TO: Business Board

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DATE: February 21, 2003 for April 7, 2003

AGENDA ITEM: **3(b)**

ITEM IDENTIFICATION:

University Funds Investment Policy

JURISDICTIONAL INFORMATION:

The Business Board is responsible for:

- The review and approval from time to time of the investment policies for university investment funds and amendments thereto, such policy to include, without limitation: normal asset mixes, asset-mix ranges, risk tolerances, quality criteria, and rate of return objectives including benchmarks for each fund.
- The approval of the conditions for the delegation of authority to a University-controlled asset management corporation of the management of the investment of university funds.

PREVIOUS ACTION TAKEN:

The University Funds Investment Policy was last approved by the Business Board at its meeting of November 19, 2001.

HIGHLIGHTS:

The University Funds Investment Policy provides investment direction from the University to the University of Toronto Asset Management Corporation (UTAM) with respect to the long-term capital appreciation pool (LTCAP, the expendable funds investment pool (EFIP), and specifically invested funds. This revision proposes changes to the investment policy for LTCAP and to the general section, and a short to medium term variation to the investment policy for EFIP Appendix 1 contains the revised policy. Appendix 2 contains the current policy for comparison purposes.

LTCAP – SECTIONS 2, 3 AND 4 OF THE POLICY:

LTCAP consists of the University's endowed funds, and a few other funds of a long-term or permanent nature such as the supplemental retirement arrangement. Investment returns generated through investments of these funds support payouts to faculties and divisions for expenditures in accordance with the terms and conditions of individual endowments and other funds.

The current policy articulates a return objective and risk tolerance and specifies the associated asset mix. The proposed policy changes are to reduce the return objective from 5.0% real return to 4.0% real return, to establish a risk tolerance expressed as a target standard deviation of 10.0% and to delegate determination of asset mix to UTAM.

A recent study on the endowment concluded that a 5% return objective would likely require too aggressive an asset mix for the University's tolerance to risk. The University requires a steady and predictable flow of income from the endowment to support the programs funded. The study indicated that the current 5% return objective results in an income shortfall seven years out of ten. The likelihood that this shortfall is greater than $10 million is four years out of ten. As such, a lower return objective, recommended at 4%, would enable a less aggressive asset mix to be utilized and would significantly reduce the likelihood of shortfalls on endowment income.

The revised policy, unlike the current one, does not specify an asset mix. It focuses instead on the return and risk objectives. This puts the accountability for the specific choice of asset classes and the resultant asset mix on UTAM, which will also be responsible for portfolio diversification, categories and subcategories of investments, use of derivatives and investment restrictions. A requirement that UTAM develop, approve and review these policies will be incorporated into the service agreement. Performance benchmarks against market indices and peer universes will be established for the fund and described in the service agreement. Sections 2, 3 and 4 of the policy have been modified to reflect these changes.

EFIP – SECTION 5 OF THE POLICY:

The expendable funds investment pool contains expendable funds which are pooled and invested until spent. It includes the University's cash for operations, capital projections, ancillary operations, expendable donations, expendable payouts from endowments and research grants.

The current policy states that "while the purpose of EFIP is to pool for investment purposes capital that is predominately short term in nature, trend-line growth of the capital base over the past several years has created a substantial core balance that is expected to be sustained on an on-going basis. Therefore, a risk profile that is greater than what would be expected for funds with a short-term investment horizon is appropriate for a significant portion of the fund."

The current policy assumes that 40% of the pool will be invested in short-term investments and 60% in longer-term investments including equities. Analysis of actual cash inflows and outflows for the years 1999-2000 through 2001-2002 shows that the University's outflows generally do not exceed inflows by more than about $50 million in a particular month. Even with a margin of safety, this historical data would suggest that we need to keep only about $75 million on average in short term investments, and that the remainder of EFIP can be invested for longer periods of time.

The equity investment results in an investment portfolio which contains significant risk that investment return targets will not be met in any given year. The projected investment income for 2002-2003 is a negative investment return of $8.2 million on a projected average capital balance of $445 million. Overhead fees and interest payments to depositors (including the operating fund) total a further $9.2 million, for a total loss for the year of $17.4 million. Adding this to the $22.6 million at April 30, 2002 results in a total accumulated loss of $40.0 million at April 30, 2003. If we would continue to follow the write off strategy adopted last year, the entire $40 million sum would have to be written off by April 30, 2004.

Due to the current budget situation, a longer write off period is desirable. However, the only prudent way of doing this is to ensure that these losses are capped and do not keep growing. While the above analysis shows that a significant proportion of the EFIP pool may be invested in longer term investments, those investments should have stable and predictable returns. This means that, for the foreseeable future, EFIP should be invested in fixed income investments with a more predictable return, which provides a reasonable justification for smoothing the accumulated investment losses over a longer period of time.

On a go forward basis, for up to five years, the University of Toronto Asset Management Corporation (UTAM) will apply a swap to the long-term investments to convert them to fixed income. This will prevent the occurrence of future investment losses and thus enable amortization of current accumulated losses against the operating fund deficit over a period of longer than one year. The current plan is to amortize the $40 million accumulated losses at the rate of $10 million per annum over the next four years ending in 2006-2007, with no expectation of any additional losses in those years. This swap can be reversed in future if the equity markets recover.

The variations in the short-term component of the pool and the use of fixed income investment for the long-term portion of the pool represent variations to the current investment policy that we recommend putting in place for a period of up to five years. These variations are added to the policy as section 5.3, with an expiration date of April 30, 2008.

Performance benchmarks against market indicators and peer universes will be established for the fund and described in the service agreement between the University and UTAM. The wording of section 5.2 of the policy has been changed to reflect this.

GENERAL

Finally, section 7.2 regarding custody arrangements has been modified to reflect UTAM's accountability.

FINANCIAL AND/OR PLANNING IMPLICATIONS:

The implication of these changes is a steadier, more predictable flow of investment return to the University. In the case of LTCAP, there is a lower risk that the University will be called upon to backstop shortfalls in endowment payout. In the case of EFIP, investment losses should be contained, thus enabling them to be written off over time, and future investment income should be more predictable.

RECOMMENDATION:

It is recommended that the Business Board approve the Investment Policy for University Funds as contained in Appendix 1.

Appendix 1

VELUT ARBOR ÆVO

UNIVERSITY OF TORONTO

UNIVERSITY FUNDS INVESTMENT POLICY

UNIVERSITY OF TORONTO

UNIVERSITY FUNDS INVESTMENT POLICY

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UNIVERSITY OF TORONTO

UNIVERSITY FUNDS INVESTMENT POLICY

1. DESCRIPTION OF UNIVERSITY FUNDS

1.1. Long-Term Capital Appreciation Pool (LTCAP)

The LTCAP, formerly known as the Consolidated Investment Pool (CIP), consists of the university's endowed trust funds or other funds of a permanent or long-term nature. In addition, external funds may be invested in the LTCAP including funds of affiliated organizations and funds where the university is a beneficiary.

1.2. Expendable Funds Investment Pool (EFIP)

The EFIP consists of expendable funds, which are pooled for investment purposes until the funds are required for expenditure.

1.3. Specifically Invested Trust Funds

The specifically invested trust funds consist of both endowed and expendable funds which cannot be pooled for investment purposes because of constraints or conditions attached to the funds.

2. LONG-TERM CAPITAL APPRECIATION POOL (LTCAP)

2.1. General Description of the Fund and Governance

The LTCAP represents the pooling of invested assets accumulated by or donated to the University for endowed purposes.

The Governing Council has delegated management of the LTCAP assets to the University of Toronto Asset Management Corporation in accordance with the Service Agreement dated May 1, 2000 between The Governing Council and the University of Toronto Asset Management Corporation (UTAM). The investment decisions of UTAM and its Board of Directors are subject to the overall policy direction of the Business Board as reflected in this policy and in amendments the Board may make from time to time.

3. THE NATURE OF LTCAP LIABILITIES

The LTCAP provides funding to the faculties and departments of the university to be used for endowed purposes in accordance with the terms of each endowment or trust. The LTCAP is subject to the capital preservation policy currently in place and as may be amended from time to time, and as such the distribution and reinvestment rates must be harmonized on an inflation-adjusted basis.

4. Investment Policies and Goals of the LTCAP

4.1. Investment Policy, Objectives and Risk Tolerance

The University of Toronto has engaged the University of Toronto Asset Management Corporation (UTAM) to manage the LTCAP. As a client of UTAM, it is important that the University delivers to its fund manager a concise statement of return objectives as well as risk tolerance, and that these two components are congruous. The purpose of this policy is to establish both of these objectives with regard to the Long-Term Capital Appreciation Pool (LTCAP).

The purpose of the LTCAP is to provide cash flows that will grow each year at a minimum of the rate of inflation in order to preserve the purchasing power of the fund and provide the same or better level of support for future generations. This necessitates a balance between the desire to reward unit holders in the present and a long-term view toward developing a sustained or increasing contribution from endowed assets. In addition, the University's Policy for the Preservation of Capital of Endowment Funds identifies the following:

a) The need to maintain the inflation-adjusted value of endowment capital; and

b) The need to provide a stable flow of expendable income for the purposes of each fund.

4.2. Return Expectations and Risk Tolerance

In order to meet the planned payouts, the return objective is a 4.0% real, inflation-adjusted return over a 10-year period. This return objective is net of all fees and levies. For purposes of this return objective, the level of University levies should be set at 0.4% to 0.5% of assets.

To keep risk at a reasonable level, UTAM shall manage the asset portfolio to achieve a target standard deviation of 10.0% or less in nominal terms.

4.3. Asset Mix

UTAM shall establish the asset mix investment mandates and then select investment managers to be responsible for the management of the portfolios in accordance with those mandates. Funds will normally be allocated to external managers in accordance with those mandates. Funds will normally be allocated to external managers, or when determined to be advantageous, may be allocated to internal management.

Performance benchmarks against market indices and peer universes will be established for the fund. The details of these benchmarks will be described in the service agreement between the University and UTAM. Portfolio diversification, categories and subcategories of investments, use of derivatives, and investment restrictions will be accountabilities of UTAM and a requirement that UTAM develop, approve and review these policies will be incorporated into the service agreement between the University and UTAM.

Each investment manager shall adhere to this policy and shall follow the investment policies and goals with the care, diligence and skill that a person of ordinary prudence would use in dealing with the property of another and shall use all relevant knowledge and skill that the investment manager possesses or ought to possess. Investment managers are expected to be in compliance with the standards of professional conduct and code of ethics established by the Association for Investment Management and Research (AIMR).

5. EXPENDABLE FUNDS INVESTMENT POOL (EFIP)

5.1. Investment Policy, Risk Tolerance and Objectives

While the purpose of EFIP is to pool for investment purposes capital that is predominately short term in nature, trend-line growth of the capital base over the past several years has created a substantial core balance that is expected to be sustained on an on-going basis. Therefore, a risk profile that is greater than what would be expected for funds with a short-term investment horizon is appropriate for a significant portion of the fund.

5.1.1. Short-Term Funds

The cash equivalent portion of EFIP must be maintained in assets with a duration comparable to 91-Day T-bills recognizing that these funds may be used immediately or sometime within a twelve month time horizon. An analysis of past cash flow patterns indicates that maintaining approximately 15% of the average balance of the total pool over a one year operating cycle in cash or cash equivalents is sufficient to meet short-term demands.

In order to further ensure that adequate liquidity is available, approximately 25% of the market value of EFIP at the peak of its annual cycle in September shall be invested in short-term bonds. Individual securities in the short-term bond component must have a minimum of an “A” rating. The total short-term bond component shall have a duration in the range of 1.5 to 4 years.

5.1.2. Long-Term Core Funds

EFIP may invest approximately 30% of the market value of EFIP as measured at the peak of its annual cycle in September of each year in the LTCAP. While the LTCAP provides an appropriate investment pool for long-term funds, there must be a high degree of certainty that EFIP funds invested in the LTCAP would never require an urgent, unplanned or significant liquidation in a period of less than five years. The five year investment horizon in important, in that it is generally considered the minimum investment horizon required for investments in the equity markets. Withdrawals of EFIP balances invested in the LTCAP will be limited to $25 million in any given year and any withdrawal in excess of this amount must be mutually agreed upon by the University of Toronto Asset Management Corporation and the Chief Financial Officer of the University of Toronto. The purpose of this investment is to provide for a higher rate of return and avoid the opportunity cost associated with holding large cash and cash equivalent balances.

Additionally, up to 30% of the market value of EFIP as measured at the peak of its annual cycle in September of each year may be invested in diversified equity accounts, pooled funds, exchange-traded funds or equivalents, absolute return strategies or market neutral strategies, or equivalent exposure through synthetic products. While it is recognized that there is a very low probability that these funds will need to be liquidated in any given operating budget cycle, this structure enables the ability to provide liquidity without adversely impacting the value of the LTCAP.

The purpose of this investment is to provide for a higher rate of return and avoid the lost potential returns associated with holding large cash and cash equivalent balances, while providing a structure that enables the generation of liquidity for re-balancing purposes of adjusting exposure back to appropriate levels.

5.2. Performance Benchmarks and Rate of Return Objectives

Performance benchmarks against market indices and peer universes will be established for the fund and its components. The details of these benchmarks will be described in the service agreement between the University and UTAM.

5.3. Variation on the investment policy for the expendable funds investment pool for a period to end no later than April 30, 2008

This section provides a time-limited variation on the investment policy for the expendable funds investment pool by giving the Vice-President, Business Affairs the following authority for a period of about five years, up to April 30, 2008:

a) to reduce the average annual short-term portion to the extent appropriate to meet current short-term cash flow requirements and to allow a somewhat larger proportion of funds to be invested long term;
b) to use swaps or other suitable means to convert some or all of the current long-term investments to fixed income for that portion of the expendable funds investment pool which is to be invested long-term and to make other long-term investments in fixed income to manage the pool's exposure to equities.

6. SPECIFICALLY INVESTED TRUST FUNDS

The assets of Specifically Invested Trust Funds shall be invested to achieve the maximum total rate of return through a combination of capital appreciation and current income consistent with any liquidity or other constraint specified and subject to any consultation required by contractual agreement, or by condition of the estate, or administrative arrangement.

7. GENERAL

7.1. Conflict of Interest Guidelines

Anyone involved directly or indirectly with the University's fund investments shall immediately disclose, at the time of its discussion of the policy or of matters related to the investment of University funds, any actual or perceived conflict of interest that could be reasonably expected to impair, or could be reasonably interpreted as impairing, his/her ability to render unbiased and objective advice to fulfill his/her fiduciary responsibility to act in the best interests of the funds.

7.2. Custody

Custody requirements will be an accountability of UTAM and a requirement that UTAM develop, approve and review these requirements will be incorporated into the service agreement between the University and UTAM.

7.3. Policy Review

This statement shall be reviewed at least once a year and either confirmed or amended as necessary.

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Felix P. Chee
Vice-President, Business Affairs
March 2003

Appendix 2

UNIVERSITY OF TORONTO

UNIVERSITY FUNDS INVESTMENT POLICY

University of Toronto

University Funds Investment Policy

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2.2. Nature of LTCAP Liabilities

The LTCAP provides funding to the faculties and departments of the university to be used for endowed purposes in accordance with the terms of each endowment or trust.

The LTCAP is subject to the capital preservation policy currently in place and as may be amended from time to time, and as such the distribution and reinvestment rates must be harmonized on an inflation-adjusted basis.

3. PHILOSOPHY OF THE LTCAP FUND

Historical results show that the investment objectives would have been met by the appropriate asset mix and the utilization of passive management. In order to achieve superior returns and increase diversification, the philosophy of the fund is to invest a portion in active management through the use of specialist managers when there exists the potential to exceed the returns of standard market indexes on a fee-adjusted basis.

4. INVESTMENT POLICIES AND GOALS OF THE LTCAP

4.1. Investment Policy, Objectives and Risk Tolerance

The University of Toronto has engaged the University of Toronto Asset Management Corporation (UTAM) to manage the LTCAP. As a client of UTAM, it is important that the University delivers to its fund manager a concise statement of return objectives as well as risk tolerance, and that these two components are congruous. The purpose of this policy is to establish both of these objectives with regard to the Long-Term Capital Appreciation Pool (LTCAP).

The purpose of the LTCAP is to provide cash flows that will grow each year at a minimum of the rate of inflation in order to preserve the purchasing power of the fund and provide the same or better level of support for future generations. This necessitates a balance between the desire to reward unit holders in the present and a long-term view toward developing a sustained or increasing contribution from endowed assets. In addition, the University's Policy for the Preservation of Capital of Endowment Funds identifies the following:

a) The need to maintain the inflation-adjusted value of endowment capital; and

b) The need to provide a stable flow of expendable income for the purposes of each fund.

In order to achieve these objectives, it is important that the LTCAP have a heavy weighting in equity securities relative to fixed income securities, and consequently it is expected that the LTCAP will typically be weighted 80% in equity and equity-like securities. This is based on historical data that indicates that bonds do not provide a high enough return after adjusting for inflation to meet the dual objectives of maintaining the inflation-adjusted value of the endowment and the cash flows generated to support current and future generations.

It is recognized that the expected volatility of the LTCAP will be high relative to a fund that has a much heavier weight in fixed income securities. This means that the market value in any given month, quarter, or year may decline due to market fluctuations. However, based on historical data, it is expected that this is a reasonable trade-off in order to ensure a long-term growth rate that is consistent with the Policy for the Preservation of Capital of Endowment Funds.

While equity securities are expected to provide the majority of the capital appreciation, it is recognized that fixed income securities serve a very specific role in the LTCAP. This specific role is to provide a hedge against deflation that will help maintain the spending policy in the event of a large decline in the equity markets. Large and sustained declines in the rate of economic growth have historically had a corresponding negative impact on corporate profits, which typically results in a sustained decline in equity prices. This type of macroeconomic scenario has historically brought about a decline in interest rates, which increases the prices of fixed income securities. Should this type of event take place, the increase in the price of the fixed income securities will help offset the decline in equity prices, thus providing a mechanism to help maintain current spending and avoid erosion of original principal.

4.2. Asset Mix

The long-term asset mix will be determined by these four factors:

a) Projected long-term cash flows;

b) The objective for real rate of return;

c) The historic pattern of equity investments producing higher rates of return than debt instruments over the long-term;

d) Role of foreign markets and special asset classes in optimizing the trade off between risk (defined as volatility) and return.

The virtually infinite time horizon of the fund dictates the adoption of a long-term asset mix policy favoring a high investment in equities along the following parameters.

Long-Term Asset Mix

	Minimum	**Normal**	**Maximum**
Equities	70%	**80%**	90%
Fixed Income	10%	**20%**	30%

All investments will be undertaken with a view toward preserving capital and enabling the fund to meet its inflation-adjusted payout rate.

UTAM shall establish investment mandates and then select investment managers to be responsible for the management of the portfolios in accordance with those mandates. Funds will normally be allocated to external managers, or, when determined to be advantageous, may be allocated to internal management.
Each investment manager shall adhere to this policy and shall follow the investment policies and goals with the care, diligence, and skill that a person of ordinary prudence would use in dealing with the property of another and shall use all relevant knowledge and skill that the investment manager possesses or ought to possess. Investment managers are expected to be in compliance with the standards of professional conduct and code of ethics established by the Association for Investment Management and Research (AIMR).

4.3. Portfolio Diversification

The objectives of diversification are to:

a) Reduce the fund's total return variability;

b) Reduce exposure to any single component of the capital markets;

c) Reduce the risk of returns not tracking or exceeding inflation;

d) Increase the longer-term risk-adjusted return potential of the fund.

To achieve diversification the fund will invest in the following asset classes subject to indicated limits based on total market value.

I.	Equities	Minimum	Normal	Maximum
a)	Canadian stocks and equivalent	5%	**10%**	45%
b)	U.S. stocks and equivalent	22.5%	**35%**	50%
c)	Non-North American stocks and equivalent	22.5%	**35%**	50%
d)	Private equity and real estate *	0%	**Not specified**	25%
e)	Overall	70%	**80%**	90%

* Includes investments in venture capital, buyouts, subordinated or mezzanine debt, distressed securities, energy, mining, timber and real estate properties. Investments in these categories are included in other equity categories for performance measurement purposes.

II.	Fixed Income	Minimum	Normal	Maximum
a)	Money market securities	(5)%	**0%**	10%
b)	Bonds, debentures, term loans, mortgages and real return bonds	10%	**20%**	30%
c)	Overall	10%	**20%**	30%

To achieve the above mix, derivatives and other synthetic products may be employed.

4.4. Categories & Subcategories of Investments

Investments that are permitted shall be classified within the general categories of:

4.4.1. Equity Investments

Public and private equity securities, including common shares of domestic, foreign and emerging markets equity, ADR's, warrants, convertible bonds, initial public offerings, and equivalent exposures using derivatives.

4.4.2. Fixed Income Investments

Money market securities, including cash on hand both domestic and foreign, call loans, demand deposit notes, treasury bills, promissory notes (secured and unsecured), term loans (secured and unsecured), banker's acceptances, commercial paper, swap deposits, repurchase and reverse repurchase agreements, foreign pay bills, other money market securities, and equivalent exposures using derivatives.

Bonds, debentures, term loans, mortgages, real return bonds, including short and long dated publicly-traded debt securities, foreign-pay bonds, preferred shares, private placement debt and equivalent exposures using derivatives.

4.4.3. Private Equity, Real Estate and Other Investments

Real estate equity and debt, managed futures, venture capital and private equity, distressed securities, resource properties, leveraged buyouts, mezzanine financing, oil and gas, hedge funds, market neutral and long/short strategies.

Investment Managers may use pooled unit trusts, mutual fund vehicles or limited partnerships that include any of the above categories.

4.5. Use of Derivatives

Derivatives may be used for hedging and risk management including the hedging of foreign currency exposure.

They may also be used as a substitute for more traditional investments if they are based on and consistent with achieving the fund's long-term asset mix goal and rate of return objectives. Such products include debt, equity, commodity and currency futures, options, swaps, forward contracts and pooled, mutual or segregated funds that employ derivatives and synthetic products for purposes consistent with the investment objectives of the fund.

Synthetic products used as a substitute for more traditional investments will not be used to gain leveraged exposure to various asset classes and will be collateralized by cash equal to the risk-adjusted market value of the synthetic exposure.

4.6. Restrictions

Investment restrictions apply within the context of overall fund objectives and the asset mix policy described above.

4.6.1. Minimum Quality Standards for Debt Securities in the Fixed Income Asset Allocation

Credit ratings of individual securities in passively-managed accounts will be in accordance with the construction of major Canadian fixed income indexes. Corporate bonds, debentures and other debt securities purchased for the fund in actively-managed mandates shall have a rating of "A" or better or the equivalent thereof according to a recognized bond rating service.

In the case of private placements not rated by a recognized bond rating service, active managers shall apply standards consistent with a minimum "A" rating.

Short-term notes and other evidences of indebtedness of corporations, banks and trust companies shall have a rating of R-1 or the equivalent thereof according to a recognized bond rating service.

For the purposes of this policy, the approved credit rating and the approved credit line for counterparties, with respect to over-the-counter options and forward contracts or its equivalent debt shall be equal to or higher than the “A” rating level as above.

4.6.2. Limitations on Securities of any Single Issuer

Maximum 10% of the book value of the total fund assets to be loaned to any person, partnership or association.

Maximum 5% of the book value of the total fund assets to be invested in any single holding categorized as real estate and other investments.

Maximum 10% of the book value of total fund assets invested in any one equity holding.

4.6.3. Investment Manager Constraints

Investment Managers may not:

i) make loans or invest with persons that have fiduciary, employer or employee status with respect to the fund;

ii) use derivatives for financial leverage purposes;

iii) except with the written consent of UTAM, purchase or sell pre-specified derivative financial instruments;

iv) except with the written consent of UTAM, borrow money to purchase securities, purchase securities on margin or short-sell securities.

4.7. Rate of Return Objectives

It is expected that the fund will over any four-year period:

a) achieve an annualized rate of return of least five percentage points above the Consumer Price Index increase for the same period;

b) exceed the following composite benchmark of standard market indexes as measured over the same period:

TSE 300	10%
Russell 3000	35%
MSCI EAFE	35%
SC Bond Universe	12%
SC Long Bond Index	8%

c) achieve an above median return in comparison to an appropriate investment fund universe comprised of funds with similar asset mix and return objectives.

5. Expendable Funds Investment Pool (EFIP)

5.1. Investment Policy, Risk Tolerance and Objectives

While the purpose of EFIP is to pool for investment purposes capital that is predominately short term in nature, trend-line growth of the capital base over the past several years has created a substantial core balance that is expected to be sustained on an on-going basis. Therefore, a risk profile that is greater than what would be expected for funds with a short-term investment horizon is appropriate for a significant portion of the fund.

5.1.1. Short-Term Funds

The cash equivalent portion of EFIP must be maintained in assets with a duration comparable to 91-Day T-bills recognizing that these funds may be used immediately or sometime within a twelve month time horizon. An analysis of past cashflow patterns indicates that maintaining approximately 15% of the average balance of the total pool over a one year operating cycle in cash or cash equivalents is sufficient to meet short-term demands.

In order to further ensure that adequate liquidity is available, approximately 25% of the market value of EFIP at the peak of its annual cycle in September shall be invested in short-term bonds. Individual securities in the short-term bond component must have a minimum of an "A" rating. The total short-term bond component shall have a duration in the range of 1.5 to 4 years.

5.1.2. Long-Term Core Funds

EFIP may invest approximately 30% of the market value of EFIP as measured at the peak of its annual cycle in September of each year in the LTCAP. While the LTCAP provides an appropriate investment pool for long-term funds, there must be a high degree of certainty that EFIP funds invested in the LTCAP would never require an urgent, unplanned or significant liquidation in a period of less than five years. The five year investment horizon in important, in that it is generally considered the minimum investment horizon required for investments in the equity markets. Withdrawals of EFIP balances invested in the LTCAP will be limited to $25 million in any given year and any withdrawal in excess of this amount must be mutually agreed upon by the University of Toronto Asset Management Corporation and the Chief Financial Officer of the University of Toronto. The purpose of this investment is to provide for a higher rate of return and avoid the opportunity cost associated with holding large cash and cash equivalent balances.

Additionally, up to 30% of the market value of EFIP as measured at the peak of its annual cycle in September of each year may be invested in diversified equity accounts, pooled funds, exchange-traded funds or equivalents, absolute return strategies or market neutral strategies, or equivalent exposure through synthetic products. While it is recognized that there is a very low probability that these funds will need to be liquidated in any given operating budget cycle, this structure enables the ability to provide liquidity without adversely impacting the value of the LTCAP.

The purpose of this investment is to provide for a higher rate of return and avoid the lost potential returns associated with holding large cash and cash equivalent balances, while providing a structure that enables the generation of liquidity for re-balancing purposes of adjusting exposure back to appropriate levels.

5.2. Performance Benchmarks and Rate of Return Objectives

Each component of the fund will have the following performance benchmarks:

Cash and Short-Term Investment:	91-day T-Bills
Short-Term Bonds:	Scotia Capital Short-Term Bond Index
Absolute Return Strategies:	91-day T-Bills + 250 basis points
Canadian Equities:	TSE 300
U.S. Equities:	Russell 3000
Non-North American Equities:	MSCI EAFE
Investments in LTCAP:	LTCAP Composite Benchmark

It is expected that the fund over any four-year period, will achieve an annualized rate of return that exceeds the following composite benchmark:

91 Day T-Bills	15%
SC Short-Term Bond	25%
91 Day T-Bills + 250 basis points	15%
TSE 300	5%
Russell 3000	20%
MSCI EAFE	20%

6. SPECIFICALLY INVESTED TRUST FUNDS

The assets of Specifically Invested Trust Funds shall be invested to achieve the maximum total rate of return through a combination of capital appreciation and current income consistent with any liquidity or other constraint specified and subject to any consultation required by contractual agreement, or by condition of the estate, or administrative arrangement.

7. GENERAL

7.1. Securities Lending

The securities of the LTCAP, or EFIP may be loaned to investment dealers and banks as part of the trustee/custodian's lending program when it is deemed that such lending may add incremental return to the fund at minimal risk and provided the loan is collateralized in accordance with industry standards and marked-to-market and adjusted on a daily basis.

7.2. Exercise of Proxies and Voting Rights

Unless the University advises UTAM otherwise, proxy or other voting rights, associated with any of the University fund investments must be exercised by the investment manager in the best interest of the fund.

7.3. Valuation of Private Placements & Other Non-traded Investments

The valuation of private placements and other infrequently traded securities shall be determined by the trustee/custodian of the fund. In the case of direct investments in real estate and resource properties, the valuation shall be based on independent opinions of qualified appraisers at a minimum of every three years.

7.4. Conflict of Interest Guidelines

Anyone involved directly or indirectly with the University's fund investments shall immediately disclose, at the time of its discussion of the policy or of matters related to the investment of University funds, any actual or perceived conflict of interest that could be reasonably expected to impair, or could be reasonably interpreted as impairing, his/her ability to render unbiased and objective advice to fulfill his/her fiduciary responsibility to act in the best interests of the funds.

7.5. Custody

To maintain a proper segregation of duties and adequate controls, all securities held shall remain with a third-party custodian.

7.6. Policy Review

This statement shall be reviewed at least once a year and either confirmed or amended as necessary.

Felix Chee
Vice President, Business Affairs
November 2001