

PENSION NEWS

UBC FACULTY PENSION PLAN | Second Quarter 2011 Edition

Guaranteed Investment Certificates

The Faculty Pension Plan (FPP) will offer a new investment option later this year – the Guaranteed Investment Certificate (GIC). The investment performance of the five investment options currently offered by the Plan all vary depending on the financial markets; the GIC will provide more predictable investment income. This article describes the new option as well as the advantages and disadvantages of investing in GICs.

NOTHING VENTURED, NOTHING GAINED

FPP members are offered a number of 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 8.2% 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) was the lowest-risk fund – it never had a negative year in the 10-year period. But the average annual rate of return to December 31, 2010 was only 2.6%, 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 4% 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%. Although there is much speculation about the direction of interest rates, the STIF may not earn much more than that for the next year or two. The Trustees considered other types of conservative funds that might offer better performance, and decided to offer GICs. Additionally, it was felt that GICs could assist members with their cash flow planning needs, especially at or near retirement.

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 might appear to be straightforward, there are a number of complicating features.

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

Table 1: FPP Fund Returns for 10-year period (Jan 1, 2001 to Dec 31, 2010)

Fund Option	10-year Returns (net)
Balanced	5.1%
Bond	6.2%
Canadian Equity	8.2%
Foreign Equity	-1.4%
Short Term Investment	2.6%
GIC 1-year*	2.7%
GIC 5-year*	4.0%

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

In This Issue

- Guaranteed Investment Certificates **1**
- Trustee Election **3**
- New Member and Retirement Workshops **3**
- Market Commentary **3**
- Fund Performance and Composition **4**
- FPP Board of Trustees, Management, and Staff **4**

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.



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THE UNIVERSITY OF BRITISH COLUMBIA

continued from page 1

guaranteed for the term you select. For instance, if you purchase a 3-year GIC with your January 2012 contributions, then the rate applicable to 3-year GICs at the time of purchase will apply to those contributions until maturity, which will be in January 2015. All of the interest will be paid out at that time.

Similarly, for the following month, your February 2012 contributions will receive the interest rate applicable at the time of purchase and the rate may be higher, lower or the same as the January interest rate. The rate on these contributions will apply until maturity, which will be in February 2015. As a result, if you choose the GIC option, you will have a series of GICs for each month of contributions, each with its own guaranteed interest rate.

You will also be able to transfer assets from any of the other investment options to a GIC. The same principles will apply as for new contributions: you may choose one or more of the one to five year terms and the interest rate applicable at the time of purchase will apply for the entire term of the period you selected.

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 for a retired member or a member 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%. Based on this formula, the rates for the

Faculty Pension Plan as at the end of June would have been 1.9% for a 1-year GIC and 2.9% for a 5-year GIC.

It should be noted, though, 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.

GUARANTEED PRINCIPAL

Not only is the amount of interest earned on a GIC guaranteed, but up to \$200,000 of each member's principal is also guaranteed. The first \$100,000 is guaranteed by Sun Life and secured by their general assets.

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

The second \$100,000 is guaranteed by Sun Life Financial Trust. In the event of their insolvency, the protection is provided by the Canadian Deposit Insurance Corporation (CDIC) if the GIC is purchased through Sun Life Financial Trust. Sun Life will ensure that GICs are automatically purchased through Sun Life Financial Trust once a member has purchased \$100,000 through Sun Life.

LIMITATIONS ON REDEMPTIONS

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 is a penalty, referred to as a "market value adjustment" if you choose to redeem a GIC before its maturity date. There is no penalty when a GIC is liquidated on death or disability.

MAKING A CHOICE

GICs are intended to be an investment option for members who are risk averse, typically those approaching retirement or who have reached retirement and are receiving pension income from the pension plan. But 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. GICs can also be used for a member's cash flow planning needs by staggering the various maturity dates.

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. A member would also need to be mindful of the \$200,000 guarantee limit on the protection of the principal amount.

Although investing in riskier assets such as stocks may lead to poor results from time to time, riskier assets should perform better than very conservative assets over the long term. A fund such as the Balanced Fund, which is invested in a range of diverse asset categories 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 and the timing of its availability will be communicated in the coming months. ■

This article was prepared by Satanove & Flood Consulting Ltd. for the UBC Faculty Pension Plan. Comments should be sent to: fpp@hr.ubc.ca

Trustee Election

Annually, in November, an election is held to select two trustees for the FPP Board of Trustees. A Call for Nominations is sent to all members in September, asking for candidates. If you are interested in running for one of these two positions, please contact Cheryl Neighbour, Secretary to the Board, regarding the responsibilities and duties of Board members.

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.

Understanding Your Retirement Income Options

August 24, 2011
November 1, 2011
November 29, 2011
12 pm to 3 pm

You & Your Pension Plan

September 29, 2011
9:30 am to 11:30 am

For more info or to register for one of the sessions above, 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.

MARKET COMMENTARY



Investors became more risk averse in the second quarter of 2011 as much of the economic and geopolitical news was negative. This included events such as monetary tightening in China, disruptions from the Japanese earthquake, concerns over high sovereign debt levels, and a general lowering of personal consumption in many areas.

The Canadian stock market had a weak second quarter, returning -5.1%, which erased almost all of the gains of the first quarter. The market's high exposure to cyclical stocks hurt as commodity prices dropped in most areas, leading to the weak performance in the Materials and Energy sectors. These two large industry sectors both returned in the -5% range in the second quarter. The other large industry sector, Financials, also had a negative return of -2.7% for the quarter.

The U.S. stock market also had a negative second quarter, being down 0.7% in Canadian dollar terms. The return of the S&P 500 for the first half of 2011 is 3.0% and 18.7% over the one-year period. Non-North American equities (as measured by the EAFE index) returned 0.8% over the first quarter and 18.4% over the one-year period in Canadian dollar terms.

The Canadian Bond market had a strong return of 2.5% in the second quarter as a general aversion to riskier assets led to increased demand for bonds. The Bank of Canada left its key interest rate unchanged in the second quarter, and in the U.S., their second quantitative easing program (QE2) came to an end on June 30. In terms of returns by issuer, Provincial bonds were the strongest in the second quarter at 3.2%. Real Return Bonds returned 4.0% for the quarter. Inflation, as measured by the CPI, was 3.7% over the one-year period, increasing expectations that interest rates may rise in the not too distant future. ■

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**PERFORMANCE OF THE FUNDS
FOR PERIODS ENDING JUNE 30, 2011**

**Annualized returns*

	3 Months	YTD	1 year	5 years*	10 years*
Balanced Fund - gross	0.99%	3.22%	14.95%	5.10%	6.12%
Balanced Fund - net	0.84%	2.92%	14.26%	4.58%	5.63%
Composite Index 1	0.38%	2.56%	12.92%	4.65%	5.70%
Bond Fund - gross	2.79%	2.81%	6.88%	6.76%	6.59%
Bond Fund - net	2.71%	2.64%	6.53%	6.46%	6.31%
Composite Index 2	2.79%	2.69%	6.08%	6.26%	6.52%
Canadian Equity Fund - gross	-4.04%	1.27%	23.93%	6.66%	9.52%
Canadian Equity Fund - net	-4.15%	1.04%	23.36%	6.20%	n/a
Composite Index 3	-5.10%	0.27%	20.25%	5.71%	8.06%
Foreign Equity Fund - gross	1.25%	3.55%	20.82%	-0.94%	0.17%
Foreign Equity Fund - net	1.06%	3.16%	19.81%	-1.45%	n/a
Composite Index 4	0.01%	2.67%	17.92%	-0.28%	0.77%
Short Term Investment Fund - gross	0.29%	0.61%	1.06%	2.27%	2.58%
Short Term Investment Fund - net	0.25%	0.53%	0.90%	2.12%	2.39%
Composite Index 5	0.24%	0.50%	0.82%	2.07%	2.46%

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% 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 from September 2007 to January 2011, DEX 91-Day TB Index commencing February 2011.

** Composite Index 5 has changed as of February 1, 2011 to reflect investment changes within the Short Term Investment Fund.

**COMPOSITION OF THE FUNDS
AS AT JUNE 30, 2011**

	Market Value (\$ Millions)	% of Funds		Market Value (\$ Millions)	% of Funds
BALANCED FUND			CANADIAN EQUITY FUND		
Equities - Canada	245.8	21.3%	Equities - Canada	113.7	99.3%
Equities - Non-Canadian	305.8	26.4%	Cash	0.8	0.7%
Absolute Return Hedge Fund	32.0	2.8%	Total Canadian Equity Fund	114.5	100.0%
Real Estate - Canada	113.3	9.8%	FOREIGN EQUITY FUND		
Fixed Income	359.5	31.1%	Equities - Non-Canadian	38.7	93.7%
Real Return Bonds - Canada	93.8	8.1%	Absolute Return Hedge Fund	1.9	4.6%
Cash	5.4	0.5%	Cash	0.7	1.7%
Total Balanced Fund	1,155.6	100.0%	Total Foreign Equity Fund	41.3	100.0%
BOND FUND			SHORT TERM INVESTMENT FUND		
Fixed Income	47.7	78.8%	Total Short Term Inv. Fund	50.2	100.0%
Real Return Bonds - Canada	12.4	20.5%			
Cash	0.4	0.7%			
Total Bond Fund	60.5	100.0%			