SUBJECT	MAIN ENDOWMENT POOL SPENDING RATE
SUBMITTED TO	Finance Committee
MEETING DATE	November 20, 2020
SESSION CLASSIFICATION	Recommended session criteria from Board Meetings Policy: OPEN
REQUEST	Action requested - Recommendation to Board for approval IT IS HEREBY RESOLVED that the Finance Committee recommends to the Board of Governors approval of retaining the endowment spending rate at 4.0% for Fiscal Year 2022 for the Main Endowment Pool.
LEAD EXECUTIVE	Peter Smailes, Vice-President Finance & Operations
SUPPORTED BY	Yale Loh, Treasurer Karamjeet Heer, Comptroller Dawn Jia, CEO, UBC IMANT

PRIOR SUBMISSIONS

The subject matter of this submission has been considered previously by the Board of Governors on the following occasions:

1. June 16, 2020 (OPEN SESSION) – Recommendation approved to delay Endowment Asset Mix Study to first quarter of calendar 2021
2. December 5, 2019 (OPEN SESSION) – Recommendation approved to maintain 4.0% spend rate for FY2021
3. December 4, 2018 (OPEN SESSION) – Recommendation approved to maintain 4.0% spend rate for FY2020

EXECUTIVE SUMMARY

In accordance with Endowment Management Policy FM5, the spending rate for each of the endowment pools is established by the Board of Governors annually based on advice from UBC Finance, UBC Treasury, and UBC Investment Management Trust ("UBC IMANT"). In determining the appropriate Spending Rate for an endowment pool, the overall objective is to maintain the real value of that endowment pool over time. Based on a review of the recent and rolling endowment returns and the current reserves in the endowment's stabilization accounts, UBC Finance recommends that the Main Endowment Pool spending rate remain at 4.0% for Fiscal Year 2022.

This rate will be applied on the rolling three-year average market value to determine each endowment fund's spending allocation.

In addition to the annual review, an independent asset and liability review is conducted every three to five years by IMANT to assess the ability to preserve intergenerational equity, the outlook for long term investment returns and ultimately the Spending Rate. UBC IMANT commissioned Aon Hewitt in the Summer of 2016 to assist in a review of the asset mix for the UBC endowment fund. The asset mix review was carried out under the guidance of the sub-committee of UBC IMANT Board and UBC IMANT Staff.

Aon Hewitt undertook a projection of all key variables over a 10-year horizon under 1,000 different capital market simulations. The purpose of the study was to perform an update of the risk diagnosis and stress testing of the Fund's investment and spending policies. The outcome of this review was that the UBC IMANT Board recommended the spending rate increase from 3.5% to 4.0% for the Main Endowment pool, effective April 1, 2017. The next review for the Main Endowment Pool is scheduled to be completed by the second quarter of fiscal 2021 (or third quarter of calendar year 2021).

The annual spending rate advice provided to the Board of Governors by UBC Finance, UBC Treasury, and UBC IMANT is informed by an evaluation by UBC IMANT of the 10-year performance of the applicable endowment pool and an assessment of the historical investment returns from the applicable endowment pool, costs charged against the applicable endowment pool, inflation and the aggregate balance of the Stabilization Accounts of the endowment funds in the applicable endowment pool.

Annual Interim Review

This interim review is based on recent and rolling endowment returns, as well as the status of the stabilization accounts for the Main Endowment Pool. The Return Objective for the Main Endowment Pool invested by UBC IMANT is 6.65%. (4% spending rate + 2% inflation + 0.65% administrative cost recovery)

While returns over the past year have been lower than the required return due to the market volatility driven by the pandemic, the longer-term returns and most recent quarter have exceeded the required returns. The following table provides the actual returns and required returns over the most recent and longer time periods.

Investment Performance to September 30, 2020:

	Quarter	1 Year	4 Years	10 Years
Actual Returns	3.8%	3.0%	6.2%	8.2%
Required Returns	0.9%	5.2%	6.2%	5.9%
Excess (Deficit):	2.9%	(2.2%)	—	2.3%

[1] Net of investment manager fees

Although the longer-term historical returns have exceeded the target, the changes in capital market assumptions since the 2016 asset mix review point toward a future that is likely to have lower expected returns than the past. Based on UBC IMANT's review of Aon Hewitt's 2020 assumptions and other providers and asset management firms, the changes in assumptions suggest an expected 10-year return that could be 0.5% to 0.7% lower than the 4.3% real return forecasted in 2016. In this scenario, with no changes in spending rate, asset mix, risk tolerance, or degree of active management, the realized return may be lower than the required return, and lead the Main Endowment Pool value to drop below today's value in real terms over the next 5-10 years. Please see attached in Appendix A for more detailed information and analysis.

Given the uncertainty caused by the pandemic's impact on the economic outlook and market environment, we believe it is appropriate to retain the current year spending rate based on the strong historical returns, while acknowledging the likely challenging future environment. UBC IMANT will complete the asset mix review in calendar year 2021 to confirm the future likely scenarios and propose any solutions to mitigate the negative impact expected on the spending rate. We will provide updates as progress is made and results become clear.

Stabilization Accounts

There are 3,686 endowment funds administered under the University's Policy FM5 Endowment Management with an aggregate stabilization account balance of $198.2m (see Endowment Status Report for more details).

The stabilization account measures the health of each endowment by tracking cumulative income earned against cumulative spending allocation, investment management and central administrative expenses charged and inflation.

The stabilization ratio measures the stabilization accounts relative to the value of the capital accounts:

Date	Number of Endowments	Capital Account Balance (000's)	Stabilization Account Balance (000's)	Stabilization Ratio
March 31, 2018	3,499	$1,357,603	$263,114	19.38%
March 31, 2019	3,598	$1,492,129	$259,596	17.40%
March 31, 2020	3,663	$1,560,587	$145,825	9.34%
September 30, 2020	3,686	$1,584,392	$198,197	12.51%

The aggregate stabilization ratio has remained at very healthy levels since the 4% spending rate was implemented in April, 2017. It has come down somewhat since 2018 due to recent market volatility and global instability but still remains strong.

APPENDIX

1. UBC IMANT – Endowment Spending Rate Sustainability

UBC Investment Management Trust Inc.

Endowment Spending Rate Sustainability

2020 BRIEFING NOTE FOR UBC FINANCE & TREASURY

OCTOBER 2020

Capital Markets – Then and Now

Although returns have exceeded UBC's target in the past, future returns are expected to be significantly lower which will put pressure on spending rate and may threaten the sustainability and intergenerational equity of UBC's Endowment.

Select Asset Class Assumptions (nominal returns)	Aon 2016	Aon 2020 CMA*		Avg of Asset Manager Survey**	
Inflation	2.0%	2.0%		1.6%	↓ 40 bps
Cash	1.3%	0.7%	↓ 60 bps	0.8%	↓ 50 bps
Universe Bonds	1.7%	1.0%	↓ 70 bps	1.3%	↓ 40 bps
Canadian Equities	6.9%	6.3%	↓ 60 bps	5.8%	↓ 110 bps
Global Equities	6.9%	6.3%	↓ 60 bps	5.5%	↓ 140 bps
Estimated Real Return **(all return estimates applied to 2020 Endowment Target Mix)**	**4.3%**	**3.8%**	↓ 50 bps	**3.6%**	↓ 70 bps

Note: Only major asset class categories have been illustrated above. The major drivers of the return differences are due to cash, inflation, bonds and the resulting impact these returns have had on the expected returns of other asset classes. The other major factor implicit in above is the extent to which current valuations of asset such as equities appear expensive relative to history and future economic growth expectations especially in US equity markets.

- The extent of returns that have been brought forward due to unprecedented intervention by central banks has driven down return of cash, bonds, and overall return premiums
- This major change in assumption since the 2016 Aon study has impacted the future returns of all asset classes (i.e. private equity, private debt, infrastructure, real estate, etc.).
- It is worthwhile to note that consultants such as Aon, Russell, Mercers, and Towers Watson tend to be more anchored to historical returns than investment management firms.
- **The return estimate from leading investment managers** (known for asset allocation and investment performance) **is 20 bps lower** than that of consultants.

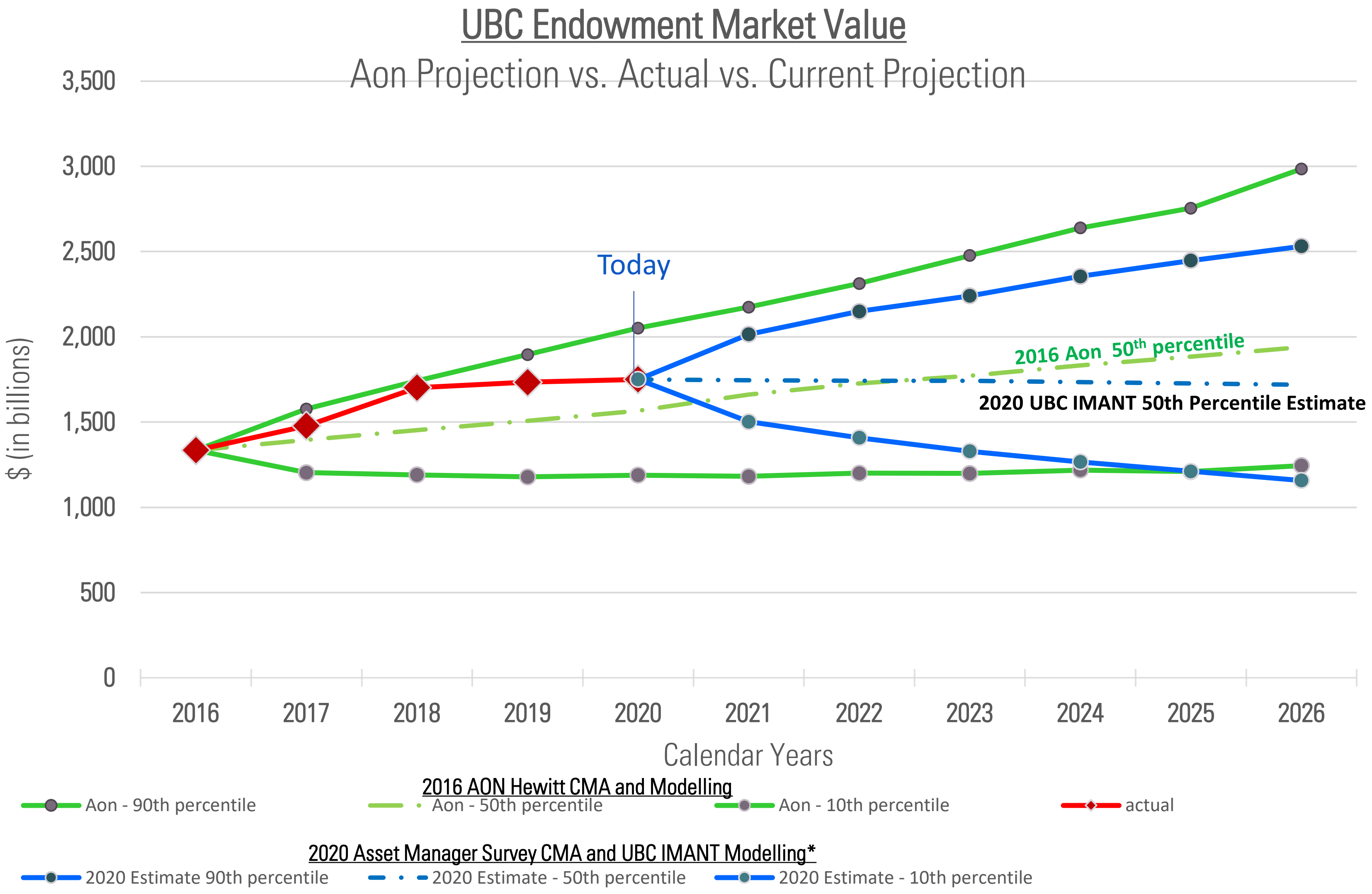
* Aon Hewitt June 30th, 2020 Capital Market Assumptions

** Asset Manager Survey included estimates from AQR Capital Management, Bridgewater Associates, Goldman Sachs Asset Management, Grantham Mayo Van Otterloo & Co LLC, JP Morgan Asset Management, State Street Global Advisors

*** Aon 2020 and Avg. Asset Manager Survey includes 30 bps of diversification benefit that was embedded in the Aon 2016 assumption.

Charting the Path – Past, Present, and Potential Future Endowment Value

It is more likely that the Endowment value, in less than a decade, will be lower than today's value



- The **returns since the 2016** asset mix study **have outpaced the target return** resulting in the Endowment value exceeding Aon's 2016 50th percentile projection.
- As noted on Slide 4, the real return **over the next 10 years is expected to be between 50 bps to 70 bps lower than the 2016 Assumption**; if spending rate, and donation assumptions remain unchanged the **value of Endowment is likely to fall below the 50th percentile by 2023/2024**
- If no changes are made to asset mix, active management, risk tolerance, donation levels or spending rate the Endowment value is likely to be lower than today's value beyond 2025.

*UBC IMANT modeling was based on Average of Asse Manager returns with proxies being made to fit the historical data and universe coverage available to team; Modelling methodology likely differs from that used by Aon Hewitt