

# Gwaii Trust Society Statement of Investment Policies and Procedures

(Revised May 21 2010)

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Signed by

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Date

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## **ABOUT THIS DOCUMENT**

This Statement of Investment Policies and Procedures ("the Statement") has been written in order to assist the Board of Directors of the Gwaii Trust Society ("the Board") in establishing the investment procedures and guidelines for the investment of the assets of the Gwaii Trust Society ("the Society") and in monitoring and evaluating the investment performance achieved on such assets.

The Board of Directors has delegated the authority to oversee the investments and governance of the assets of the Gwaii Trust Society to an Executive Committee. However such Executive Committee is only empowered to make recommendations to the Board of Directors, unless an expressive authority has been delegated, in writing, by the Board of Directors.

This Statement contains:

- Investment policies and procedures of the Society established by the Board.
- Guidelines to be followed by the Society's Investment Manager(s) that are consistent with the investment policies and objectives established by the Board for the Society;
- Investment performance objectives and other criteria to be used by the Board to review and evaluate the investment results of the Society's Investment Manager(s).

It is anticipated that the current investment policy will be reviewed regularly (at least annually) and may be changed based on altered economic conditions. The Board may amend or modify the statement at any time, and shall notify the Investment Manager(s) of any such amendment or modification.

### **The Investment Objectives:**

The Society is to be managed on a going concern basis. All aspects of fiduciary conduct in respect of the Society's investments will be undertaken in a prudent manner. The investment of the Society's assets will always comply with the requirements of the relevant legislation.

## **INVESTMENT OBJECTIVES**

The Society's current investment objective comprises of the following components:

1. Capital/income requirements sufficient to compensate for the erosion in capital value of the Society's funds, as a result of price inflation;
2. Income requirements sufficient to meet commitments to current programs and administrative expenses.

These objectives have been taken into account in setting the Society's asset profile.

## **RISK PROFILE**

### **Longer Term Risk Profile:**

The major long term risk to the Society is the possibility of not meeting the objectives set out in 1 and 2 above, over the longer term. Prior to meeting the ongoing income requirements, the Society has to maintain the real value of its capital in order to maintain its spending ability. This risk is defined as the probability of not maintaining the real value of the Society's capital over 5 year and longer periods of time.

### **Shorter Term Risk Profile:**

The short term risk is having insufficient liquidity to meet short term obligations.

### **Fund Return Objectives:**

The basic goal underlying the establishment of the Society's investment policy is to ensure that the assets, along with expected future net cash flows, are invested in a prudent manner to preserve the purchasing power of the fund (using the CPI Index as a proxy) and to meet the Society's anticipated cash flow requirements, without the need for external financing or reductions in program spending from a level that can reasonably be expected to be maintained over the long term.

Subject to the above requirement, the secondary objective is to maximize the return on the assets over the longer term, taking into account the restrictions on allowable investments.

### **Investment Manager Return Expectations:**

The Investment Manager(s) are expected to achieve returns that:

1. Net of investment expenses, exceed the return that would be achieved on a benchmark portfolio with an asset mix in accordance with the Target Allocations and Duration requirements listed under Strategic Asset Mix over moving 4 year time periods, by 0.5% per annum. The returns assumed on the benchmark portfolio will be the composite of indices chosen by the Board as set forth in Appendix II.
2. Net of investment expenses, exceed the return that would be achieved on a portfolio of Real Rate Bonds over moving 4 year time periods. This is a proxy for meeting the program and administration expenses of the Society over time.

## **ASSET MIX AND ELIGIBLE INVESTMENTS**

### **Strategic Asset Mix**

The asset mix has been set so as to achieve the investment objectives of the Society within the restrictions of the regulatory environment. A Benchmark Portfolio consisting primarily of Fixed income, and Equities and other pre approved investments will form the basis of the investment strategy. The Investment Manager(s) may only invest in securities listed in this document or securities that the board has given explicit written consent to invest in.

### **Determination of the Strategic Asset Mix**

An analysis of the probable returns based on historical relationships between asset classes was undertaken. The strategic mix was chosen in a manner to maximize the expected long term return subject to the constraints of the regulatory environment and the long term spending needs. The inputs to this analysis are set out in Appendix I.

### **Constraints**

Income tax considerations need to be taken into account in determining the asset mix and management of the Fund.

### **Target Asset Mix**

Taking account of the above mentioned constraints and expectations, a target, minimum and maximum allocation of assets has been derived as follows:

% of Portfolio

| Asset Class              | Minimum | Target | Maximum |
|--------------------------|---------|--------|---------|
| Fixed Income Instruments | 32      | 37     | 75      |
| Real Rate Bonds          | 0       | 15     | 25      |
| Real Estate              | 0       | 10     | 15      |
| Equities                 | 28      | 38     | 48      |
| Canadian                 | 8       | 13     | 18      |
| Global                   | 20      | 25     | 30      |

The portfolio can be altered within the bounds set out above to take account of shorter term fluctuations in the market and economic cycle. The Investment Manager(s) shall notify the Board in writing in the event the manager believes that these Policies and Procedures are adversely affecting performance or are unattainable.

### **Asset Classes Eligible for Investment and Guidelines in respect thereof:**

The Investment Manager(s) is expected to exercise due prudence in the management of the assets and diversify investments sufficiently to minimize the risk of large losses unless prevailing circumstances or the constraints of the mandate render it imprudent or impractical to do so.

### **Rebalancing:**

A disciplined rebalancing procedure for the asset mix will be followed and will be implemented on a quarterly basis. The assessment of the need to rebalance the assets of the Plan will be undertaken on a quarterly basis and will be done on a passive threshold (3% shift) approach. In other words, when the asset mix has drifted as of the end of a quarter by more than 3% away from its long term strategic target, then the assets will be “automatically” rebalanced back to the target weights. This 3% test will be applied to Canadian assets (i.e. fixed income plus real rate bonds plus Canadian equities) versus global equities. When implemented, the rebalancing will be done at an asset class level and at the investment manager level.

## **QUANTITATIVE AND QUALITATIVE GUIDELINES:**

All investments are expected to conform to the guidelines presented herein. Due consideration will be given to the liquidity requirements of the Fund as these exist from time to time. The extent of further debt and equity diversification shall be at the discretion of the Managers. In addition to the industry and economic sector limitations indicated, Managers are expected to exercise prudence and follow internal policy norms as set from time to time. In addition to any other restrictions imposed by the Regulations, the following quantitative and qualitative guidelines must be met.

### **Equity Guidelines:**

1. Investment in any one corporation or 2 or more affiliated corporations may not exceed 10% of the book value of the Fund. Investment in any one corporation may not exceed 10% of the market value of the equity portfolio. This restriction does not apply to an investment in any segregated, mutual or pooled fund that complies with these guidelines.
2. Writing of covered options on equity shares held is permitted.
3. No more than 10% of the voting shares of any one corporation may be held.

### **Bond Guidelines:**

1. The minimum quality standard for individual bonds and debentures in the Fund will be "BBB" rating, as rated by the Dominion Bond Rating Service or the equivalent rating by a recognized rating agency, at the time of acquisition.
2. Private placements should be rated "A" or better by the above-mentioned agencies, have at least \$100 million outstanding, be broadly diversified and are not to constitute more than 10% of the market value of the bond portfolio.
3. No more than 10% of the bond portfolio by market value may be held in "BBB" issues at the time of purchase. If any individual bond or debenture in the Fund is downgraded to "BBB" subsequent to the time of acquisition, the investment manager must outline, by way of a formal written communication to the Board, the investment reasons for holding the security.
4. Bonds of Canadian issuers denominated in foreign currencies other than the U.S. dollar are limited to 5% of the market value of the bond portfolio. In total, foreign currency denominated issues are limited to 10% of the market value of the bond portfolio.
5. No more than 10% of the market value of the bond portfolio may be held in fixed price callable bonds.

### **Corporate Issues:**

Corporate issues include corporate bonds, debentures not including convertible debentures.

1. Corporate issues may not exceed 50% of the market value of the bond portfolio.
2. Investments in issues of any one corporation may not exceed 8% of the market value of the bond portfolio.

### **Short Term Investment Guidelines:**

Short term investments are bond and money market investments and deposits having maturity of twelve months or less and:

1. Holdings of such assets will be sufficient to meet the liquidity requirements of the Fund as these exist from time to time.
2. Rating may not be less than R-1(low)/A (low) at the time of acquisition.
3. Deposits with banks, trust companies and other financial institutions shall be limited to 10% of the book value of the Fund's assets.
4. No more than 3% of the book value of the Fund may be held on deposit with any single bank, trust company or other financial institution.

### **Mortgage Guidelines:**

1. The total investment in mortgages may not exceed 15% of the market value of the Fund. Mortgage investments made by Investment Managers including pooled mortgage fund investments may not exceed 15% of the market value of the assets managed by such Investment Manager.
2. Mortgage investments shall be restricted to first mortgages of industrial, residential, commercial and office properties across Canada. Pooled mortgage fund investments shall be restricted to mortgage funds whose portfolios conform to the Regulations.
3. Individual mortgage investments may not exceed 75% of the market value of the underlying property.

### **Real Estate Guidelines:**

1. Real estate investments may include direct investments or investments through participating debentures, shares of corporations or partnerships formed to invest in real estate properties, or securities held in a real estate pooled fund.
2. Any interest in a partnership must be as a limited partner and not as a general partner.
3. Real estate investments may include trust units, income trust units and interests limited partnerships of Canadian issuers traded on recognized public exchanges.
4. In respect of any real estate investment trust and income trusts held, such trusts:
  - (i) must be reporting issuers under the applicable securities legislation in Canada
  - (ii) must be governed by the laws of a province that limits the liabilities of unit holders by statute.

**Other Guidelines:**

1. Private placements may not be made without prior approval of the Board.
2. The following derivative instruments and their combinations are acceptable:
  - i) Forward Rate Agreements
  - ii) Equity and Fixed Income Options
  - iii) Financial Futures
  - iv) Interest Rate and Inflation Swaps

Activity must be restricted to amounts required for hedging or short term portfolio adjustment on a non-leveraged basis. Other commodities or future contracts and short sales are not permitted.

4. Lending of securities is permitted pursuant to appropriate agreements and documentation and approval of the Board.
5. The voting rights on securities held in the portfolio are left to the discretion of the investment managers. The investment managers are expected to act in good faith and to inform the Board of any upcoming vote that may significantly affect the value of the securities. In the case of pooled funds, the investment managers are exempted from informing the Board of any upcoming votes.
5. All investments that are not regularly traded will be appraised and valued periodically but not less frequently than triennially by qualified independent professionals appointed by the Board.

**Socially responsible Investments:**

All other factors being equal, favourable consideration is to be given by the Investment Manager(s) to investment opportunities which may serve to benefit the environment and the local economy. To the extent that these opportunities fall outside the acceptable asset classes set out herein, the Board reserves the right to invest in such investments subject to compliance with the Trustee Act (See Appendix 3 – Trustee Act). Any such investment shall be excluded from any measurement of the Investment Manager(s) performance.

**Related Party Transactions:**

No related party transactions will be permitted. Related party transactions include any proposals made by such parties concerning any potential investment in which such related party has a material beneficial interest. A related party is any person responsible for holding or investing the assets of the Society or any person involved in setting policy related thereto, including officers, directors and employees with such involvement.

### **Investment Manager Responsibilities:**

The duties and responsibilities of each Investment Manager include:

1. Adhering to these policies and procedures.
2. Communication with the Board on a regular basis and notifying the Board in the event the manager believes that the guidelines are adversely affecting performance or are unattainable.
3. Notifying the Board of any change in economic or market circumstances which may adversely impact on this investment strategy.
4. Notify of any change in investment personnel, ownership or other factors which may influence the investment process.
5. Investing the Society's assets with the care, skill, prudence and diligence that a professional investment manager / prudent person would exercise in the investment of the Society's assets.
6. Ensuring at all times that investments are in compliance with any relevant legislation. Reporting on such compliance on a regular basis.
7. Pooled fund investments will be subject to the investment manager's pooled fund SIP. The investment managers SIP must be approved by the Board prior to investing in the pooled fund. The manager is responsible for providing a copy of the SIP to the board. Any subsequent changes to the pooled Fund SIP must be communicated and approved by the Board to ensure that the investment remains compliant.

### **Measurement of Performance:**

Suitable benchmarks for the performance of the assets in the Benchmark Portfolio will be established by the Board in conjunction with the Investment Manager(s). These are set out in Appendix II.

### **Dismissal of Investment Manager:**

Reasons for terminating the service of an investment manager include, but are not limited to, the following factors:

- Failure of the Investment Manager to meet the return expectations, specified under Section I, will result in the Trustees giving consideration to termination of the manager's services.
- In addition the failure of the Investment Manager to meet the above noted benchmark less a margin of 2% p.a. over moving 2 year periods will result in the Trustees giving consideration to termination of the manager's services.
- Changes in investment professionals, firm structure, or investment philosophy, style or approach which might adversely affect the potential return and/or risk level of the portfolio.
- Failure to adhere to the stated investment policies and procedures.
- Changes in the structure of the overall Fund which would no longer necessitate the use of a manager's service.

### **Other Considerations:**

This investment policy has been established based on an assumption that the Society will remain a tax exempt entity.

**Budgeting:**

Each year, the Directors of the Society will develop a budget which is consistent with the current asset mix and investment policy. This budget will incorporate the Society's anticipated spending plans in respect of programs and administration costs.

**Spending Policy:**

A 4% spending rate is sustainable as long as investment returns and inflation do not vary greatly from what is expected. After the current business plan has elapsed (fiscal year 2010-2011), it is to be revisited with the expectation of reducing expenditures and revising the budget downwards between 3% and 4% of assets on hand with the intention of stabilizing the surplus position. The revised budget will represent a continued reduction in spending from current levels.

## **APPENDIX I**

### **Assumptions Underlying the Determination of the Strategic Asset Mix July 2009 Canadian Asset Assumptions**

| <b>Asset Class</b>          | <b>1st Year Returns</b> |                           | <b>10th Year Returns</b> |                           | <b>10 Year Returns</b> |                           |
|-----------------------------|-------------------------|---------------------------|--------------------------|---------------------------|------------------------|---------------------------|
|                             | <b>Arithmetic Mean</b>  | <b>Standard Deviation</b> | <b>Arithmetic Mean</b>   | <b>Standard Deviation</b> | <b>Geometric Mean</b>  | <b>Standard Deviation</b> |
| Inflation                   | 1.0%                    | 1.6%                      | 2.2%                     | 2.3%                      | 1.8%                   | 1.4%                      |
| Cash/Short-term             | 1.1%                    | 1.4%                      | 3.7%                     | 2.6%                      | 3.0%                   | 1.7%                      |
| Universe Bonds              | 3.7%                    | 5.6%                      | 5.1%                     | 6.5%                      | 4.3%                   | 0.8%                      |
| Long Bonds                  | 5.2%                    | 10.3%                     | 5.5%                     | 11.3%                     | 4.7%                   | 1.4%                      |
| Real Return Bonds           | 2.6%                    | 6.1%                      | 4.9%                     | 7.5%                      | 3.9%                   | 1.7%                      |
| Cdn Large Cap               | 10.5%                   | 30.3%                     | 9.1%                     | 19.0%                     | 7.2%                   | 7.4%                      |
| Cdn Small Cap               | 11.6%                   | 35.4%                     | 9.8%                     | 24.0%                     | 7.1%                   | 8.9%                      |
| US Large Cap (u)            | 11.0%                   | 31.6%                     | 9.5%                     | 20.2%                     | 7.4%                   | 7.8%                      |
| US Small Cap (u)            | 12.0%                   | 35.8%                     | 10.3%                    | 24.7%                     | 7.3%                   | 9.2%                      |
| US Large Cap (h)            | 10.0%                   | 27.5%                     | 9.0%                     | 16.4%                     | 7.3%                   | 6.7%                      |
| US Small Cap (h)            | 10.9%                   | 32.0%                     | 9.6%                     | 21.2%                     | 7.2%                   | 8.1%                      |
| EAFE (u)                    | 10.8%                   | 30.4%                     | 9.5%                     | 18.8%                     | 7.6%                   | 7.5%                      |
| EAFE (h)                    | 10.0%                   | 27.2%                     | 9.1%                     | 16.0%                     | 7.5%                   | 6.8%                      |
| Global (u)                  | 10.9%                   | 28.8%                     | 9.5%                     | 18.0%                     | 7.9%                   | 7.0%                      |
| Global (h)                  | 10.0%                   | 25.4%                     | 9.0%                     | 15.0%                     | 7.7%                   | 6.2%                      |
| Emerging Markets (u)        | 14.0%                   | 42.9%                     | 11.6%                    | 31.6%                     | 7.2%                   | 11.3%                     |
| Fund of Hedge Funds (h)     | 5.6%                    | 8.9%                      | 6.7%                     | 7.3%                      | 6.2%                   | 2.9%                      |
| Private Equity (h)          | 12.2%                   | 39.2%                     | 10.1%                    | 28.0%                     | 6.4%                   | 10.2%                     |
| Global Agg Bonds ex-Can (u) | 4.3%                    | 10.3%                     | 5.5%                     | 10.3%                     | 4.7%                   | 3.2%                      |
| Global Agg Bonds ex-Can (h) | 3.7%                    | 5.1%                      | 5.0%                     | 5.1%                      | 4.5%                   | 1.6%                      |
| High Yield Bonds (h)        | 8.2%                    | 22.1%                     | 7.7%                     | 10.1%                     | 6.9%                   | 4.6%                      |
| Real Estate                 | 5.5%                    | 12.0%                     | 6.5%                     | 10.0%                     | 5.7%                   | 3.3%                      |
| Infrastructure              | 8.7%                    | 22.1%                     | 8.6%                     | 14.1%                     | 7.5%                   | 5.3%                      |
| 20+ Strip                   | 5.8%                    | 17.9%                     | 6.6%                     | 19.3%                     | 5.8%                   | 2.7%                      |

## **APPENDIX II**

### **Proxy Indices for Benchmark Portfolios:**

1. Interest Bearing Portion of Benchmark Portfolio / Bond Portion of Benchmark Portfolio  
DEX Universe Index
2. Interest Bearing Portion of Benchmark Portfolio. / Real Return Bond Portion of Benchmark  
Portfolio  
DEX Real Return Bond Index.
3. Equity Portion of Benchmark Portfolio  
Index of Trustee Act eligible common stocks  
Canadian - S&P/TSX Composite Total Return Index.  
Global - MSCI World Index (w/ gross dividends reinvested) (CDN\$)

Total return over the measurement period on Canada Government Real Return Bonds

## **APPENDIX III**

R.S.B.C. 1996, c. 464, s. 15

[eff April 21, 1997 to February 27, 2003]

### **TRUSTEE ACT**

#### **RSBC 1996, CHAPTER 464**

#### **SECTION 15**

##### *Trustee authorized investments*

15 A trustee may invest trust money in his or her hands, if the investment is in all other respects reasonable and proper, in

- (a) securities of Canada, a province, the United Kingdom, the United States of America or a municipal corporation in a province,
- (b) securities the payment of the principal and interest of which is guaranteed by Canada, a province, the United Kingdom, the United States of America or a municipal corporation in a province,
- (c) securities issued for school, hospital, irrigation, drainage or other similar purposes that are secured by or payable out of rates or taxes levied under the law of a province on property in that province,
- (d) bonds, debentures or other evidence of indebtedness of a corporation that are secured by the assignment to a trustee of payments that Canada or a province has agreed to make, if those payments are sufficient to meet the interest on all the bonds, debentures or other evidence of indebtedness outstanding as it falls due and also to meet the principal amount of all the bonds, debentures or other evidence of indebtedness on maturity,
- (e) bonds, debentures or other evidence of indebtedness of a corporation incorporated under the laws of Canada or a province that are fully secured by a mortgage, charge or hypothec to a trustee on any one or combination of the following assets:
  - (i) land;
  - (ii) the plant or equipment of a corporation that is used in the transaction of its business;
  - (iii) bonds, debentures or other evidence of indebtedness or shares of a class or classes authorized by this section,
- (f) bonds, debentures or other evidence of indebtedness of a corporation incorporated under the laws of Canada or a province if the corporation has earned and paid a dividend,
  - (i) in each of the 5 years immediately preceding the date of investment, at least equal to the specified annual rate on all of its preferred shares, or

- (ii) in each year of a period of 5 years ending less than one year before the date of investment, on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid,
- (g) guaranteed trust or investment certificates of
  - (i) a bank, or
  - (ii) a corporation that is incorporated under the laws of Canada or of a province and that has a business authorization to carry on trust business or deposit business,
- (h) bonds, debentures or other evidence of indebtedness of a loan corporation or similar corporation
  - (i) that at the time of investment has all of the following:
    - (A) power to lend money on mortgages, charges or hypothecs of real estate;
    - (B) a paid up nonreturnable capital stock of not less than \$500 000;
    - (C) a reserve fund amounting to not less than 25% of its paid up capital, and
  - (ii) the stock of which has a market value that is not less than 7% in excess of its par value,
- (i) preferred shares of a corporation incorporated under the laws of Canada or of a province if the corporation has paid a dividend,
  - (i) in each of the 5 years immediately preceding the date of investment, at least equal to the specified annual rate on all of its preferred shares, or
  - (ii) in each year of a period of 5 years ending less than one year before the date of investment, on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid,
- (j) first mortgages, charges or hypothecs on land in Canada, but only if the loan does not exceed 75% of the value of the property at the time of the loan as established by a valuator whom the trustee believes on reasonable grounds to be competent and independent,
- (k) securities issued or guaranteed by the International Bank for Reconstruction and Development established by the Agreement for an International Bank for Reconstruction and Development, approved by the Bretton Woods and Related Agreements Act (Canada), but only if the bonds, debentures or other securities are payable in the currency of Canada, the United Kingdom, a member of the British Commonwealth or the United States of America,

(l) fully paid common shares of a corporation incorporated under the laws of Canada or of a province that, in each year of a period of 7 years ending less than one year before the date of investment, has paid a dividend on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid, and

(m) deposits in, or non-equity or membership shares or other evidence of indebtedness of, a credit union.

*RSBC 1979-414-15; SBC 1989-47-407; SBC 1995-12-29.*

## **Section 15.1**

**Effective May 18, 2006 – present (Current to March 10, 2009)**

### *Investment of trust property*

15.1 (1) A trustee may invest property in any form of property or security in which a prudent investor might invest, including a security issued by an investment fund as defined in the Securities Act.

(2) Subsection (1) does not authorize a trustee to invest in a manner that is inconsistent with the trust.

(3) Without limiting subsection (1), a trustee may invest trust property in a common trust fund managed by a trust company, whether or not the trust company is a co-trustee.

**\*\* Editor's Table \*\***

| Provision | Changed by | In force    | Authority    |
|-----------|------------|-------------|--------------|
| 15.1      | 2002-33-23 | 2003 Feb 28 | BC Reg 34/03 |
| 15.1(1)   | 2006-32-69 | 2006 May 18 | R.A.         |

\*\*\*\*\*

*SBC 2002-33-23; SBC 2006-32-69.*

## Section 15.1

### Effective February 28, 2003 to May 17, 2006:

#### *Investment of trust property*

15.1 (1) A trustee may invest property in any form of property or security in which a prudent investor might invest, including a security issued by a mutual fund as defined in the Securities Act.

(2) Subsection (1) does not authorize a trustee to invest in a manner that is inconsistent with the trust.

(3) Without limiting subsection (1), a trustee may invest trust property in a common trust fund managed by a trust company, whether or not the trust company is a co-trustee.

\* Editor's Table \*\*

| Provision | Changed by | In force    | Authority    |
|-----------|------------|-------------|--------------|
| 15.1      | 2002-33-23 | 2003 Feb 28 | BC Reg 34/03 |

*SBC 2002-33-23.*

## Section 15.2

### Effective February 28, 2003 to present (current to March 10, 2009):

#### *Standard of care*

15.2 In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.

\*\* Editor's Table \*\*

| Provision | Changed by | In force    | Authority    |
|-----------|------------|-------------|--------------|
| 15.2      | 2002-33-23 | 2003 Feb 28 | BC Reg 34/03 |

\*\*\*\*\*

*SBC 2002-33-23.*

### **Section 15.3**

#### **Effective February 28, 2003 to present (current to March 10, 2009)**

*Trustee not liable if overall investment strategy is prudent*

15.3 A trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return that a prudent investor would adopt under comparable circumstances.

**\*\* Editor's Table \*\***

| Provision | Changed by | In force    | Authority    |
|-----------|------------|-------------|--------------|
| 15.3      | 2002-33-23 | 2003 Feb 28 | BC Reg 34/03 |

\*\*\*\*\*

*SBC 2002-33-23.*

## **Definitions:**

### **Hedge Fund:**

An aggressively managed portfolio of investments that uses advanced investment strategies such as leveraged, long, short and derivative positions in both domestic and international markets with the goal of generating high returns (either in an absolute sense or over a specified market benchmark).

Legally, hedge funds are most often set up as private investment partnerships that are open to a limited number of investors and require a very large initial minimum investment. Investments in hedge funds are illiquid as they often require investors keep their money in the fund for at least one year. For the most part, hedge funds (unlike mutual funds) are unregulated because they cater to sophisticated investors. In the U.S., laws require that the majority of investors in the fund be accredited. That is, they must earn a minimum amount of money annually and have a net worth of more than \$1 million, along with a significant amount of investment knowledge. You can think of hedge funds as mutual funds for the super rich. They are similar to mutual funds in that investments are pooled and professionally managed, but differ in that the fund has far more flexibility in its investment strategies.

It is important to note that hedging is actually the practice of attempting to reduce risk, but the goal of most hedge funds is to maximize return on investment. The name is mostly historical, as the first hedge funds tried to hedge against the downside risk of a bear market by shorting the market (mutual funds generally can't enter into short positions as one of their primary goals). Nowadays, hedge funds use dozens of different strategies, so it isn't accurate to say that hedge funds just "hedge risk". In fact, because hedge fund managers make speculative investments, these funds can carry more risk than the overall market.

### **What Does Private Equity Mean?**

Equity capital that is not quoted on a public exchange. Private equity consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Capital for private equity is raised from retail and institutional investors, and can be used to fund new technologies, expand working capital within an owned company, make acquisitions, or to strengthen a balance sheet.

The majority of private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time. Private equity investments often demand long holding periods to allow for a turnaround of a distressed company or a liquidity event such as an IPO or sale to a public company.

The size of the private equity market has grown steadily since the 1970s. Private equity firms will sometimes pool funds together to take very large public companies private. Many private equity firms conduct what are known as leveraged buyouts (LBOs), where large amounts of debt are issued to fund a large purchase. Private equity firms will then try to improve the financial results and prospects of the company in the hope of reselling the company to another firm or cashing out via an IPO

### **What is an Emerging Market?**

An emerging market economy (EME) is defined as an economy with low to middle per capita income. Such countries constitute approximately 80% of the global population, and represent about 20% of the world's economies. The term was coined in 1981 by Antoine W. Van Agtmael of the International

Finance Corporation of the World Bank.

Although the term "emerging market" is loosely defined, countries that fall into this category, varying from very big to very small, are usually considered emerging because of their developments and reforms. Hence, even though China is deemed one of the world's economic powerhouses, it is lumped into the category alongside much smaller economies with a great deal less resources, like Tunisia. Both China and Tunisia belong to this category because both have embarked on economic development and reform programs, and have begun to open up their markets and "emerge" onto the global scene. EMEs are considered to be fast-growing economies.

### **What an Emerging Market Exchange (EME) Looks Like?**

EMEs are characterized as transitional, meaning they are in the process of moving from a closed economy to an open market economy while building accountability within the system. Examples include the former Soviet Union and Eastern bloc countries. As an emerging market, a country is embarking on an economic reform program that will lead it to stronger and more responsible economic performance levels, as well as transparency and efficiency in the capital market. An EME will also reform its exchange rate system because a stable local currency builds confidence in an economy, especially when foreigners are considering investing. Exchange rate reforms also reduce the desire for local investors to send their capital abroad (capital flight). Besides implementing reforms, an EME is also most likely receiving aid and guidance from large donor countries and/or world organizations such as the World Bank and International Monetary Fund.

One key characteristic of the EME is an increase in both local and foreign investment (portfolio and direct). A growth in investment in a country often indicates that the country has been able to build confidence in the local economy. Moreover, foreign investment is a signal that the world has begun to take notice of the emerging market, and when international capital flows are directed toward an EME, the injection of foreign currency into the local economy adds volume to the country's stock market and long-term investment to the infrastructure.

For foreign investors or developed-economy businesses, an EME provides an outlet for expansion by serving, for example, as a new place for a new factory or for new sources of revenue. For the recipient country, employment levels rise, labour and managerial skills become more refined, and a sharing and transfer of technology occurs. In the long-run, the EME's overall production levels should rise, increasing its gross domestic product and eventually lessening the gap between the emerged and emerging worlds.

### **Portfolio Investment and Risks of EME's**

Because their markets are in transition and hence not stable, emerging markets offer an opportunity to investors who are looking to add some risk to their portfolios. The possibility for some economies to fall back into a not-completely-resolved civil war or a revolution sparking a change in government could result in a return to nationalization, expropriation and the collapse of the capital market. Because the risk of an EME investment is higher than an investment in a developed market, panic, speculation and knee-jerk reactions are also more common - the 1997 Asian crisis, during which international portfolio

flows into these countries actually began to reverse themselves, is a good example of how EMEs can be high-risk investment opportunities. (For more insight on getting into emerging economies, read Forging Frontier Markets.)

However, the bigger the risk, the bigger the reward, so emerging market investments have become a standard practice among investors aiming to diversify while adding risk.

### **What is a Strip Bond?**

A bond where both the principal and regular coupon payments--which have been removed--are sold separately. Also known as a "zero-coupon bond."

An investment firm will usually buy a debt instrument and "strip" it into its separate parts. Strip bonds usually trade at a discount and mature to par value.

### **What is an Agg Bond - What is the Lehman Aggregate Bond Index?**

Now called the Barclays Capital Aggregate Bond Index, previously called the "Lehman Aggregate Bond Index," is a broad base index, maintained by Barclays Capital, which took over the index business of the now defunct Lehman Brothers, and is often used to represent investment grade bonds being traded in United States. Index funds and exchange-traded funds are available that track this bond index.

An index used by bond funds as a benchmark to measure their relative performance. The index includes government securities, mortgage-backed securities, asset-backed securities and corporate securities to simulate the universe of bonds in the market. The maturities of the bonds in the index are more than one year.

The index constructed by Lehman Brothers was/is considered to be the best total market bond index, as it is used by more than 90% of investors in the United States. Along with the aggregate index, Lehman also had bond indexes tailored to European and Asian investors. This index cannot be purchased, but it is tracked by bond index funds; there also has an iShare exchanged-traded fund (ETF) that tracks the index. The Lehman Aggregate Bond Index trades on the PSE under the ticker AGG.

### **What Is A Long Bond?**

A bond that matures in more than 10 years. When people refer to "the long bond," this typically is the 30-year U.S. treasury.

Because they tie up money for such a long time, a long bond will usually pay investors a higher yield.

### **What Does Small Cap Mean?**

This refers to stocks with a relatively small market capitalization. The definition of small cap can vary among brokerages, but generally it is a company with a market capitalization of between \$300 million and \$2 billion.

One of the biggest advantages of investing in small-cap stocks is the opportunity to beat institutional investors. Because mutual funds have restrictions that limit them from buying large portions of any one

issuer's outstanding shares, some mutual funds would not be able to give the small cap a meaningful position in the fund. To overcome these limitations, the fund would usually have to file with the SEC, which means tipping its hand and inflating the previously attractive price.

Keep in mind that classifications such as "large cap" or "small cap" are only approximations that change over time. Also, the exact definition can vary between brokerage houses

### **What Does Mid Cap Mean?**

A company with a market capitalization between \$2 and \$10 billion, which is calculated by multiplying the number of a company's shares outstanding by its stock price. Mid cap is an abbreviation for the term "middle capitalization".

As the name implies, a mid cap company is in the middle of the pack between large cap and small cap companies.

### **What Does Large Cap - Big Cap Mean?**

A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Large cap companies are the big Kahunas of the financial world. Examples include Wal-Mart, Microsoft and General Electric.

### **What are Micro & Nano Cap Stocks?**

While there are indexes that track micro cap stocks, there are few indexes tracking nano caps. Although definitions vary, a nano cap stock generally has a market capitalization of less than \$50 million and a micro cap has \$50 million to \$300 million. A company's market cap is simply its share price multiplied by the number of shares outstanding.

The Russell Micro Cap™ Index (created in June 2005 by Russell, is well-known for its small cap Russell 2000) is made up of stocks with a market cap of \$55 million to \$500 million. While this does go a little above the market cap of micro caps and into small caps, this index is still an accurate measure of the overall returns of micro cap stocks in the market. However, this index excludes stocks trading below \$1, which are generally found on the over-the-counter bulletin board (OTCBB) and/or the pink sheets.

The Dow Jones-Wilshire U.S. Micro Cap Index is another index that can be used to measure the returns of micro caps in the market. This index tracks around 2,500 stocks in the Dow Jones Wilshire 5000 Index. Despite its name, the Dow Jones Wilshire U.S. Micro Cap Index not only tracks micro caps but also small caps, having broadened its capitalization selection criteria to between \$100 million and \$1 billion, with an average of about \$300 million. It contains around 300 companies and differs from the other two micro cap indexes in that it screens its stocks based on fundamentals. This means that it tries to select higher quality small caps, which are likely to have a longer life cycle.

Therefore, while there are indexes that include micro cap stocks, it's important to realize that they cover the smallest stocks from the major exchanges and tend to exclude OTCBB, pink sheets and stocks below \$1

### **What Does S&P/TSX Composite Index Mean?**

The Canadian equivalent to the S&P 500 market index in the United States. The S&P/TSX Composite Index contains stocks of the largest companies on the Toronto Stock Exchange (TSX). The index is calculated by Standard and Poor's, and contains both common stock and income trust units. Additions to the index are generally based on quarterly reviews.

The Toronto Stock Exchange is dominated by a lot of commodity stocks, most notably crude oil, due to the concentration of natural resources in Canada. Thus, the S&P/TSX Composite Index is more correlated to the fluctuation in commodity prices than its counterparts in the U.S

### **What Does MSCI Mean?**

A market-capitalization-weighted index maintained by Morgan Stanley Capital International (MSCI) and designed to provide a broad measure of stock performance throughout the world, with the exception of U.S.-based companies. The MSCI All Country World Index Ex-U.S. includes both developed and emerging markets.

For investors who benchmark their U.S. and international stocks separately, this index provides a way to monitor international exposure apart from U.S. investments. In August of 2008, the MSCI ACWI Ex-U.S. held 23 countries classified as developed markets and 25 classified as emerging markets

### **What is the Dex? Or Universe Bond index?**

The DEX Universe Bond Index is designed to be a broad measure of the Canadian investment-grade fixed income market. As of August 29 2008, the Universe Index consisted of 1,026 securities, with a total market value of approximately \$764 Billion. Returns are calculated daily, and are weighted by market capitalization, so that the return on a bond influences the return on the index in proportion to the bond's market value. The Universe Index has been published since 1979. It is intended to be a transparent index, with individual security holdings disclosed electronically each day.

There are four main credit or borrower categories: bonds issued by the Government of Canada (including Crown Corporations), Provincial bonds (including provincially guaranteed securities), Municipal Bonds, and Corporate Bonds. As of August 29 2008, the Canada and Crown Corporation sector accounted for approximately 42.56% of the Universe Bond Index. The Provincial sector was 26.33%, the Municipal sector was 1.33%, and the Corporate Sector was 29.78%.

The Corporate sector is further divided into sub-sectors based on major industry groups:

- Financial,
- Communication,
- Industrial,
- Energy,
- Infrastructure,
- Real Estate, and
- Securitization.

The Corporate sector is also divided into sub-indices based on credit rating: a combined AAA/AA sector, a single A sector, and a BBB sector.

**What Does EAFE Mean?**

An acronym referring to the geographical area that includes three regions: Europe, Australasia, and the Far East. These regions represent the most developed areas outside of North America.

Owning an index fund comprised of companies from the EAFE area is one way to invest in those international markets. Indexes, such as the MSCI EAFE, are used as a benchmark for North American equity performance

**What Does (h) & (u) Stand For?**

These simply denote whether or not the fund or fund index is (h) edged or (u) nhedged.