PENSION NEWS

UBC FACULTY PENSION PLAN | First Quarter 2012 Edition

New FPP Investment Option: Guaranteed Investment Certificates

The Faculty Pension Plan (FPP) has expanded its investment options to include Guaranteed Investment Certificates (GICs). FPP members may invest in any of the five investment funds: Balanced, Bond, Canadian Equity, Foreign Equity and Short Term Investment, and now in GICs as well. The investment performance of the five funds will vary depending on the financial markets; whereas, GICs will provide more predictable investment income. This article describes the new option as well as the advantages and disadvantages of investing in GICs.

RISK AND REWARD

The FPP offers investment options that have different investment characteristics. Two key characteristics are risk and reward. Risk is the chance that an investment might lose value; reward is the long-term rate of return. Risk and reward are related – financial theory says that to earn a high rate of return over the long term, an investor must be prepared to take short-term risk. If the goal is to minimize short-term risk, an investor must be prepared to earn a smaller long-term reward.

The FPP's investment options provide empirical evidence that mostly supports the theory as shown in Table 1. The Canadian Equity Fund provided the highest reward – it was the best performing fund over the 10 years, earning 7.6% on average each year. But the Canadian Equity Fund also provided the greatest risk – it had the worst single year of any of the funds – losing 30.7% in 2008. Conversely, the Short Term Investment Fund (STIF) – the most conservative investment currently offered by the FPP – was the lowest risk fund. Although the STIF did not have a negative year in the 10-year period, the average annual rate of return in the STIF to December 31, 2011 was only 2.2%, leading to the second lowest reward. The historical rates for the GICs show the 1-year GIC being marginally higher than the STIF. The 5-year GIC return at 3.7% was between the Bond Fund return and the STIF return, which would be a reasonable expectation going forward. Typically, the longer the term of the GIC, the higher its rate of return will be.

For many years, the STIF earned between 2% and 4% per year; in the period from 1995 to 2000, it earned more than 6% each year. However, in each of 2009 and 2010, it earned less than 1%, and in 2011, it earned only 1.1%. Although there is much speculation about the direction of interest rates, the STIF may not earn much more than 1% for the next year or two. Having considered other types of conservative funds that might offer better

Table 1: FPP Fund Returns for 10-year period (Jan 1, 2002 to Dec 31, 2011)

Fund Option	10-year Returns (net)
Balanced	5.3%
Bond	6.4%
Canadian Equity	7.6%
Foreign Equity	-0.8%
Short Term Investment	2.2%
GIC 1-year*	2.6%
GIC 5-year*	3.7%

*based on actual historical rates for the 10-year time period shown, including Sun Life's 0.75% premium.

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performance, the FPP trustees decided to offer GICs. Additionally, the trustees and their advisors believe that GICs could assist members with their cash-flow planning needs, especially at or near retirement. Please see the article, *Using GICs in Your Investment Strategy*, on page 3 for more information.

GUARANTEED INVESTMENT CERTIFICATES

As the name suggests, the investment contains a guarantee by the issuer – the principal is guaranteed not to lose value, and the interest rate is guaranteed for a specified period of time. Although this new investment option appears to be straightforward, you should be aware of certain features of GICs in order to decide if they are right for you.

GICs will be offered for terms of one, two, three, four or five years; you may choose one or more of these terms for your investments and the rate of return will be guaranteed for the term you select. For instance, if you purchase a 3-year GIC in June 2012, the rate applicable to 3-year GICs at the time of purchase will apply until maturity, which will be in June 2015.

Similarly, if you purchase a 3-year GIC in August 2012, you will receive the interest rate applicable at the time of purchase and the rate may be higher, lower or the same as the June 2012 interest rate. The rate on this GIC will apply until maturity, which will be in August 2015.

Rate Guarantee

One of the unique features of the GIC is that it offers a guaranteed rate of return. The market value of your holdings in each of the five other fund options will vary from month to month depending on the performance of the investments in each of the funds. Because the GIC provides a guaranteed rate of return, the amount of income that it generates and the ending balance are predictable, which could be a valuable feature if you are retired or are approaching retirement.

We expect that a GIC will return more than the STIF given the very short-term nature of the holdings in the STIF. The GICs will be purchased from Sun Life, who will be offering a rate equal to the average rate of the five leading Canadian banks for non-redeemable GICs applicable for that term plus 0.75%. This rate will be reduced by 0.10% to cover the Plan's internal administration fees. Based on this formula, the rates for the FPP as at the end of March 2012 were 1.7% for a 1-year GIC and 2.7% for a 5-year GIC.

It's important to note that once a GIC is purchased, the rate will not change, even if interest rates rise. Therefore, although presently GIC rates may be higher than the STIF's current rate of return, the rate of return on the STIF will increase as interest rates rise; the rate on a purchased GIC will not.

Investment Protection

Sun Life's GICs are guaranteed by the Sun Life Assurance Company of Canada, which makes them very safe as there are many legislative rules in place to ensure that life insurance companies have sufficient funds on deposit to cover all of their liabilities. Sun Life's current capital surplus ratio is 208%, which is well above the minimum ratio required by the Insurance Companies Act of Canada.

In the unlikely event of Sun Life's insolvency, further protection is provided by Assuris, the not-for-profit organization that protects policyholders, if their life insurance company should fail. Every life insurance company in Canada is required by law to be a member of Assuris.

Limitations on Redemption

GICs are intended to be held until maturity. As described above, GICs will provide you with a guaranteed amount of interest for a specified period of time.

In return for the guarantee, there may be an interest rate penalty depending upon current interest rates at the time of redemption, if you choose to redeem a GIC before its maturity date. This interest rate penalty is also referred to as a "market value adjustment." There is no penalty when a GIC is liquidated on death or disability.

MAKING A CHOICE

Should you use GICs? You might wish to consider them if you are risk averse, especially if you are approaching retirement or have retired and are receiving RRIF/LIF-type payments from the pension plan. However, even in these cases, choosing a guaranteed, low rate of return (at today's present rates) for a large part of the account balance may lead to inadequate retirement income, considering that a typical retiree has a future life expectancy that could exceed 25 years.

A member with a long-term investment time horizon would not typically invest exclusively in GICs; however, it might be reasonable to include GICs for part of the account.

Although investing in riskier investments such as stocks may lead to poor results from time to time, riskier investments should perform better than very conservative investments over the long term. A fund such as the Balanced Fund, which is invested in a range of diverse asset classes to manage risk, should provide a better long-term return. GICs are suitable investments for a member seeking predictable income or wishing to have a certain value of their account at a specific time. Additional information on the new GIC option will be communicated in the coming months. ■

This article was originally provided by Satanove and Flood Consulting Ltd. for the Q2/11 Pension News newsletter. It has been revised and updated to reflect current information. Comments should be sent to: fpp@hr.ubc.ca

When may I start purchasing FPP GICs?

In April, we completed the pilot stage of the GIC project, in which a small group of members made the first GIC purchases. This step helped to ensure that all processes were working properly.

As of May 7, 2012, GICs are being offered to the entire FPP membership. Please visit the FPP website at **www.pensions.ubc.ca/faculty** for further details on how to purchase GICs.

Using Guaranteed Investment Certificates in Your Investment Strategy

As previously announced, the Faculty Pension Plan (FPP) will be offering a new investment option - Guaranteed Investment Certificates (GICs). Please see the article, *New FPP Investment Option: Guaranteed Investment Certificates*, on page 1 for more information. Once the GIC investment option is in place, you need to consider if GICs are right for you and how best to use them. The following article is provided by Clay Gillespie of Rogers Group Financial and outlines possible ways to use GICs in your investment strategy.

THE "LADDERING STRATEGY"

One potential GIC strategy is to use "laddering" as a means of both cash-flow planning and as protection against possible increases in interest rates. Laddering refers to the technique of staggering the GIC maturity dates. For example, let's say you want to invest $100,000 in GICs and you want some flexibility with these funds. You could stagger the GIC maturities by investing $20,000 for 1 year, $20,000 for 2 years, $20,000 for 3 years, $20,000 for 4 years and $20,000 for 5 years. You would then have approximately $20,000 maturing every year. Further, if you did not need these funds on their maturity, you could reinvest them in another 5-year GIC. Therefore, you would have approximately $20,000 maturing every year and you would (eventually) earn the average 5-year GIC rate which historically has been approximately 1.0% to 1.5% higher than a 1-year GIC rate.

This laddering strategy provides flexibility and also protects your investment from changes in interest rates. If interest rates were to rise (say due to inflationary pressures) then at least 20% of your GIC funds (assuming they are rolled over) would be at the higher interest rate, which would provide some protection against rising interest rates. If interest rates were to decrease, then only 20% of your funds would be at the lower interest rates, which would provide some protection against falling interest rates.

APPROACHING AND DURING RETIREMENT

When you are still working and accumulating retirement savings over a long time period, stock market volatility is not as an immediate concern as long as your portfolio is properly diversified. One of the greatest risks in retirement planning, however, is having the stock market drop substantially just before or just after you retire (assuming that a portion of your retirement savings is invested in the stock market). Proper diversification techniques alone will not offset this problem.

One way to address this problem is to hold some GICs in your portfolio as you approach your desired retirement age so that you will have a certain amount of money maturing when you retire. This could also allow you to manage the volatility of returns from the stock portion of your portfolio more effectively. For example, you could plan to have three to five years' worth of retirement income in GICs that mature when you want to retire. If the stock market declines in value in the year in which

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you intend to retire, you can draw your income from the matured GICs instead of the stock portion of your portfolio. This would allow time for the rest of your investments to (hopefully) recover during the stock market correction without being forced to redeem funds from the more volatile (i.e. stocks) portion of your account to maintain your desired income.

When generating income at or during retirement, it is important not to withdraw funds from an investment that is declining in value. If you were to retire at a time when the stock market is performing poorly (and you need to generate income from this portion of your portfolio), you may end up depleting your capital at an alarming rate. Ultimately, this will reduce the chance of your investments being able to generate the income you need throughout your remaining retirement years.

You could use GICs to implement the following risk reduction strategy. This example is based on investing three years' worth of your required annual income. For example, let's say that you need $50,000 of annual income. First, invest one year's required income ($50,000) in the Short Term Investment Fund ("STIF") and this will be used for your first year's income needs. Additionally, invest another one year's income ($50,000) in a 1-year GIC and invest another one year's income ($50,000) in a 2-year GIC.

The benefit of using GICs for this strategy is both the interest rate and principal amounts are guaranteed. Their value will not fluctuate with market changes and their value is known for a specific future maturity date. A bond fund is not as suitable for this purpose because its value will fluctuate with changes in interest rates – as interest rates rise, bond market values decline.

The rationale behind this strategy is that the portion of funds invested in the STIF will deplete itself over the first year. After the first year, if the growth (i.e. stock) portion of your FPP account has grown in value then you take the following year's income from this growth portion to replenish the allocation in the STIF. If, however, the stock market has performed poorly and the growth portion of your pension funds has decreased in value, then you could use the maturing GIC to replenish the STIF allocation. If the maturing GIC is not needed for that year's income, it could be re-invested in another 2-year GIC.

This strategy means that unless there is a stock market decline that persists over three years, you would not have to take income from the stock portion of your pension investments while these stocks are decreasing in value. So, while the stock market is declining, you will not be digging into the capital (for at least three years) and hopefully you have enough fixed income investments to weather the storm.

Always Consider Inflation

Inflation is usually measured by the year over year change in the Consumer Price Index (CPI). It measures how much a "basket of commonly purchased goods and services" increases in price over time.

The following chart demonstrates that if you would like an income of $50,000 per year during retirement, you will need to spend more every year to maintain that standard of living.

For example, if the inflation rate was 4%, in 20 years, you would need an income of $109,556 in order to buy the same basket of goods which you could buy today for $50,000.

Inflation Rate	10 years	20 years	30 years
2%	$60,950	$74,297	$90,568
3%	67,196	90,306	121,363
4%	74,012	109,556	162,170
5%	81,445	132,665	216,097

Even with today's lower inflation rate, it is important to plan for the negative consequences of inflation.

Inflation is one of the biggest potential drawbacks with GICs. In any overall investment strategy it is imperative that you invest to beat inflation. The ultimate goal of investing for retirement is to generate an income that maintains the lifestyle you want in retirement. The only way you can do that is to have your investments earn more than the rate of inflation.

This strategy works only because you avoid taking income from any part of your portfolio that is declining in value. The rationale for this strategy is to increase the life span of your portfolio.

TIMING CONSIDERATIONS

As mentioned, one of the greatest risks involved in retirement income planning is the risk of the stock market correcting (dropping) right before or right after you retire.

Your portfolio should be aligned with your retirement objectives at least five years before your retirement date. So, five years before retirement you should consider having at least two to three years' worth of your desired retirement income in GICs that will mature the day you retire.

It's important to note that your portfolio must be monitored each year, as you must also decide whether to take the following year's income from the fixed income portion of your account or from the growth portion of your account. In the years when the stock market earns high returns, not only should you use this growth for income purposes, but you should also take additional funds from the growth account to add to the fixed income portion of your account, thus rebalancing your portfolio.

GICS AND LONG-TERM INVESTING

GICs can be a powerful retirement investment strategy as you approach retirement to reduce and mitigate possible stock market volatility. However, in most cases, GICs are not a good long-term investment for building wealth. A GIC portfolio historically has returned approximately 2% less than a diversified portfolio over time (i.e. the UBC balanced fund) and thus needs to be used wisely.

A difference in returns dramatically affects the value of your investments over a longer period of time. Compare the following:

If you invest $20,000 at age 35 and earn 3% per year - at age 65, you would have $48,545 in your account.

If you invest the same $20,000 at age 35 and earn 5% per year - at age 65, you would have $86,439 in your account.

The 2% difference in investment return would represent an 84% difference in your account balance.

GICs can be a valuable investment to be used in your portfolio; however, it is important to consider that personal situations vary greatly. You should consult with your financial advisor about your personal circumstances and investment goals. ■

Clay Gillespie is a Portfolio Manager and Managing Director with Rogers Group Financial. The views expressed are those of the author and not necessarily those of Rogers Group Financial or the UBC Faculty Pension Plan trustees and staff, which make no representations as to their completeness or accuracy.

MARKET COMMENTARY

Positive news around the global economy helped the equity markets have a very strong first quarter in 2012. The US economy continued to show positive signs of growth in both the service and manufacturing sectors, which also led to improvement in their unemployment rate. In Europe, investors were somewhat calmed as a sovereign debt and banking crisis was averted for the time being. Growth within China continued to slow, albeit from a very high level. Bond markets had a weak first quarter as both long-term interest rates experienced a modest rise and foreign interest in Canadian bonds waned a little during the time period.

The Canadian stock market returned a solid 4.4% in the first quarter; however, this was lower than most other foreign stock market returns. Much of this performance was achieved in January as the decline in commodity prices in the latter two months of the quarter hurt results. The Canadian market's high exposure to commodity stocks (i.e. the Materials and Energy sector) dampened returns, while the large Financial/Banking sector returned a strong 11% for the quarter.

The US stock market had a good first quarter, with results up 10.5%, largely driven by strengthening of the Banking and Info Technology sectors. Global equities (as measured by the MSCI World index) were also very positive, returning 9.6% in the first quarter in Canadian dollar terms. These returns were largely a result of strong returns in both European and Far Eastern markets with their Financial sectors contributing significantly to the gains. Emerging markets, which performed poorly in 2011, rebounded with a positive return of 12.1% in the first quarter in Canadian dollar terms.

The Canadian Bond market had a weak first quarter return of -0.2%, although still producing a positive return of 9.7% for the one-year period. An increase in longer term interest rates in the first quarter hurt longer duration bonds the most, with Long-term bonds (-0.8%) and Real Return bonds (-1.1%) being the weakest performers after experiencing strong returns in 2011. Corporate bonds significantly outperformed government bonds in the quarter as investors reacted to the improving economic outlook by bidding up the prices of corporate bonds. ■

Retirement Counselling Funding for Faculty Association Members

The University provides several resources to support members with their retirement, one of which includes funding for financial and retirement counselling.

UBC will reimburse Faculty Association members for counselling services from a UBC-approved financial consultant up to a maximum of 3 hours ($750 limit) per member. For more information and to request reimbursement, please refer to **www.hr.ubc.ca/faculty-relations/retirement/planning-retirement/**

2012 Variable Payment Life Annuities (VPLA)

Aon Hewitt Inc. has calculated the changes in the VPLA values for 2012. The changes were effective with the April 1, 2012 retirement payment.

Option	Change in Value
4% VPLA	-2.34%
7% VPLA	-5.09%

FPP 2011 Annual Report

The 2011 Annual Report is available online now at the FPP website. Similar to last year, the report is integrated with the FPP website as a separate section called "2011 Year in Review." This online format allows members to find information more easily, and as part of the University's sustainability commitment, it also allows members to select and print specific sections of the report, rather than printing the full report. Visit the FPP website and follow the link from the main page to view the report.

The Final Edition. The 2011 Annual Report will be the final annual report publication produced by the FPP. In order to improve our member communications and provide timely information sooner to our members, we have decided to incorporate our annual report information into the fourth quarter issues of the *Pension News* newsletter. We will continue to provide a copy of the audited Financial Statements online at the FPP website. If you have any questions or comments regarding this new format, please send us an e-mail at fpp@hr.ubc.ca

Communications for FPP RRIF/LIF-Type Plans

RRIF/LIF-Type Plan members are reminded that they should contact the FPP for any changes or requests regarding their accounts. These requests may include:

- additional lump sum withdrawals,
- changes to scheduled payments,
- changes to withholding tax amounts,
- changes to investment allocations or,
- changes or corrections to personal information reported on their statements

Sun Life Financial remains the record keeper for the RRIF/LIF-type plans; however, as of April 1, 2012, Sun Life has been instructed to no longer accept member requests. This change is to help ensure that our members are receiving the highest level of customer service. Sun Life's website and call centre will remain available to members wishing to enquire about their investment balances or payment schedules.

RRIF/LIF-Type plan members were mailed a letter in March 2012 informing them of this change. New forms have been added to the FPP website to assist with this transition.

New Member and Retirement Workshops

The Faculty Pension Plan provides the following workshops for new Plan members and members who are approaching retirement:

You & Your Pension Plan
This new member workshop focuses on the Plan's provisions, principles of investing, and the differences between the various investment choices. The next workshop will be held on **September 27, 2012 from 9:30 am to 11:30 am**.

Understanding Your Retirement Income Options
This workshop focuses on retirement income options and investment choices. The next workshop will be held on **August 30, 2012 from 12:00 pm to 2:30 pm.**

For more info or to register for one of the sessions above, please contact Lorraine Heseltine at lorraine.heseltine@ubc.ca. Please refer to the Workshops page on the FPP website for up-to-date workshop information and dates.

FPP Pension Forum

Don't miss this opportunity to learn more about your pension plan

Wednesday, May 23, 2012
10:30 am to 12:30 pm
Ponderosa Centre – Arbutus Room
2071 West Mall (at University Boulevard)

Please RSVP by May 16 to:

pensions@hr.ubc.ca | 604.822.8100

Members are not required to attend the entire event; however, if you wish to attend either or both parts, we ask that you please RSVP in advance for planning purposes.

Information Tables

10:30 am to 11:30 am

Representatives from the following areas will be present to answer your questions:

- **UBC Faculty Pension Plan**
  Ask questions about the Plan's investment and retirement options, investment performance, and member services and resources.
- **UBC Retirement & Survivor Benefits**
  Learn about the health benefits that are available to you as part of this retirement program.
- **UBC Faculty Relations**
  Learn about the resources that Faculty Relations provides to you as a faculty member.
- **Service Canada**
  Do you have questions about the Canada Pension Plan or Old Age Security? Here's your opportunity to speak in person with a representative.

Presentation

11:45 am to 12:30 pm

There will be a 30-minute presentation on the Plan's 2011 investment performance, and a review of 2011/12 initiatives.
A 15-minute question period will follow the presentation.

Correspondence/Queries:

Reception, 604.822.8100
Lorraine Heseltine, 604.822.3485
Louise Mah, 604.822.6015
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PERFORMANCE OF THE FUNDS
FOR PERIODS ENDING MARCH 31, 2012

**Annualized returns*

	3 Months	1 year	3 years*	5 years*	10 years*
Balanced Fund - gross	4.39%	5.38%	11.29%	3.26%	6.00%
Balanced Fund - net	4.25%	4.80%	10.70%	2.71%	5.51%
Composite Index 1	3.63%	4.71%	10.51%	2.84%	5.24%
Bond Fund - gross	-0.13%	10.35%	9.11%	6.91%	6.66%
Bond Fund - net	-0.21%	10.01%	8.76%	6.59%	6.37%
Composite Index 2	-0.39%	11.07%	7.69%	6.63%	6.75%
Canadian Equity Fund - gross	5.18%	-8.26%	15.73%	2.16%	8.15%
Canadian Equity Fund - net	5.06%	-8.67%	15.22%	1.72%	n/a
Composite Index 3	4.43%	-9.86%	14.99%	1.60%	7.16%
Foreign Equity Fund - gross	11.12%	6.32%	12.35%	-3.42%	0.41%
Foreign Equity Fund - net	10.92%	5.55%	11.59%	-3.98%	n/a
Composite Index 4	9.45%	5.98%	12.02%	-2.73%	0.97%
Short Term Investment Fund - gross	0.27%	1.20%	0.77%	1.81%	2.41%
Short Term Investment Fund - net	0.23%	1.05%	0.61%	1.65%	2.23%
Composite Index 5	0.22%	0.94%	0.60%	1.57%	2.28%

The Average Rate of Return for the FPP funds are updated on a monthly basis and are available under the QuickFind menu on the FPP website.

Composite Index 1: 32% DEX Universe, 10% S&P/TSX Capped, 5% S&P/TSX, 5% S&P/TSX 60 Capped, 6% S&P 500, 21% MSCI World Ex Canada, 3% Dex 91-Day TB, 10% CPI + 4% commencing November 2011 (retroactive), 8% DEX Real Return Bonds
Composite Index 2: 80% DEX Universe, 20% DEX Real Return Bonds
Composite Index 3: 25% S&P/TSX, 50% S&P/TSX Capped, 25% S&P/TSX 60 Capped
Composite Index 4: 73% MSCI World Ex Canada, 21% S&P 500, 6% DEX 91-Day TB
Composite Index 5: DEX 91-Day TB Index until August 2007; DEX 30-Day from September 2007 to January 2011; DEX 91-Day TB Index as of February 2011.

COMPOSITION OF THE FUNDS
AS AT MARCH 31, 2012

	Market Value ($ Millions)	% of Funds
BALANCED FUND		
Equities - Canada	233.2	19.7%
Equities - Non-Canadian	330.8	28.0%
Absolute Return Hedge Fund	32.5	2.7%
Real Estate - Canada	122.1	10.3%
Fixed Income	359.5	30.4%
Real Return Bonds - Canada	100.6	8.5%
Cash	4.4	0.4%
Total Balanced Fund	1183.1	100.0%
BOND FUND		
Fixed Income	65.2	77.5%
Real Return Bonds - Canada	18.3	21.7%
Cash	0.7	0.8%
Total Bond Fund	84.2	100.0%

	Market Value ($ Millions)	% of Funds
CANADIAN EQUITY FUND		
Equities - Canada	99.9	98.7%
Cash	1.3	1.3%
Total Canadian Equity Fund	101.2	100.0%
FOREIGN EQUITY FUND		
Equities - Non-Canadian	38.4	92.3%
Absolute Return Hedge Fund	2.0	4.8%
Cash	1.2	2.9%
Total Foreign Equity Fund	41.6	100.0%
SHORT TERM INVESTMENT FUND		
Total Short Term Inv. Fund	57.7	100.0%