

PENSION NEWS

UBC FACULTY PENSION PLAN | Third Quarter 2010 Edition

Investing According to your Risk Tolerance

Financial theory states that there is a direct relationship between risk and reward: over the long term more risk should lead to more reward and less risk should lead to less reward. When investing pension money we must consider how much or little risk we are prepared to take that will help us pass the SWAN test: **Sleep Well At Night**. This article looks at some of the issues around risk tolerance and managing asset mixes.

RISK TOLERANCE

Shorter term risk can be defined as the volatility of the returns – how variable the results are from period to period. Longer term risk can be thought of as the chance that we will fail to accumulate sufficient funds to achieve our financial goals.

Our tolerance for shorter or longer term risk can be affected by the length of time we have to invest and this can be longer than we think. For example, we sometimes think our investment time horizon is until we retire; however, with the most popular retirement income choices being the flexible RRIF/LIF Type payment options, the investment time horizon increases significantly. This means shorter term volatility of returns has much less significance than the returns that are realized over 20, 30 or 40 years.

Our tolerance for risk can also be affected by our emotional response to risk and to the changes in the value of our investments. Some people are quite comfortable with the ups and downs, knowing that past market

corrections have only been temporary, while others are nervous about market swings. However, there is no right answer to the question of “how much risk should I take” because it is a personal issue that is different for everyone.

ASSET MIX

Our risk tolerance does not change with the weather. Investors who have spent time (often with the help of a financial advisor) understanding their risk tolerance usually feel more comfortable and have less trouble continuing with their investment allocation decision during times of market volatility. On the other hand, investors who are not comfortable with their investment allocation decision may panic and make hasty decisions in response to short-term changes in the markets.

An investor’s goal should be to make changes to their asset mix only when they feel there is a change in their risk tolerance or when the returns have resulted in their current asset mix being out of balance with their original investment allocation decision.



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This material has been compiled by the University of British Columbia Faculty Pension Plan Administration Office from information provided to them and is believed to be correct. If there is any inconsistency between the contents of the newsletter and the pension plan trust or legislation, the trust and legislation will prevail.



a place of mind

THE UNIVERSITY OF BRITISH COLUMBIA

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An example of a change in risk tolerance could be at retirement. At that time, even if we have 25-35 years of investment exposure ahead of us, we may feel a need for a more conservative asset mix since contributions to our pension plan account will cease. We will be in the withdrawal phase, which means our account balance will be decreasing and that will feel very different than when we were in our contributing years. The important point is that we want to make changes to our asset mix in response to our own personal situation and risk tolerance, and not in response to what is currently happening in the markets. This will provide some comfort and sense of control.

REBALANCING

Another reason for changing our asset mix is to rebalance back to the target allocation percentages that reflect our risk tolerance. Investment advisors recommend rebalancing at least once annually to avoid what is called “portfolio drift”, where the portfolio becomes out of balance with our risk tolerance. This is because over time, your actual asset mix will change with fluctuations in the value of each asset class or fund and you may find it is shifting away from the target allocation that you chose.

If your investment allocation is 100% Balanced Fund, then the Trustees ensure that the allocation to each asset class is rebalanced whenever it deviates outside of certain tolerance ranges from the Fund’s target policy allocation. However, if you invest in more than one of the Investment Fund options available, then it is recommended that you review your asset mix at least annually and rebalance it to the target allocation that best reflects your investment needs and risk tolerance. Significant variations and fluctuations in market

returns throw your asset allocation strategy off track, if not revisited on a consistent basis.

Investment advisors point out that investors who don’t rebalance their portfolio will typically end up holding too much of an asset class at the wrong time and not enough at the right time. The table below shows the change in an asset mix over 5 years if rebalancing is not done:

	2002	2007
Canadian Equity Fund	20%	32%
Foreign Equity Fund	20%	18%
Bond Fund	60%	50%

This member’s comfort level was 40% invested in stocks, but due to the positive stock market returns leading up to the economic downturn in 2008, the member is invested in 50% equities at the end of 2007, which is well beyond their target allocation and comfort level. The steep stock market decline in the fall of 2008 would no doubt have caused this member more concern than if the allocation had been rebalanced back to the 40% level earlier. Rebalancing ensures that you avoid experiencing more volatility than you are comfortable with.

Transferring money from an asset class that is performing well to an asset class that is not performing well may seem counter-intuitive, but it can help lock in gains already made and keep you well balanced for the next stock market correction. How often have we heard the adage “sell high and buy low.” By rebalancing back to our target asset mix we are adhering to this adage.

INVESTMENT ADVICE

It is helpful to meet with your investment advisor on an annual basis and review your financial situation.

As your life changes you will want to reassess your risk tolerance, make changes to your investment funds and review your total financial plan to ensure you are on track. When investing for the long-term it is important at any given time to determine the asset mix that is most appropriate for you based on your long term investment objectives and risk tolerance.

The Board of Trustees encourages members to seek independent financial advice when making investment allocation and retirement decisions. Members are reminded that the Trustees of the Plan, the University, and the Pension Administration Office, or its respective employees, *do not endorse any particular advisors*. It is the member’s responsibility to make their own enquiries before engaging an advisor (See “Choosing a Financial Advisor” in the 2nd Quarter 2003 issue of *Pension News*). The FPP can provide some suggested criteria to help you select an advisor for matters relating to the Plan, and a list of the financial planners who meet these criteria. To obtain a copy of this list, please send an e-mail to fpp@hr.ubc.ca with “Financial Planners List” in the subject line.

Furthermore, the University provides funding for financial and retirement counselling, and 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 visit the ‘Retirement’ section at the UBC Human Resources Faculty Relations website. ■

This article was prepared by Jim Loughlean, Member Services Specialist for the UBC Faculty Pension Plan. Comments should be sent to: fpp@hr.ubc.ca

Expected Future Lifetime at Age 65

There is a correction to the expected future lifetime figures reported in the "Paving the Path: Retirement Planning" article in the Q2 2010 *Pension News*. The expected future lifetime for a 65 year-old female is 22.2 years and for a 65 year-old male is 19.9 years. We apologize for any confusion that resulted from this misprint.

Change to U.S. Equity Mandate

As of October 1, 2010, the existing U.S. Equity mandate with BlackRock Inc. will change from their current S&P 500 Alpha Tilts product to an S&P 500 Index fund. This new fund is designed to very closely track the performance of the S&P 500 Equity Index. As the investment management fees are lower for this BlackRock index fund, the fees for the Balanced and Foreign Equity Funds should slightly reduce by 0.01% and 0.02% respectively. These changes are also referenced on the Fund Updates page at the FPP website.

Trustee Election

Packages for the 2010 FPP Election were mailed to members on October 20, 2010. The deadline for casting ballots is midnight, Monday, November 15, 2010, with results being announced on November 22, 2010. We encourage you to take time to exercise your vote in this year's election.

MARKET COMMENTARY

THE THIRD QUARTER OF 2010 produced strong returns for most stock markets despite economic news reports of slowing growth. Renewed expectations that the U.S. government would continue to support their economy increased investors' enthusiasm and willingness to increase their investments in the stock markets.

The Canadian stock market had a strong third quarter, returning 10.3%, increasing the one-year return to 11.6%. The stock index returns remain low over the last four years at an annualized rate of only 4.2%. Almost all of the industry sectors had positive returns in Q3/10, with the Info Technology sector, being the only exception, down 1.7%.

The U.S. stock market also had a strong third quarter, up 11.3% with the one-year return at 10.2% in U.S. dollar terms. This translated into returns of 7.4% for the third quarter, and 5.3% for the one-year period in Canadian dollar terms. Non-North American equities (as measured by the EAFE index) returned 7.1% and 2.6% over the third quarter and one-year period respectively, in local currency terms. These returns were 12.4% and -1.3% over the third quarter and one-year period respectively, when converted into Canadian dollars. Emerging markets had a very strong third quarter at 13.9%, returning 14.9% over the one-year period.



The Canadian Bond market had another positive return of 3.2% in the third quarter and 7.3% over the one-year period. The Bank of Canada increased rates twice in the quarter, bringing the overnight interest rate target to 1.0%. Long Term Bonds in the third quarter returned 5.6% versus 3.8% for Mid Term Bonds and 1.6% for Short Term Bonds. The Corporate bond sector at 3.2% outperformed Federal Bonds (2.4%); however, Provincial Bonds (4.5%) were the strongest sector in the third quarter. Real Return Bonds continued to perform well at 5.2% and 14.3% for the third quarter and one-year period respectively. ■

PERFORMANCE OF THE FUNDS FOR PERIODS ENDING SEPTEMBER 30, 2010

	3 months	YTD	1 year	5 years*	10 years*
Balanced Fund - gross	6.79%	5.47%	7.36%	4.65%	4.90%
Balanced Fund - net	6.65%	5.07%	6.81%	4.16%	4.44%
Composite Index 1	6.15%	5.46%	6.93%	4.22%	4.31%
Bond Fund - gross	4.01%	8.66%	9.61%	5.93%	6.73%
Bond Fund - net	3.93%	8.39%	9.28%	5.64%	6.46%
Composite Index 2	3.57%	7.91%	8.39%	5.51%	6.69%
Canadian Equity Fund - gross	11.17%	7.17%	11.23%	5.93%	7.08%
Canadian Equity Fund - net	11.05%	6.81%	10.78%	N/A	N/A
Composite Index 3	9.88%	6.88%	10.66%	5.25%	4.47%
Foreign Equity Fund - gross	9.57%	-0.20%	1.81%	-1.69%	-2.14%
Foreign Equity Fund - net	9.36%	-0.72%	1.18%	N/A	N/A
Composite Index 4	8.84%	0.31%	1.96%	-0.96%	-1.59%
Short Term Investment Fund - gross	0.19%	0.33%	0.40%	2.62%	2.96%
Short Term Investment Fund - net	0.15%	0.21%	0.23%	2.46%	2.76%
Composite Index 5	0.09%	0.21%	0.26%	2.44%	2.79%

*Annualized returns

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% IPDCPI, 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 TB Index commencing September 2007

**Composite Indices 1, 2, and 4 have changed as of April 1, 2010 to reflect investment changes within the Balanced, Bond, and Foreign Equity Funds.

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.

COMPOSITION OF THE FUNDS AS AT SEPTEMBER 30, 2010

	Market Value (\$ Millions)	% of Funds
BALANCED FUND		
Equities - Canada	225.5	21.0%
Equities - Non-Canadian	279.7	26.0%
Absolute Return Hedge Fund	31.1	2.9%
Real Estate - Canada	102.0	9.5%
Fixed Income	346.7	32.2%
Real Return Bonds - Canada	86.9	8.1%
Cash	3.5	0.3%
Total Balanced Fund	1075.4	100.0%
BOND FUND		
Fixed Income	52.5	79.3%
Real Return Bonds - Canada	13.2	19.9%
Cash	0.5	0.8%
Total Bond Fund	66.2	100.0%

	Market Value (\$ Millions)	% of Funds
CANADIAN EQUITY FUND		
Equities - Canada	94.6	99.4%
Cash	0.6	0.6%
Total Canadian Equity Fund	95.2	100.0%
FOREIGN EQUITY FUND		
Equities - Non-Canadian	30.8	92.2%
Absolute Return Hedge Fund	1.9	5.7%
Cash	0.7	2.1%
Total Foreign Equity Fund	33.4	100.0%
SHORT TERM INVESTMENT FUND		
Total Short Term Invest. Fund	56.0	100.0%

CANADA PENSION PLAN CHANGES NOW IN EFFECT

Several changes to the Canada Pension Plan (CPP) that were previously announced have now become law. These changes do not impact anyone currently receiving a CPP pension or who will start their CPP pension in 2010.

Here's an overview of the changes, many of which will be gradually phased in.

Changes to early and late retirement rules

Currently, CPP benefits are reduced by 6 per cent for each year you begin your pension before age 65 and increase by 6 per cent for each year that you begin your pension after age 65. These increases or reductions are designed to reflect the shorter (or longer) payout times associated with beginning your pension after or before the normal retirement age of 65.

Under the new rules, pensions will now be reduced by 7.2 per cent (versus the current 6 per cent) for each year you begin your pension before age 65. It is being phased in over a five year time period beginning in 2012, and will allow many people to take advantage of the phased in retirement provisions before the full impact of these greater reductions take effect.

In addition to the information under the "Changes to early and late retirement rules" section, the FPP would like members to also consider that although retirement adjustments appear to be small, they can have a significant long term impact. For example, at age 60 you are currently eligible to receive 70% of your expected age 65 benefit; however, as these rate adjustments take effect, this benefit will eventually reduce to 64%. This translates into an annual reduction of almost \$700 at current CPP rates.

The pension increase for delaying your CPP start date until after age 65 goes from 6 per cent a year to 8.4 per cent a year, phased in over three years beginning in 2011. This means that someone who delays starting their CPP benefits until age 70 (the maximum age you can begin) will receive a pension that's 42 per cent higher than they would receive at age 65.

Removal of work cessation test for CPP before age 65

Currently, to apply for CPP benefits from age 60 to 64, you must have either stopped working before your CPP retirement pension begins, or have earnings less than the current monthly maximum CPP retirement pension benefit.

Under the new rules that take effect in 2012, you can start receiving your CPP benefits after age 60 without any requirement to stop working or significantly curtail work. In addition, if you are under age 65, both you and your employer will continue to contribute to the CPP to grow your pension while you are receiving benefits. These continued contributions are optional after age 65. These new rules are designed for people who want to ease into retirement but still want to maintain a certain level of income.

Increase in general low earnings dropout

When the government calculates your CPP benefits, they adjust the calculation to allow for a "dropout" of certain periods of low or no income. In addition, they apply other dropout provisions such as for child rearing and for periods spent receiving a CPP disability benefit. When these periods are excluded there is the potential to increase your monthly CPP benefit up to the maximum amount.

Currently, the general dropout provision is 15 per cent of the years where your earnings are low or nil. For example, if you take your benefits at age 65, your CPP benefit calculation will drop almost seven years of low or zero earnings.

Under the new rules, the general dropout provision will increase to 16 per cent in 2012 and 17 per cent in 2014. This will allow a maximum of almost 7.5 years of low or zero earnings to be dropped in the CPP benefit calculation for years 2012 to 2013 and 8 years of low or zero earnings to be dropped starting in 2014.

These changes may increase your CPP benefit, especially if you have multiple years of low or no income because you immigrated to Canada and entered the workforce late, spent extended time in school, cared for family members or any other reason. ■

This article is being reprinted with permission of Sun Life Financial - Group Retirement Services. If you have any questions regarding the new CPP changes, please contact Human Resources Development Canada at 1-800-277-9914 or visit their website at www.hrsdc.gc.ca.

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Improvement to Member Statements

The Faculty Pension Plan has made some changes to your member statement. Some of the information has been rearranged on the statement to make it more streamlined and easier to read. Also, to provide more transparency, your investments are now expressed not only in dollar values, but also in number of units held, including the corresponding unit value and market value as at the end of the statement period.

To allow room for the unit information, net fund performance is no longer shown, but this information can be found in the *Pension News* enclosed with your statement, or by clicking on the Rate of Return link under QuickFind on the FPP website.

myPension Access for Deferred Members

FPP members who have left the University and still have funds invested in the Plan on a deferred basis, are now able to access myPension. myPension is a customized online tool that allows members in a secure real-time environment to do the following:

- View their monthly account balance
- View their beneficiary information
- View their account requests such as transfers-in, withdrawals, and investment allocations
- Estimate their future account balance and retirement income at a specific age, using their personalized account balance data

To establish myPension access, you will need to set up your personalized Campus-Wide login ID and password. Please send us an e-mail with "Access to myPension" in the subject line to fpp@hr.ubc.ca and we will be happy to help you obtain access to this service.

New Member and Retirement Workshops

"You & Your Pension Plan" workshops for new members or members wishing to learn more about the Plan are available throughout the year, as well as "Understanding Your Retirement Income Options" workshops for members approaching retirement.

For more info or to register for a workshop, please contact Jim Loughlean at jim.loughlean@ubc.ca. Please refer to the Workshops page on the FPP website for up-to-date workshop information and dates.

Holiday Closure

The Pension Administration Office will be closed from noon on December 24, 2010 to January 3, 2011 inclusive. All termination and retirement benefit payments will be processed by December 23. If you are planning to transfer funds or begin a retirement benefit in January 2011, please submit your forms to the Pension Administration Office by December 17.

If you have an urgent pension inquiry during the holiday closure, please leave a message at 604-822-8647. These messages will be monitored daily over the holiday period.