Statement of Investment Guidelines

University of Waterloo
Endowment Fund

Effective November 1, 2018

APPROVED on this 30th day of October 2018

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Section 1— Overview

1.01 **Purpose of Statement**

This Statement of Investment Guidelines (the “Guidelines”) provides the framework for the investment of the assets for the University of Waterloo Endowment Fund (“Fund”).

These Guidelines are based on the “prudent person approach” to ensure the prudent investment and administration of the assets of the Fund.

These Guidelines also seek to establish ongoing communication between UW and others engaged in the administration of the Fund.

1.02 **Standard of Care**

These Guidelines are based on the “prudent person approach” to ensure the prudent investment and administration of the assets of the Fund. UW shall exercise the care, diligence and skill in the administration and investment of the Fund that a person of ordinary prudence would exercise. Such persons must further use all knowledge and skill that they possess or ought to possess.

1.03 **Objective of the Fund**

The objective of the Fund is to provide an annual revenue stream in perpetuity to fund specific activities of UW and to preserve its purchasing power.

1.04 **Administration**

UW is the legal owner of the Fund and is therefore responsible for all matters relating to the administration, interpretation and application of the Fund.

1.05 **Background of the Fund**

To provide investment income within acceptable risk tolerances, it is necessary to strive for sufficient/appropriate real investment returns on the Fund assets over medium- and long-term periods. The investment philosophy, policies and procedures adopted in this document will assist in the achievement of this goal in a prudent and effective manner.

These Guidelines have been developed taking into account factors such as:

a) The nature of the Fund’s liabilities;

b) Historical and expected capital market returns; and

c) The benefits of investment diversification.
Section 2 — Asset Mix and Diversification Policy

2.01 Risk/Return Considerations
Investment objectives for the Fund have been established (target 3% - 5% real rate of return) with regard to the:

a) Rate of return sufficient to meet the annual expendable obligations;

b) Rate of return sufficient to maintain the purchasing power of the endowed capital;

c) The risk tolerance which is acceptable to UW; and

d) Special factors, if any, which UW considers significant.

2.02 Investment and Risk Philosophy
UW recognizes that, based on historical data, the asset classes most likely to produce the greatest return over time are also likely to exhibit the most volatility. Conversely, the asset classes likely to be the least volatile are likely to produce the lowest returns over time. Therefore, the investment philosophies and strategies must take into account both return and risk objectives.

a) Investment Philosophy
The investment management structure employs a mix of active and passive management styles. Active management has been adopted for portions of the assets as it provides the opportunity to outperform common market indices over the long-term, while controlling active risk levels. Passive management has been adopted for portions of the assets as it minimizes the risk of underperformance relative to a benchmark index and is generally less expensive than active management. For information on how environmental, social and governance factors are considered in selecting investment managers, refer to Section 3.05.

Active equity fund managers are to apply the long-term value approach by investing in companies at prices below their underlying long-term values to protect capital from loss and earn income over time. The fund managers will attempt to identify financially sound companies with good potential profitability, which are selling at a discount to their intrinsic value. Appropriate measures of low prices may consist of low price-earnings, high dividend yields, and significant discounts to book value and low price to free cash flow. Downside protection is obtained by seeking a margin of safety in terms of sound financial position and a low price in relation to intrinsic value. Appropriate measures of financial integrity include debt/equity ratios, financial leverage, asset turnover, profit margin, return on equity, and interest coverage. It is anticipated that purchases will be made when economic and issue-specific conditions are less than ideal and sentiment is uncertain or negative. Conversely, it is expected that gains will be realized when issue-specific factors are positive and sentiment is buoyant. Assets of the Fund are administered and managed on a combined basis through specialist portfolios. Fund managers will be expected to generate a rate of return in the first quartile or better over a market cycle.
b) Risk Philosophy

In order to achieve its long-term investment goals, the Fund must invest in assets that have uncertain returns. However, UW attempts to reduce the overall level of risk by diversifying the asset classes and further diversifying within each individual asset class.

2.03 Portfolio Return Expectations

The annualized rate of return of the Fund must exceed the annualized rate of increase in the CPI by 300 – 500 basis points net of the associated investment management fees over rolling ten-year period.

2.04 Expected Volatility

The volatility of the assets of the Fund is directly related to its asset mix. Since the fund managers do not have authority to make any type of leveraged investment on behalf of the Fund, the volatility of the assets of the Fund should be similar to the volatility of the Benchmark Portfolio set out in section 4.02 (Performance Measurement).

2.05 Asset Mix

At all times, the market value of the individual asset classes will be within the minimum and maximum aggregate investment limits as listed.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Minimum %</th>
<th>Maximum %</th>
<th>Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>0.0</td>
<td>10.0</td>
<td>FTSE TMX Canada 91-Day T-Bill</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>30.0</td>
<td>70.0</td>
<td>FTSE TMX Universe Bond</td>
</tr>
<tr>
<td><strong>Total Fixed Income</strong></td>
<td><strong>30.0</strong></td>
<td><strong>70.0</strong></td>
<td></td>
</tr>
<tr>
<td>Canadian Equity</td>
<td></td>
<td></td>
<td>S&amp;P/TSX Composite</td>
</tr>
<tr>
<td>Global Equity</td>
<td></td>
<td></td>
<td>MSCI World (CAD)</td>
</tr>
<tr>
<td><strong>Total Equity</strong></td>
<td><strong>30.0</strong></td>
<td><strong>70.0</strong></td>
<td></td>
</tr>
<tr>
<td>Infrastructure</td>
<td></td>
<td></td>
<td>UBS 50/50 (CAD)</td>
</tr>
<tr>
<td>Real Estate</td>
<td></td>
<td></td>
<td>FTSE EPRA/NAREIT Developed (CAD)</td>
</tr>
<tr>
<td><strong>Total Alternatives</strong></td>
<td><strong>0.0</strong></td>
<td><strong>20.0</strong></td>
<td></td>
</tr>
</tbody>
</table>

For the purpose of the total asset mix described above, the fund managers’ asset class pooled funds are deemed to be 100% invested, even though these funds may contain a portion held in cash and cash equivalent instruments.

The asset mix may deviate from the above mix, within the limits prescribed in these Guidelines. The monitoring of the asset mix and rebalancing guidelines are set out in Section 5.02 (Monitoring...
Of Asset Mix). In order to ensure that the assets operate within the minimum and maximum ranges, UW shall review the asset mix on a quarterly basis. Rebalancing will be conducted as required.

2.06 Management Structure

A diversified management structure has been adopted for the Fund consisting of several managers. This structure has been adopted, as it is believed that the different investment mandates will result in increased diversification, while reducing the ‘manager risk’ effect for the Fund.

Section 3 — Permitted and Prohibited Investments

3.01 General Guidelines

The investments of the Fund must comply with the requirements and restrictions imposed by the applicable legislation.

3.02 Permitted Investments

In general, and subject to the restrictions in this section (Section 3), the investment manager may invest in any of the following asset classes and in any of the investment instruments listed.

a) Cash and Short Term Investments

Cash on hand, demand deposits, treasury bills, short-term notes and bankers’ acceptances, commercial paper, term deposits and guaranteed investment certificates having a term of less than or equal to one year.

b) Fixed Income

Bonds, debentures, or other debt instruments of corporations, Canadian Governments, Government agencies, or guaranteed by Governments, supranationals, federal real return bonds, mortgage-backed securities, mortgages, asset-backed securities, non-convertible preferred shares, term deposits, guaranteed investment certificates, insurance contracts, private placements and bonds where capital, interest or both are linked to increases in the cost-of-living (i.e. real return bonds).

c) Equities

Common shares, preferred shares, American Depository Receipts, Foreign Depository Receipts, rights, warrants, installment receipts, index units, income trust units (including real estate investment trusts) and securities convertible into common shares.

d) Derivatives

The pooled funds in which the Fund invests may invest directly in derivatives to create synthetic exposures, or for hedging purposes, if their objectives and strategies permit, and if the exposure to derivatives is subject to limits based on the intended use and strategies for derivatives and the risks associated with them. Derivatives may also be used to hedge currency. Derivatives may not be used for speculative trading or to create a portfolio with leverage. Investment funds that invest in derivatives must comply with all applicable statutory provisions and regulations, including the Prudent Person Rule, must be invested,
and managed in accordance with regulatory derivatives best practices.

e) **Pooled Funds**

Investments in open-ended or closed-ended pooled funds provided that the assets of such funds are permissible investments under these Guidelines. While these Guidelines are intended to guide the management of the assets, it is recognized that, where pooled funds are held, there may be instances where there is a conflict between these Guidelines and the investment policy of a pooled fund. In that case, the pooled fund policy shall dominate, subject to the compliance reporting procedures outlined in Section 4.03. However, the investment manager is expected to advise UW in the event of any material discrepancies between the above guidelines and the pooled fund’s own investment guidelines. In addition, the investment manager will ensure that UW has received a copy of the most recent version of the pooled fund policy and of any amendments made to the pooled fund policy.

### 3.03 Minimum Quality Requirements

#### a) Quality Standards

Within the investment restrictions for individual portfolios, all portfolios should hold a prudently diversified exposure to the intended market.

i. The minimum quality standard for individual bonds and debentures is ‘BBB’ or equivalent as rated by at least two Recognized Bond Rating Agencies, at the time of purchase. Where an investment in the portfolio is downgraded below a ‘BBB’ rating, the following steps will be taken:

- The investment manager will notify UW of the downgrade by telephone at the earliest possible opportunity;
- Within ten business days of the downgrade, the investment manager will advise UW in writing of the course of action taken or to be taken by the investment manager, and its rationale; and
- Immediately upon downgrade, the investment manager will place the asset on a Watch List subject to monthly review by the investment manager with UW until such time as the security matures, is sold or until it is upgraded to a level consistent with the purchase quality standards as expressed in the guidelines mentioned above.

ii. In cases in which the Recognized Bond Agencies do not agree on the credit rating, the bond will be classified according to the methodology used by FTSE TMX, which states:

- If two agencies rate a security, use the lower of the two ratings;
- If three agencies rate a security, use the most common; or
- If all three disagree, use the middle rating.

#### b) Rating Agencies

For the purposes of these Guidelines, the following rating agencies shall be considered to be ‘Recognized Bond Rating Agencies:’

i. Dominion Bond Rating Agency;

ii. Standard and Poor’s; and

iii. Moody’s Investors Services.
3.04 Maximum Quantity Restrictions

a) Total Fund Level

UW shall not, directly or indirectly, lend or invest moneys of the Fund to or in any one person, any associated persons or any affiliated corporations if:

• 10% or more of the total market value of the Fund’s assets has already been lent or invested in total to, or in, the person, the associated persons or the affiliated corporations; or

• 10% or more of the total market value of the Fund’s assets would be lent or invested in total to, or in, the person, the associated persons or the affiliated corporations as a result of the loan or investment.

UW shall not directly or indirectly, invest the moneys of the Fund in the securities of a corporation to which are attached more than 30% of the votes that may be cast to elect the directors of the corporation.

b) Fixed Income

i. Maximum 15% of the market value of the Canadian fixed income securities shall be invested in BBB bonds or debentures

ii. Maximum 10% of the actively managed fixed income portfolio may be invested in debt denominated in US currency, including debt issued by the US Government, its agencies and instrumentalities. No other foreign currency debt will be purchased.

c) Equities

No one equity holding shall represent more than 10% of the total market value of the manager’s portfolio.

3.05 Environmental, Social and Governance Factors

Consistent with its obligation to act in the best interest of the Fund, UW chooses investments and investment managers that it believes will deliver superior financial performance over the long term. In this regard, UW considers environmental, social and governance (“ESG”) factors in selecting investment managers with whom it invests the assets of the Fund as well as assets that are directly held. UW recognizes, however, that managers may consider ESG factors in different ways in assessing whether a given investment will have the best economic outcome. In order to protect and enhance the value of the Fund’s investments, when selecting investment managers or direct investments, UW considers criteria that include: the manager’s business and staff; historical performance; and the consideration of ESG factors in the investment process. As well, the proactive disclosure and analysis of ESG factors by the investment manager will be considered in the monitoring of, and ongoing decisions pertaining to, the retention of investment managers. For the purposes of this section, ESG factors refer to the environmental, social and governance factors relevant to an investment that may have a financial impact on that investment. It is accepted that the understanding of and the impact from ESG factors may change over time.

3.06 Prior Notice Required

The fund managers shall not make investments in asset categories other than those explicitly permitted in these Guidelines, unless UW first consents in writing. Each fund manager’s portfolio shall also comply with all requirements and constraints in any supplementary document provided by UW.
3.07 **Securities and Cash Lending**

The fund managers and custodian may participate in securities lending programs for the purpose of generating revenue.

Such loans must be secured by cash and/or readily marketable government bonds, treasury bills and/or letters of credit, discount notes, banker’s acceptances of Canadian chartered banks or high quality, liquid equities. The amount of collateral taken for securities lending should reflect OSFI standards and best practices in local markets. This market value relationship must be calculated at least daily.

Fund managers and custodians participating in securities lending will make available the terms and conditions of any securities lending program(s) with UW.

3.08 **Short Selling**

Short selling and/or pair trading are not permitted.

3.09 **Liquidity**

Investments should be liquid enough so that they can be sold in a reasonable period of time. The investments should be valued at least monthly and selected to ensure sufficient liquidity to meet transaction needs.

3.10 **Borrowing**

The Fund shall not borrow money, except to cover short-term contingency and the borrowing is for a period that does not exceed ninety days, subject to the written permission of UW.

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**Section 4 — Monitoring and Control**

4.01 **Delegation of Responsibility**

The Board of Governors of the University of Waterloo (the “Board”) has established a Finance and Investment Committee (“F&I Committee”) to assist in the determination of UW’s overall investment philosophy, policies, objectives and strategies. UW assists in carrying out the responsibilities listed below.

a) The F&I Committee will:
   i. review this document annually;
   ii. review Fund performance on at least a semi-annual basis;
   iii. review Fund Manager performance on at least a semi-annual basis;
   iv. make recommendations on the selection of Fund Managers;
   v. make recommendations on the purchase of specific investments; and
   vi. provide cash flow information to the Fund Managers, if necessary;
   vii. be responsible for the delegation of any responsibilities not specifically mentioned;
   viii. review and approve the purchase of specific investments.
b) The Fund Managers will:
   i. forward to UW quarterly reviews of investment performance, expectations of future
      returns on various asset classes and proposed investment strategies for the
      following 12 to 24 months;
   ii. upon direction of the F&I Committee, invest in passive asset classes such as
       indexed bond funds, indexed equity funds, real-return bonds, etc.;
   iii. manage asset mix and select securities within each asset class, subject to
        applicable legislation and the philosophy and other constraints set out in this
        document;
   iv. forward to UW quarterly reports describing their ESG analysis and
       approach;
   v. advise UW immediately of any changes in its senior investment personnel
      and/or significant changes in the size or mix of assets managed;
   vi. comply with all relevant laws concerning the investment of the Fund; and
   vii. complete and deliver a compliance report to the F&I Committee each quarter. The
        compliance report will indicate whether or not the Fund Manager was in
        compliance with these Guidelines during the quarter. In the event that the Fund
        Manager is not in compliance with this Statement, the Fund Manager is required to
        advise UW immediately, detail the nature of the non-compliance and recommend
        the appropriate course of action to remedy the situation.
   viii. comply, at all times and in all respects, with the Code of Ethics and Standards of
        Professional Conduct as promulgated by the CFA Institute.
   ix. manage the assets with the care, diligence and skill that an investment manager of
       ordinary prudence would use in dealing with the Fund’s assets.
   x. use all relevant knowledge and skill that they possess or ought to possess as a
      prudent investment manager.

c) The Custodian/Trustee will:
   i. fulfill the regular duties required by law of a Custodian/Trustee and perform the
      specific duties required of the Custodian/Trustee pursuant to agreements entered
      into from time to time with UW; and
   ii. provide UW with monthly portfolio printouts of all assets of the Fund
       and transactions during the period.

4.02 Performance Measurement

For purposes of evaluating the performance of the Fund and the fund managers, all rates of returns
are measured over rolling four-year periods. Return objectives are net of fees and include realized
and unrealized capital gains or losses plus income from all sources.

(a) Total Fund

Investment weightings and results for the Fund are to be tested regularly against a long-
term Benchmark Portfolio comprising:
Benchmark | %
--- | ---
FTSE TMX Canada 91-Day T-Bill | 0.0
FTSE TMX Universe Bond | 40.0
S&P/TSX Composite | 30.0
MSCI World (CAD) | 30.0
UBS 50/50 (CAD) | 0.0
FTSE EPRA/NAREIT Developed (CAD) | 0.0

(b) Investment Manager Mandates

Fund managers are subject to the following objectives on a gross of fees basis and over rolling four-year periods:

<table>
<thead>
<tr>
<th>Investment Manager and Mandate</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indexed Universe Bonds</td>
<td>Tracking error within +/- 6 basis points of index return</td>
</tr>
<tr>
<td>Canadian Fixed Income</td>
<td>Index + 50 basis points</td>
</tr>
<tr>
<td>Active Short Term Corporate Bond</td>
<td>Index + 50 basis points</td>
</tr>
<tr>
<td>Canadian Equity</td>
<td>Index + 100 basis points</td>
</tr>
<tr>
<td>Global Equity</td>
<td>Index + 200 basis points</td>
</tr>
</tbody>
</table>

(c) Qualitative Monitoring

In addition to performance criteria, the following qualitative factors will also be monitored and evaluated:

i. Stability of the investment firm (personnel, assets under administration, operational capabilities, etc.);

ii. Investment objective and portfolio composition;

iii. Changes in the investment philosophy used in the investment fund;

iv. Consistency of style or approach;

v. Adherence to investment policy statement; and

vi. ESG analysis and reporting.

4.03 Compliance Reporting by Investment Manager

The investment manager is required to complete and deliver a compliance report to UW each quarter. The compliance report will indicate whether or not the investment manager was in compliance with these Guidelines, including its ESG requirements, during the quarter.

In the event that an investment manager is not in compliance with these Guidelines, the investment manager is required to advise UW immediately, detail the nature of the non-compliance and recommend an appropriate course of action to remedy the situation.

The Fund invests in pooled funds with separate investment policies. Should a conflict arise between those investment policies and these Guidelines, the investment manager’s pooled fund
policy shall dominate. However, the investment manager is required to advise UW immediately, detail the nature of the conflict and recommend an appropriate course of action to remedy the situation.

Section 5 — Administration

5.01 Conflicts of Interest

a) Responsibilities

This standard, which is consistent with UW Policy 69 (Conflict of Interest) applies to UW and the members of UW, as well as to all agents employed by them, in the execution of their responsibilities (the “Affected Persons”).

An “agent” is defined to mean a company, organization, association or individual, as well as its employees who are retained by UW to provide specific services with respect to the investment, administration and management of the assets of the Fund.

b) Disclosure

In the execution of their duties, the Affected Persons shall disclose any material conflict of interest relating to them, or any material ownership of securities, which could impair their ability to render unbiased advice, or to make unbiased decisions, affecting the administration of the Fund assets.

Further, it is expected that no Affected Person shall make any personal financial gain (direct or indirect) because of his or her fiduciary position. However, normal and reasonable fees and expenses incurred in the discharge of their responsibilities are permitted if documented and approved by UW.

No Affected Person shall accept a gift or gratuity or other personal favour, other than one of nominal value, from a person with whom they deal with in the course of performance of his or her duties and responsibilities for the Fund.

It is incumbent on any Affected Person who believes that he or she may have a conflict of interest, or who is aware of any conflict of interest, to disclose full details of the situation to the attention of UW immediately. UW, in turn, will decide what action is appropriate under the circumstances but, at a minimum, will table the matter at the next regular meeting of the F&I Committee.

No Affected Person who has or is required to make a disclosure as contemplated in this Policy shall participate in any discussion, decision or vote relating to any proposed investment or transaction in respect of which he or she has made or is required to make disclosure.

5.02 Monitoring of Asset Mix

In order to ensure that the assets of the Fund operate within the minimum and maximum ranges, as prescribed in the Guidelines in Section 2.05 (Asset Mix), UW shall review the asset mix at least quarterly. Rebalancing will be conducted as required.
5.03 **Selecting Fund Managers**

In the event that a new investment manager must be selected or additional investment manager(s) added, UW will undertake an investment manager search. The criteria used for selecting an Investment Manager will be consistent with the investment and risk philosophy set out in Sections 2.02 (Investment and Risk Philosophy) and 3.05 (Environmental, Social and Governance Factors).

5.04 **Monitoring Manager Performance**

At least quarterly, the F&I Committee and UW will monitor and review:

a) Each investment manager’s staff turnover, consistency of style and record of service;

b) Each investment manager’s current economic outlook and investment strategies (including ESG approach);

c) Each investment manager’s compliance with these Guidelines; and

d) Investment performance of the assets of the Fund in relation to the rate of return expectations outlined in these Guidelines.

5.05 **Dismissal of an Investment Manager**

Reasons for considering the termination of the services of an investment manager include, but are not limited to, the following factors:

a) Performance results which are below the stated performance benchmarks;

b) Changes in the overall structure of the Fund’s assets such that the investment manager’s services are no longer required;

c) Change in personnel, firm structure or investment philosophy which might adversely affect the potential return and/or risk level of the portfolio; and/or

d) Failure to adhere to these Guidelines.

The failure to achieve the goals stated in Section 4.02 (Performance Measurement) over a period of four consecutive years will require a reassessment of such goals and/or the appointment of an alternative investment manager.

5.06 **Voting Rights**

The voting rights acquired through the investments held by the Fund are delegated to the fund managers of the securities. Fund managers are expected to exercise all voting rights related to investments held by the Fund in the interests of UW.

5.07 **Valuation of Investments Not Regularly Traded**

The following principles will apply for the valuation of investments that are not traded regularly:

a) **Equities**

   Average of bid-and-ask prices from two major investment dealers, at least once every month.

b) **Fixed Income**

   Same as for equities.
Section 6 — General Provisions

6.01 Related Party Transactions

UW, on behalf of the Fund, may not enter into a transaction with a related party unless:

a) The transaction is made for the operation or administration of the Fund under terms and conditions that are not less favourable to the Fund than market terms and conditions and such transaction does not involve the making of loans to, or investments in, the related party; or

b) The combined value of all transactions with the same related party is nominal or the transaction(s) is immaterial to the Fund.

For the purposes of this section, only the market value of the combined assets of the Fund shall be used as the criteria to determine whether a transaction is nominal or immaterial to the Fund. Transactions less than 0.5% of the combined market value of the assets of the Fund are considered nominal.

In addition, the prohibition to entering into transactions with a related party does not apply to investments:

a) In securities issued or fully guaranteed by the Government of Canada, the government of a province, or an agency of either one of them;

b) In a fund composed of mortgage-backed securities that are fully guaranteed by the Government of Canada, the government of a province, or an agency of either one of them;

c) In a fund that replicates the composition of a widely recognized index of a broad class of securities traded at a marketplace; and

d) That involve the purchase of a contract or agreement in respect of which the return is based on performance of a widely recognized index of a broad class of securities traded at a marketplace.

A “related party” in respect of the Fund means:

a) A person who is the administrator of the Fund including any officer, director or employee of the administrator. It also includes the Managers and their employees, a union representing employees of the employer, a spouse or child of the persons named previously, or a corporation that is directly or indirectly controlled by the persons named previously, among others.

b) An officer, director or employee of one of the administrators of the Fund;

c) A person responsible for holding or investing the assets of the Fund, or any officer, director or employee thereof;

d) An affiliate of UW;

6.02 Policy Review

The F&I Committee shall review and either confirm or amend these Guidelines at least annually. UW will also provide any amended copy of these Guidelines to the investment manager.
Appendix A — Investment Manager Compliance Letter

To be completed by fund managers each quarter.

UNIVERSITY OF WATERLOO
____________________, 201_

This is to certify that I/we have adhered to the guidelines contained in the November 2018 version of the “Investment Guidelines” for the University of Waterloo Endowment Fund approved by the Board of Governors of the University of Waterloo.

Signed ______________________

On behalf of _____________________

Date ________________________