



## **NBIMC**

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# **Statement of Investment Policies**

*New Brunswick Public Service Superannuation Fund*

*August 2009*

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## **INTRODUCTION**

The following document forms the Statement of Investment Policies of the Public Service Superannuation Fund, herein referenced as the PSSF. This document incorporates changes made during F2009-2010 and has been approved by NBIMC's Board of Directors.

The Statement of Investment Policies includes the body of this document. This document has been created to help fulfill the requirements laid out in the New Brunswick Investment Management Corporation Act and is the property of NBIMC.

The Statement of Investment Policies must be reviewed within a year of the receipt of any actuarial valuation or when dramatic events occur in capital markets. It can also be reviewed more frequently either at the request of the Board of Directors or upon recommendations from NBIMC staff.

While not part of the Statement of Investment Policies, NBIMC's investment operations are also governed by an Investment Procedures Manual, which identifies the role and responsibilities of NBIMC's investment staff, and by a Code of Ethics and Business Conduct that sets out guidelines for NBIMC's employees and Board members.

## **A. CHARACTERISTICS OF THE PLAN**

### **A.1 Plan Provisions**

The following information provides a summary of the main provisions with respect to the PSSF. More detailed information can be gained by referring to the specific Act governing the fund.

The PSSF is a defined benefit pension plan. Retiring employees are entitled to a pension payable in equal monthly installments when they reach 60 years of age **and** have completed a minimum of five years of pensionable service. Members satisfying both criteria are eligible for an immediate pension of 2.0 percent of their best average career salary (calculated over the five successive years in which their salaries were highest) multiplied by the number of pensionable years of service. However, pension payments are reduced when members reach the age at which they become eligible for a full pension under the Canada Pension Plan (CPP). Provided they attain five years of pensionable service, members may retire as early as age 55, subject to an actuarial reduction of benefits. The plan also includes survivor benefits and disability provisions.

Retirees' pensions are indexed to inflation to compensate for rising prices. For members who retire on or after May 1, 1995, the maximum annual cost-of-living increase is 5.0 percent. Prior to 1995, the inflation cap was 6.0 percent for all current and future pensioners.

### **A.2 Funding Status**

The development of the PSSF Statement of Investment Policies relies heavily on information provided by the Actuarial Report that is provided by the Plan Sponsor. This information includes the required long-term rate of return, funding status, demographic profile, and cash flow estimates for the plan.

NBIMC also monitors internal estimates with respect to the funding status of the Plan between actuarial reporting periods.

## **B. RISK TOLERANCE**

An important consideration for the investment policy portfolio is to determine the appropriate risk tolerance for the funds under NBIMC's management. In this regard, NBIMC wishes to maintain a relatively low level of risk in comparison to our peers for several reasons:

- First, fund income is required to pay for pensions; income has to be reliable to avoid the costs associated with the sales of long-term assets at potentially unfavourable prices.
- Second, preserving capital is one of NBIMC's objectives: as the equity allocation increases in the portfolio, the risk of experiencing a year of negative return rises, placing the fund's capital at a greater risk of erosion.
- Finally, a riskier asset mix could also lead to more volatility in the funding status of the pension fund.

This relatively low tolerance for risk will influence return objectives and deviations from policy allowed in this Statement of Investment Policies. From a portfolio perspective, the actuarial liability profile of the plan and the sponsor's tolerance for risk will also influence the riskiness of the invested portfolio when compared with other peer plans.

## **C. FUND OBJECTIVES**

The investment objectives of the fund must take into account the plan's assets, liabilities, and risk profile. Thus, consideration must be made for long-term capital market opportunities, funding status, anticipated cash flows, actuarial data, and the Fund Sponsor's tolerance for risk. Under these considerations and the mandate given to NBIMC by Provincial Legislation, the following long-term objectives form the basis of the PSSF's policy portfolio:

- Maximize investment returns; and
- Protect accumulated assets.

One of NBIMC's objectives is to provide a long-term real rate of return on investment superior to the assumption used in the most recent actuarial valuation. It is understood that the current policy portfolio will translate in uneven returns from year to year, but a diversified portfolio of long-term assets will partially mitigate the variability of returns.

Over the medium term, NBIMC is expected to provide rates of return in excess of those achieved by passive management of the policy portfolio. A value-added contribution of 42 basis points, after deducting NBIMC's operating costs, is the portfolio's target four-year moving average rate of return.

Moreover, given subsection 17(5) of the New Brunswick Investment Management Corporation Act, NBIMC shall have regard to investment opportunities in the Province while attempting to satisfy its two objectives. However, this mandate is secondary to the primary goals of maximizing returns and preserving capital and is explained in more detail in subsection D.6 (Local and Regional Investments).

**D. INVESTMENT STRATEGY**

**D.1 Policy Portfolio**

The following policy portfolio (based on the market value of assets) is thought to represent the best trade-off between the dual objectives of return maximization and capital preservation, keeping in mind NBIMC’s desire to assume a relatively low risk profile.

<b>ASSET CLASSES</b>	<b>POLICY TARGET WEIGHT</b>
<b>Fixed Income</b>	
Canadian Nominal Bonds	28.0%
Canadian Short Term Assets	2.5%
<b>Public Equity</b>	
Canadian	20.0%
Foreign	24.0%
<b>Inflation Linked Assets</b>	
Canadian Real Return Bonds	9.0%
Real Estate and Infrastructure	5.0%
<b>Alternative Investments</b>	
Absolute Return	6.5%
Private Equity	5.0%
<b>Total</b>	<b>100.0%</b>

Note: The Canadian Nominal Bonds portfolio includes the N.B. Fixed Income Opportunity Fund (1%) and Private Equity includes the N.B. and Atlantic Equity Opportunity Fund (1%).

Actual portfolio benchmark weights are permitted to deviate from policy target weights due to market price movements. Canadian Public Equity, Foreign Public Equity, Canadian Nominal Bonds, and Canadian Short Term Assets will be rebalanced to policy

target weights if they exceed a deviation of +/- 1%. Actual benchmark weights for Real Estate and Infrastructure, Canadian Real Return Bonds, Absolute Return and Private Equity may deviate further from policy target weights due to availability and the relatively high transaction costs associated with their implementation. Management will use their best efforts to obtain / maintain policy target weights for all asset classes in a prudent manner.

In the case of Private Equity, which is the most illiquid asset class, under or over invested amounts will be adjusted against the relevant Public Equity asset class.

## D.2 Tactical Asset Allocation

Modest deviations from benchmark are permitted to allow management to maximize returns and limit potential losses by taking advantage of relative pricing opportunities among asset classes.

Permitted Tactical Deviations from Benchmark			
	Deviation from BM	Minimum Weight	Maximum Weight
Canadian Public Equities	±5.0%	15.0%	25.0%
Foreign Public Equities	±2.5%	21.5%	26.5%
Alternative Investments	±1.0%	10.5%	12.5%
Real Estate & Infrastructure	± 1.0%	4.0%	6.0%
Canadian Nominal Bonds	±4.0%	24.0%	32.0%
Canadian Real-return Bonds	±2.0%	7.0%	11.0%
Canadian Short-term Assets	±4.0%	0.0%	6.5%

Note: Alternative Investment ranges, which include Absolute Return Strategies, and Private Equity assume a fully-invested position.

### D.3 Performance Benchmarks

NBIMC's relative performance in various markets will be evaluated against benchmarks indicated below. Because the PSSF is a fairly typical pension fund, the benchmarks follow the industry norm.

Asset Classes and Respective Benchmarks	
Asset Class	Benchmark
Canadian Public Equity	S&P/TSX Total Return Composite Index
Foreign Public Equity	
U.S.	S&P500 Total Return Composite in \$C
Non U.S.	MSCI EAFE Net Index in \$C .
Real Estate & Infrastructure	
U.S. Real Estate	FTSE - NAREIT Index in \$C
Real Estate and Infrastructure Investments	4% Real Return
Private Equity	S&P500 Total Return Composite in \$C for US Funds and MSCI EAFE Net Index in \$C for International Funds.
NB and Atlantic Opportunity	4% Real Return
Absolute Return Strategies	91 Day T-Bill (93%) plus One-day Call Loan (7%)
Canadian Nominal Bonds	Dex All Government Bond Index
Canadian Real-return Bonds	Dex Real Return Bond Index
Canadian Short-term Assets	91 Day T-Bill (93%) plus One-day Call Loan (7%)

The benchmarks, or components thereof, are created and published by external organizations; thus, they are deemed credible. They are also similar to those typically used by other institutional investors for such investment activities.

## **D.4 Permissible Investments**

### Public Equity

- NBIMC is permitted to invest in equity instruments traded on exchanges of countries included in the Fund's benchmark portfolio as well as financial vehicles (listed or unlisted) that are convertible into equities traded on those same exchanges.
- On the above securities, NBIMC is additionally allowed to execute short sales.
- Direct holdings of any one stock measured at book value will be limited to 10 percent of the total assets.

### Fixed Income

- Fixed income investments (including Canadian real return bonds) are limited to investment-grade securities (defined as BBB or higher by S&P and DBRS; and Baa and higher by Moody's) issued, guaranteed, or secured by the Government of Canada or its agencies; or a province, territory or municipality of Canada.
- Notwithstanding these permissible investments, up to 5.0 percent of the fixed income portfolio may be invested in investment-grade non-government debt. These investments may include corporate debt, mortgage backed securities, or other structured debt product.
- Additionally, the fund is permitted to invest in corporate debt under the provisions contained in subsection D.6 (Local and Regional Investments)
- Foreign currency bonds are limited to those issued by the Government of Canada or its guarantees; provinces or their guarantees; and other admissible foreign national governments<sup>1</sup>.
- Securities issued by a non-Canadian entity are limited to 10 percent of the fixed income portfolio and may be hedged against currency risk.
- Investments in short-term securities shall be limited to:

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<sup>1</sup> United-States, Asian and European countries in line with the MSCI EAFE Index are all eligible.

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- Treasury bills and promissory notes issued or guaranteed by the Government of Canada, any Canadian province, or Treasury bills of other admissible foreign national governments;
  - Deposit receipts, bearer notes, certificates of deposit, acceptances, swapped deposits and other similar instruments issued or endorsed by one of the six major Schedule I Canadian chartered banks<sup>2</sup>; and
  - Commercial paper issued by companies rated A2 or higher by S&P or R1 Low or higher by DBRS,
  - Asset Backed Commercial Paper (ABCP) rated R1 High by DBRS or A1 by S&P.
  - Additional eligible investments include coupons, residuals, and bonds (with a duration not to exceed 14 months) , Floating Rate Notes (FRNs) issued by eligible entities with a term less than three and four years for corporate and provincial FRNs respectively, futures and options on Bankers' Acceptances (BAs).
- Any fixed income security owned by the fund that fails to meet the above criteria due to unanticipated credit downgrades or other unforeseen circumstances, shall be brought to the attention of the Board of Directors at its next meeting, with a recommended course of action.

#### Derivatives

- The purchase of futures on equity and fixed income markets in Canada, United-States, and MSCI EAFE countries is allowed, provided that the equivalent amount is held in underlying money market securities to preclude the use of leverage.
- The use of foreign currency futures or forward contracts on the U.S. Dollar, U. K. Pound Sterling, Euro, Japanese Yen, or other OECD<sup>3</sup> currency is permitted.
- NBIMC is allowed to short futures on any of the equity markets where it can hold futures, as long as the total exposure for each market individually remains within the limits set in the Statement of Investment Policies.
- NBIMC can hold total return swaps on permissible investment vehicles, when the swap is demonstrably more profitable than buying futures, index-based baskets, or the underlying credit in another market.
- NBIMC is permitted to enter into Interest Rate Swaps and Cross Currency Swaps against an underlying debt instrument.

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<sup>2</sup> These banks are the Royal Bank of Canada, Canadian Imperial Bank of Commerce, Bank of Montreal, Toronto-Dominion Bank, Bank of Nova Scotia, and the National Bank of Canada.

<sup>3</sup> Organization for Economic Co-Operation and Development

- Swaps will be valued according to conventions set out in the Investment Procedures Manual.
- Volatility derivatives are considered an eligible investment for the purposes of adding value in the management of the portfolio. The underlying investment could be futures or total return swaps unless they are already offset by a short call option.
- NBIMC is permitted to buy or sell options on fixed income, equity, and foreign exchange futures, cash market indices for Canada, United-States, and MSCI EAFE countries, and individual securities that are considered permissible investments described above.
- Options must be supported with a sufficient amount of physical exposure or cash underlay in the event the option is exercised and the underlying assets need to be sold or purchased.
- Options may be transacted either through physical option exchanges or through permitted external banks and dealers.

#### Inflation-linked Investments

- Based on the investment philosophy to hedge the inflationary characteristics of the pension liabilities and provide returns that are typically non-correlated to more traditional equity and/ or fixed income asset classes, NBIMC is permitted to invest in, real estate and infrastructure markets.
- Real Estate and Infrastructure investment must be domiciled in Canada, the US, or other OECD countries and can be completed either directly, by means of an external manager, limited partnership, or pension realty corporation.

### Private Equity

- Private Equity investments must be primarily domiciled in Canada, the United States, or MSCI EAFE countries. It is understood however that the profile of investment partnerships in the private equity industry is opportunistic in nature, and may therefore have some exposure to countries outside of these primary limitations.
- These investments are to be completed primarily through an external manager or limited partnership structures.
- Investments are to be diversified by manager, geographic region, vintage year, and life cycle stage (i.e. buy-outs, venture capital, secondary transactions), while recognizing that the illiquid nature of this type of investment may result in some concentrations from time to time.

### External Managers

- NBIMC is allowed to invest in permissible assets indirectly, by using an external manager. When funds are invested through an external manager, the majority of the investments must be domiciled in Canada, the United States, or MSCI EAFE countries.
- Mandates extended to external managers should not exceed 25 percent of assets under management, measured at market value.
- For any one external manager, the mandate shall not exceed 5 percent of assets under management, measured at market value. Index mandates are exempt from this limit.
- External mandates will be used for investment in markets where NBIMC does not have the necessary expertise to provide effective active management or to provide additional diversification benefits.

### Securities Lending

- With regard to the fund's holdings of traditional bonds and stocks, NBIMC is permitted to engage in securities lending and dividend re-investment plans to add to returns.

## **D.5 Local and Regional Investments (NB and Atlantic Opportunity)**

- As a New Brunswick-based investor, NBIMC will use its geographic advantage to make investments within the Province and the Atlantic region that suit NBIMC's risk and return requirements as well as its fiduciary duties. When considering New Brunswick and regional investments not eligible under paragraph D.5 (Permissible Investments), the following criteria apply:
  - In aggregate, investments will not exceed 2.0 percent of total fund assets, measured at book value;
  - Any individual investment will not exceed 0.5 percent of the total fund assets, measured at book value; and
  - NBIMC's commitment will normally not exceed 33.3 percent (one third) of the funds raised from the target's investors and will be on the same terms as the other participants.
- These investments will require approval from the NBIMC Board of Directors.
- All investments made under this mandate are to be recorded at acquisition (book) value but subsequently measured at fair value following the procedures adopted by senior management and contained in *Valuation Policies* (December 2007); all values are to be reviewed and updated at least annually.

## **E. PERFORMANCE EVALUATION**

### **E.1 Total Fund Performance**

To evaluate the Fund's performance in a given period, the following steps are required:

1. Determine the rate of return of the total funds based on the fair value of assets;
2. Calculate the benchmark return by multiplying index rates of returns for all asset classes by the respective benchmark weights;
3. The difference between those two measures represents NBIMC's net contribution to the total Fund's performance on a \$C basis; and

## E.2 Manager's Performance

An individual manager's performance for a specific period measures their value-added contribution through active management. Similar principles and methodology apply to this calculation, as above.

Tactical asset mix contributions are obtained by taking the difference between the actual weighted index returns and subtracting the portfolio's benchmark return calculated in Step 2 above.

Individual portfolio contributions are obtained by calculating the difference between the rate of return on each manager's portfolio based on market valuation of assets and the rate of return on the relevant benchmark index.

## E.3 GIPS® Compliance

The **calculations, presentation, and disclosure** of the *Schedules of Investment Performance*, prepared annually by NBIMC staff for dissemination to the Board of Directors and available to the public, shall be in accordance with Global Investment Performance Standards (GIPS® - February 2005) and be subject to verification by an independent third party.

The **calculations** of performance results, prepared by NBIMC staff quarterly for dissemination to the Board of Directors and yearly for the *Annual Report*, are similar to those used in the *Schedules of Investment Performance*.

## F. GOVERNANCE

In accordance with the New Brunswick Investment Management Act, **the Board of Directors is responsible for the approval of a Statement of Investment Policies on behalf of the PSSF** and administering the affairs of NBIMC on a commercial basis, following sound business practices including effective internal controls.

NBIMC is responsible for the investment of PSSF funds in accordance with the Trustees Act and the Statement of Investment Policies and having regard to the investment opportunities in the Province.

The President and Chief Executive Officer's responsibility is to ensure that proper information systems and control procedures are in place to rigorously monitor NBIMC's investment activity. The President and Chief Executive Officer shall ensure that the legislative provisions and this Statement of Investment Policies are followed and shall utilize a performance measurement system to report investment results against goals and relevant benchmarks specified elsewhere in this policy.

The Chief Investment Officer's (CIO) responsibility is to develop and implement strategies under the guidance of this Statement of Investment Policies. In addition, the CIO is charged with managing relationships with outside investment counselors, where deemed prudent to augment internally managed investment activities. A structured evaluation process for selection and retention will be established by which the CIO can effectively choose between numerous services and investment styles offered by outside managers.

## **G. POLICY REVISIONS AND IMPLEMENTATION**

An investment policy should provide managers with a stable and predictable environment in which to form and implement sound investment decisions. However, a policy is a tool that can evolve, improve, and be flexible to changing conditions. This Statement of Investment Policies must be reviewed within one year of the completion of any actuarial valuation or when dramatic events occur in capital markets but can be reviewed more frequently either at the request of the Board of Directors or upon recommendations from NBIMC staff.

## **H. MISCELLANEOUS**

The voting rights on shares held by NBIMC on behalf of the PSSF shall be exercised by NBIMC according to its objective of maximizing returns to shareholders. The Board of Directors delegates to the President and Chief Executive Officer, and the President and Chief Executive Officer may delegate to any Vice-President, voting rights on shares held by NBIMC on behalf of the pension fund. Moreover, the President and Chief Executive Officer (or any Vice-President as proxy), if he/she believes it is warranted, shall consult with the Chairman to determine whether a Board meeting is required when the vote involves complex issues.

While all investment decisions of NBIMC are subject to paragraph D.5 (Permissible Investments), for ease of management and to ensure equal returns in every asset class with other funds managed by NBIMC, the PSSF holds **units of the pooled investment funds managed by NBIMC** for each asset class.