Individual Fund Manager benchmark indices and returns may differ from these. Fund Manager fee levels compared to value added expectations are an important criteria in the manager selection process.

Asset Class	Benchmark Index	Value-Added Expectation (4-Year Rolling Annualized Basis)
Canadian Equities	S&P/TSX Composite Index	75 basis points
U.S. Equities	Russell 1000 Index (Cdn. \$)	50 basis points
	Russell 1000 Index (Hedged)	
	Russell 2000 Index (Cdn. \$)	
Non-North American Equities	MSCI EAFE Index (Net)	150 basis points
Bonds	FTSE TMX Universe Bond Index	20 basis points
Real Assets	CPI + 4%	200 basis points

The primary performance objective for a Fund Manager with an active mandate shall be to exceed the annualized return of the representative benchmark index, plus a value-added expectation, specific to their mandate. The secondary performance objective, where appropriate, shall be to exceed the median return of other managers with comparable mandates in a well-recognized manager performance universe.

A Fund Manager with a passive mandate shall manage with the objective of minimizing the tracking error. Tracking error is generated from the difference between the return of the Fund Manager’s portfolio and that of the applicable benchmark index. The quantitative performance of the passive manager shall be considered satisfactory if the tracking error is within the objective stated in the mandate.

Section 8 – Asset Mix and Rebalancing Policies

Asset Mix Policy:

The market values of the individual asset class components of the Fund shall be within the following minimum and maximum ranges.

Asset Class	Minimum	Benchmark	Maximum
Canadian Equities	10%	20%	30%
U.S. Equities	10%	20%	30%
Non-North American Equities	10%	20%	30%
Bonds	25%	35%	45%
Real Assets	2.5%	5%	10%

Notwithstanding the asset mix ranges shown above, the Investment Pool Committee may recommend temporary asset mix positions outside these ranges under unusual market conditions.

Rebalancing Policy:

It is recognized that the actual allocations to these asset classes, to Fund Managers, and across mandates will change over time. This will largely be due to reasons such as the following:

- Different asset classes will provide different rates of return
- Within an asset class, different Fund Managers and styles will provide different rates of return.
- Cash flow into the Fund will affect the allocations.

Should any asset class fall outside of the minimum and maximum ranges, excluding the 5% Real Asset Benchmark allocation, outlined on the previous page, the Treasurer shall rebalance the total Fund back to the Benchmark Portfolio. The Treasurer shall rebalance as soon as is practicable, but not later than three months after any breach of the ranges.

Section 9 – Permitted Investments

The following investments may be made either directly, through pooled or mutual funds, through private partnerships, or through insurance contracts. The list of permitted investments and constraints outlined below apply to all relevant mandates. Additional constraints may be imposed on the Fund Managers through their specific mandate.

Investments:

- Publicly traded Canadian common stocks, rights, warrants, instalment receipts and debt securities convertible into common stock.
- Publicly traded U.S. and international common stocks, American depository receipts, global depository receipts, rights, warrants, instalment receipts and debt securities convertible into common stock.
- Publicly traded income trusts.
- Private placements.
- Debt securities of Canadian issuers, including bonds, debentures, or other debt instruments of corporations, Canadian Governments, Canadian Government agencies, or guaranteed by Canadian Governments; mortgage-backed securities; asset-backed securities; and, real return bonds.
- Mortgages.
- Publicly traded preferred shares.
- Foreign issuers of Canadian-denominated bonds.
- Canadian cash on hand, demand deposits, treasury bills, short-term notes and bankers' acceptances, term deposits and guaranteed investment certificates having a term of equal or less than one year.
- Foreign bonds.
- Initial public offerings.
- Exchange traded funds.
- Real estate.
- Infrastructure.

Derivatives:

Derivatives such as options, futures, swaps and forward contracts on any security allowable under this Statement are permitted, including but not limited to index option and futures, index participation units and equivalents. Derivatives may be used:

- to hedge (i.e. reduce) fully or partially any investment risk, including market interest rate, credit, liquidity and currency risk.
- replicate direct investments in the underlying assets or groups of assets (i.e. indices) so as to achieve some advantage of lower cost or market exposure.
- to effect cash and asset mix rebalancing.

Derivatives shall not be used to create leverage or for speculative purposes.

The Fund Managers shall be responsible for assessing all counter party risk associated with derivative instruments, with regard to credit rating and total exposure limits for each derivative securities dealer and bank. The minimum credit quality for the counter party of any derivative transaction shall be consistent with the credit quality requirements set out in the Fund Manager's mandate. The managers shall implement internal procedures and controls in order to ensure that derivatives are used in compliance with this Statement and their mandate at all times.

Quality Requirements:

Minimum quality requirements will be established by the Investment Committee and listed in each of the Fund Managers specific mandate, and may vary between managers within an asset class and across asset classes. Copies of mandates are available for review in the Treasury Operations Department.

Quantity Requirements:

Maximum limits or prohibitions will be established by the Investment Committee and listed in each of the Fund Managers specific mandate, and may vary between managers within an asset class and across asset classes. Copies of mandates are available for review in the Treasury Operations Department.

Section 10 – Securities Lending

Securities held by the Investment Pool may be loaned by the Trustee under a properly approved contract with the University. Such loans must be secured by cash or readily marketable securities with a quality rating of R1 or higher, a market value of at least 105% with the level of security maintained daily, and an indemnity by the custodian against all losses as a result of the custodian's securities lending program. Collateral provided with respect to any such securities lending agreement must have free and clear title and may not be subject to any right of set-off. It is recognized that this policy on security lending is not enforceable to the extent that the investment is in pooled funds.

Section 11– Delegation of Voting Rights

The University has delegated to the Fund Managers the responsibility of exercising all voting rights acquired through the Fund. The Fund Managers shall exercise such voting rights with the intent of fulfilling the investment objectives and policies of this Statement and for the long-term benefit of the Fund.

The Fund Managers shall provide their voting right policies to the Treasury Operations Department. Each Fund Manager shall provide the Treasury Operations Department with an annual report outlining how they voted and whether ESG was factored into the proxy voting decision making process and any departures from, or exceptions to, the policies and any other extraordinary matters.

At least annually, a summary report of investment manager proxy voting actions and how ESG factored into the voting shall be provided to the Planning and Resource Committee of the Board of Governors.

Section 12– Fund Manager Reporting

Each Fund Manager shall provide the Treasury Operations Department with quarterly statements including the performance, attribution of the performance, future investment strategy, compliance with the mandate and a listing of the assets in the portfolio. At least annually, each fund manager shall provide Treasury with a report of proxy voting actions and how ESG factored into the voting.

In the event that a Fund Manager is not in compliance with their mandate, the Fund Manager is required to notify the Treasurer as to the reasons for the non-compliance and to outline the course of action, including timing that will rectify the situation. The Treasurer will inform the Investment Pool Committee of the situation.

Fund Managers will make a presentation to the Investment Pool Committee on a periodic basis.

Section 13 - Conflict between Policy and Pooled Fund Investment Policies

While the guidelines in this Policy are intended to guide the management of the Fund, it is recognized that, due to the use of pooled funds, there may be instances where there is a conflict between this policy and the investment policy of a pooled fund. In that case, the pooled fund policy shall dominate. However, wherever such a conflict results in non-compliance with the Policy, the Fund Manager must report this conflict explicitly in its compliance report.

Section 14– Conflict of Interest

For the purpose of this statement a conflict of interest is defined as any event in which any employee or member of or consultant to:

- Board of Governors,
- Planning and Resources Committee,
- Audit Committee,
- Investment Pool Committee,
- Investment Manager(s),
- Custodian/Trustee, and/or
- Consultant,

or any directly related party may gain a financial or other advantage from knowledge of, or participation in, an investment decision of the Fund, or a circumstance that could reasonably be interpreted as impairing his/her ability to render unbiased and objective advice or to fulfil his/her fiduciary responsibilities to act in the best interest of the Fund.

It is not possible to anticipate in advance, in this statement, the multitude of situations which can arise. All persons listed above must, therefore, be cognizant of the possibility that conflicts, or perceived conflicts, may arise and must make timely and full disclosure in accordance with generally accepted concepts of fiduciary responsibilities and in accordance with the procedures set forth below:

Responsibilities

This standard applies to the persons named above in the execution of their responsibilities (the “Affected Persons”).

Disclosure

In the execution of their duties, the Affected Persons shall disclose any material conflict of interest relating to them, or any material ownership of securities, which could impair their ability to render unbiased advice, or to make unbiased decisions, affecting the administration of the Fund’s assets.

Further, it is required that no Affected Person shall make any personal financial gain (direct or indirect) because of his or her fiduciary position. However, normal and reasonable fees and expenses incurred in the discharge of his/her responsibilities are permitted if documented and approved by the University.

No Affected Person shall accept a gift or gratuity or other personal favour that is material, from a person with whom the Affected Person deals in the course of performance of his or her duties and responsibilities for the Fund.

It is incumbent on any Affected Person who believes that he or she may have a conflict of interest, or who is aware of any conflict of interest, to disclose full details of the situation in writing to the Chair of the respective Committee within three business days after the individual becomes aware of the conflict of interest. The disclosure should also be made orally if awareness of the conflict occurs during the discussion of the Fund’s business.

The respective committee, in turn, will decide what action is appropriate under the circumstances but, at a minimum, will table the matter at the next regular meeting of the Committee.

Normally, the individual disclosing the conflict of interest shall withdraw from the meeting during discussion of and vote on the issue causing the conflict of interest. The individual may be permitted, at the Committee's request, to participate in the discussion but he/she shall not be present for the vote.

The disclosure of a conflict of interest, the name of the individual declaring the conflict and the manner in which the conflict was resolved will be recorded in the minutes of the Committee.

Section 15 – Related Party Transactions

The Investment Pool Committee, on behalf of the Fund, may not enter into a transaction with a related party unless:

- The transaction is both required for operation and or administration of a Fund and the terms and conditions of the transaction are not less favourable than market terms and conditions; or,
- Securities of the related party are acquired at a public exchange.

A “related party” is defined to mean the administrator of the Fund, including any officer, director or employee of the administrator, or any person who is a member of the Committee. It also includes the Investment Managers and their employees, a spouse or child of the persons named previously, or a corporation that is directly or indirectly controlled by the persons named previously, among others. The concept of “related party” does not include government or a government agency, or a bank, trust company or other financial institution that holds the assets of the Fund, where that person is not the administrator of the Fund.

Section 16 – Other Policy Items

Valuation of Securities:

It is expected that all of the securities held by the Fund will have an active market and that the values of such securities will be based on their market values. The exception to this is real estate where it will be based generally on appraisals conducted on a periodic basis.

Investments that are not regularly traded shall be valued at least annually by the Fund’s custodian in co-operation with the Fund Manager. In making such valuations, consideration shall be given to bid and ask prices, previous transaction prices, discounted cash flow, independent appraisal values, the valuations of other comparable publicly-traded investments and other valuation techniques that are judged relevant to the specific situation.

Policy Review:

This Statement shall be reviewed at least annually by the Investment Pool Committee, the Planning and Resources Committee and by the Board of Governors with respect to the appropriateness of the policies and objectives contained therein.

Investment Pool Carbon Footprint Reporting:

At least every five years (ideally annually), a report summarizing the measurement of the Investment Pool's carbon footprint shall be made available for review by the Investment Pool Committee and Planning and Resources Committee.

MCMASTER UNIVERSITY
INVESTMENT POOL VALUE ADDED RATE OF RETURN OBJECTIVE

ASSET CLASS	ALLOCATION TO ACTIVE MANAGEMENT %	EXPECTED ANNUALIZED VALUE ADDED BY ASSET CLASS (bps) (a)	ACTIVE COMPONENT OF ASSET MIX % (b)	EXPECTED ANNUALIZED VALUE ADDED FROM ACTIVE MANAGEMENT (bps) (a x b)
CANADIAN EQUITY	100%	75	20	15
U.S. EQUITY	100%	50	20	10
EAFE EQUITY	100%	150	20	30
BONDS (1)	79%	20	27.5	6
REAL ESTATE	100%	200	5	10
				71
				Assume 70% Success Rate (Management Estimate) 70%
				Total Fund Value Added Rate of Return Objective <u>50</u>

(1) 78.5% of the total bond allocation of 35% is actively managed.