

Glossary of Canadian Investment Terms

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A

Absolute Return—A rate of return compared to zero.

Absolute Return Strategy—An approach to investment seeking a positive return using nontraditional investment strategies and unconventional assets. Investment managers seeking an absolute return use strategies such as short selling, futures contracts, options, derivatives, arbitrage and leverage. Hence, hedge funds are focused on absolute return. In contrast, “traditional” managers are concerned with relative return—how the return on assets compares to similar assets or the market as a whole.

Active Management—A style of investment management that seeks to attain above-average risk-adjusted performance.

Actuarial Assumptions—In an actuarial valuation, a set of estimates of future developments affecting the cost of benefits to be provided under a pension plan (e.g., mortality, salary increases, investment return, employee turnover, retirement ages).

Actuarial Cost Method—System for determining either the contributions to be made under a retirement plan or the level of benefits when the contributions are fixed. In addition to forecasts of mortality, interest and expenses, estimates as to future labour turnover, salary scales and retirement rates may be involved. The methods of prime importance are those such as the entry age method, attained age method and unit credit method.

Actuarial Gain or Loss—The effects on actuarial costs of deviations or differences between the past events predicted by actuarial assumptions and the events that actually occurred. An actuarial gain results when the actual experience under the plan is more favourable than the actuary’s estimate, while an actuarial loss reflects an unexpectedly adverse deviation.

Actuarial Value of Assets—The value of cash, investments and other property belonging to a pension plan, as used by the actuary for the purpose of an actuarial valuation. The statement of actuarial assumptions should set forth the particular procedures used in determining this value.

Actuary—A professionally trained specialist in the pension and insurance fields who deals scientifically with the financial, social and demographic implications and consequences, present and future, of contingent events called *risks*. Full professional recognition requires membership in the Canadian Institute of Actuaries.

Alpha—The rate of return above the market, or index, return.

Alternative Investment—An investment outside of traditional investments. This includes private equity, hedge funds, absolute return strategies, socially responsible investments and others.

Amortization—Paying off an interest-bearing liability by gradual reduction through a series of installments as opposed to paying it off by one lump-sum payment. A technique for gradually extinguishing a liability, deferred charge or capital expenditure over a period of time. Includes such practices as depreciation, depletion, write-off of intangibles, prepaid expenses and deferred charges (e.g., mortgages are amortized by periodically retiring part of the face amount). The liquidation of a debt on an installment basis.

Annualize—To express a rate of return for a period greater than one year or less than one year in terms of 12 months.

Appraisal—An estimation of quantity, quality or value. The process through which conclusions of property value are obtained; also refers to the report setting forth the estimate and conclusion of value reached by correlation, unless a single technique is used.

Arbitrage—Attempting to profit by exploiting price differences of identical or similar securities, on different markets or in different forms.

Asset Allocation Models—The modern portfolio theory application area that addresses the problem of the amount of assets to be allocated among various investment alternatives.

Asset-Backed Securities—Bonds or notes backed by some type of asset security.

Asset Liability Matching—A method of investing that matches the characteristics (duration) of the invested assets with the characteristics (duration) of the liabilities. Also known as liability-driven investing (LDI).

Asset Mix—The percentage investment in different types of securities such as stocks, bonds and money market. This is generally considered the most important investment decision.

B

Balanced Funds—Investment companies that diversify their portfolio holdings over a wide list of common stocks, bonds and/or preferred issues.

Balance Sheet—A condensed financial statement showing the nature and amount of an employee benefit plan's assets, liabilities and capital on a given date.

Bankers Acceptance—Short-term loan to a bank, backed by a trade receivable.

Bankruptcy—A condition characterized by the inability to repay debts in full because the liabilities (amounts owed) exceed the assets. Legally, a *bankrupt* is an individual or corporate debtor that is judged insolvent by a court.

Basis Point—One-hundredth of a percent. There are 100 basis points in 1%.

Benchmark—An investment target used to evaluate an investment manager's rate of return. A standard used for comparisons.

Beta

—The rate of return produced by an index, market or investment.

—A measure of volatility of an individual investment compared to a broad index of similar investments.

Bond

—A certificate of debt (i.e., an IOU or promissory note) issued by such entities as corporations, municipalities and the government and its agencies, that represents a part of a loan to the issuer, bears a stated interest rate and matures on a stated future date. A bondholder is a creditor of the issuer and not part owner as is a stockholder. Short-term bonds issued for five years or less are often called notes.

—A long-term loan with some type of guarantee attached, and usually, semiannual interest payments.

Book Value—The cost of an investment.

Broker—An agent who handles public orders to buy and sell securities, commodities or other property. For this service, a commission is charged that, depending upon the firm dealt with and the amount of the transaction, may or may not be negotiated.

C

Cash Equivalents—Short-term investments held in lieu of cash and readily converted into cash within a short time span (e.g., CDs, commercial paper, Treasury bills).

Certificate of Deposit—A written certification by a bank or a trust company that a fixed dollar amount has been deposited with it for a fixed period of time at a predetermined rate of interest.

Commercial Paper—Short-term loan to a corporation.

Commingled Closed-End Real Estate Funds—A pooling of multiple investors' capital. Rather than constantly taking in new subscribers, however, these funds set a pre-determined minimum and maximum subscription level. Once this has been achieved, the fund is closed to all new subscribers.

Commingled Funds—The collective investment of the assets of a number of small pension funds, allowing for broader and more efficient investing.

Commingled Open-End Real Estate Funds—A pooling of multiple investors' capital. Participants buy and sell at a unit price based on appraised value of total assets. Participants can leave and enter at any time. Properties continually are added to the fund.

Commission—The broker's basic fee for purchasing or selling securities or property as an agent. This fee may or may not be negotiated.

Compound Interest—Interest credited to the investor at a specified rate and on specified dates and added to the principal for the purpose of subsequent interest calculations.

Consumer Price Index—The series of numbers whose ratios measure the relative prices at various times of a selected group of goods and services that typify those bought by urban families. A measure of inflation.

Convexity—A measure of duration volatility of an investment.

Correlation—A relationship between two variables. A high correlation (near one) means the two variables move similarly. A low correlation (near minus one) means the two variables move in opposite directions.

Credit Rating—A measure of creditworthiness of a fixed-income investment.

Credit Spread

—The difference between the yield on Treasury and non-Treasury securities (i.e., bonds) that are identical in all respects except for their quality rating. Companies must offer a higher return on bonds because they do not have as good a credit rating as the U.S. government.

—difference in the value of two options on the same security when the value of the option written (or sold) exceeds the value of the one bought.

Custodial Arrangement—Warehousing of securities by a bank or a trust company for purposes of safekeeping. The bank or trust company may collect income and do simple reporting on the value of the assets.

Custodian—The organization (usually a bank or trust company) that holds in safekeeping the securities and other assets of a trust fund.

D

Debenture—A long-term loan with, usually, semiannual interest payments and no asset or security.

Debt—Borrowed money.

Deferred Retirement Option Plan (DROP)—An arrangement permitting an employee who is entitled to retire to receive benefits under an employer's defined benefit plan yet continue working for this employer. Instead of having the continued compensation and additional years of service taken into account in the defined benefit plan formula, the employee has a sum of money credited for each year of continued employment to a separate retirement plan account. This account earns interest at a rate stated in the plan or based on the earnings of the underlying retirement plan trust. When the employee actually retires, the money in the separate account is paid to the employee in addition to the benefit the employee has acquired under the defined benefit plan. One advantage of a DROP plan is that it enables employees who may have "maxed out" on the benefit payable under a defined benefit plan to continue to accrue benefits. Even for those who have not maxed out, the rate of accrual is often more favorable than continued accrual under the defined benefit arrangement. In many instances, the DROP benefit is payable as a lump sum, while the defined benefit is available only as a lifetime annuity.

Defined Benefit Plan—A plan that defines the pension to be provided (based on service, average earnings, etc.) but not the total contributions. If a plan is contributory, the rate of employee contributions may be specified, with the employer paying the balance of cost. To be distinguished from *Defined Contribution Plan*.

Defined Contribution (Money Purchase) Plan—A plan that defines contributions to be made by employer and possibly employees, but not the benefit formula. Accumulated contributions and interest are used to purchase an annuity for the member. To be distinguished from *Defined Benefit Plan*.

Depreciation—An expense that reduces the value of an asset over time.

De-risking—The use of appropriate investments to reduce the volatility of a defined benefit pension plan's funded ratio.

Derivative—A financial instrument whose value is derived from an underlying asset.

Directed Commissions—Those commissions charged by a broker for executing securities transactions that are placed by the investment manager with a particular broker, or brokers, resulting from instructions received from the client of the manager.

Diversification—The spreading of risk by buying several different investments.

Diversification Duration

—Weighted average term to maturity of cash flows of an investment.

—A measure of volatility (risk).

Dollar-Weighted Rate of Return

—This method of calculating rate of return is affected by the amount and the timing of cash flows during a given time period. This rate is an effective measure of the fund's rate of growth, giving full weight to the impact of cash flows on fund assets. The dollar-weighted rate also is referred to as the internal rate of return.

—Assesses what happened to all money available to a given fund during a given period. As such, it is the best way of assessing the actual condition of the fund at any point, but it may not accurately reflect the skill of the investment manager, since he or she has no control over cash flows (deposits, etc.) as to either timing or amount. Compare with *Time-Weighted Rate of Return*.

Duration—Weighted average term to maturity of all the cash flows of an investment. The change in price of a fixed income investment for a one percentage point change in yields, measured in years.

E

Earnings

—A person's money income from employment or self-employment; usually excludes such forms of income as rents or bond interest. In some pension plans certain bonuses, sick pay, etc., may be excluded in calculating benefits.

—The profit, after all costs and expenses, of a corporation or other entity. Also called net income.

Economically Targeted Investing (ETI)—Investing the plan's money in an investment vehicle that directly affects the employment environment of the industries in which the participants of the plan are employed, or bolsters the economy by creating jobs or affordable housing, for example. See also *Socially Responsible Investments*.

Efficient Frontier—A curved line that graphically represents the maximum expected investment return for different amounts of risk. Investment portfolios below the efficient frontier curve are not "efficient" because investors can achieve greater return for the same risk. No investment portfolios exist above the curve.

Equities—Refers to ownership of property, usually in the form of common stocks, as distinguished from fixed income-bearing securities, such as bonds or mortgages.

Excess Earnings—Earnings from investments of a pension fund in excess of an assumed or expected rate of return.

F

Fixed Income Investment—An investment that pays a specific interest rate.

Foreign Property Rule—The limit imposed on pension fund investments in foreign assets set by the *Income Tax Act* expressed as a percentage of total plan assets. The limit was increased from 20% to 30% in the February 2000 federal budget, and has now been increased to 100%.

Fund Earnings—Earnings that return to a benefit trust fund for reinvestment or payment of benefits.

Funded Ratio—The ratio formed by dividing a defined benefit pension plan's assets by its estimated liabilities. A funded ratio of 1.0 means assets equal the liabilities and the pension plan is fully funded.

G

Generally Accepted Accounting Principles (GAAP)—

Uniform minimum standards of and guidelines to financial accounting and reporting, which govern form and content of financial statements. GAAP encompass principles necessary to define accepted accounting practice at a particular time and include detailed procedures as well as broad guidelines.

Group Annuity—A contract under which an insurance company agrees to provide retirement pensions to members of a group.

Growth Investing—An investing style that looks for companies whose earnings are expected to grow at higher than average rates.

Guaranteed Annuity—An annuity that will be paid for the for a minimum period; for example, if an annuity is guaranteed for five years and the annuitant dies after three years, payments are continued to a beneficiary or the estate for two years.

Guaranteed Investment Contract—An investment contract entered into with an insurance company that guarantees the repayment of principal and a compound interest return. Terms of the contract and maturities vary from company to company and, over time, within the same company.

H

Hedge Fund—An investment fund that uses nontraditional methods of investment, such as leverage, shorting, arbitrage or derivatives.

High Yield Securities—Fixed income securities rated below investment grade. They provide a higher yield in return for taking on a higher credit risk.

I

Immediate Annuity—An annuity under which income payments begin one annuity period (e.g., one month or one year) after the annuity is purchased.

Income Trust—A trust designed to produce investment returns.

Indexing—Provision for periodically adjusting a benefit amount (usually after retirement) according to a formula based on a recognized index of price or wage levels, e.g., the Consumer Price Index.

Inflation—The broad, general rise in prices in an economy.

Infrastructure—The basic physical systems of a country's or community's population, including roads, utilities, water, etc.

Institutional Investor—An organization the primary purpose of which is to invest its own assets or those held in trust by it for others. Includes pension funds, investment companies, universities and banks.

Investment Consultant—An individual or firm that provides investment advice for a fixed fee based upon a percentage of assets or a fee derived from brokerage commission. Such advice generally includes analyzing portfolio constraints, setting performance objectives, counseling on allocation of assets, educating the investment manager, and selecting and monitoring services. It may or may not include performance measurement services.

Investment Earnings—Investment income on contributions, which is not normally subject to income tax for employee benefit plans but that may be taxable in certain circumstances.

Investment Policy—A document describing how contributions to an employee benefit plan are utilized from the time they are received until benefits are paid. This document should include, among other things, the goals and objectives of the plan and identify the nature of the plan's liabilities. The written policy should state investment guidelines covering such matters as investment portfolio diversification, including the aggregate and individual investment limits, asset mix policy and rate-of-return expectations, categories and subcategories of investments, and loans that may be made, lending of cash or securities, retention or delegation of voting rights acquired through investments, a conflict-of-interest policy in respect of investments, etc.

Investment Return (Yield)—Earnings of a pension fund including interest on fixed income securities (e.g., bonds, mortgages), dividends, capital gains, etc., divided by assets.

L

Large Cap or Large Capitalization—Stocks of larger corporations.

Leverage—The degree to which an investment uses borrowed money.

Liability-Driven Investment—See *Asset Liability Matching*.

Life Annuity—A series of payments under which payments, once begun, continue throughout the remaining lifetime of the annuitant. Under this form of annuity, there is no further benefit payment of any kind after the death of the annuitant.

Lifestyle Fund—See *Target-Risk Fund*.

Liquidity

—An actuarial concept that prescribes that sufficient cash, or cash-like securities, be available at times of disbursement for retirement, disability or separation.

—The ease with which an investment can be sold.

Long—The ownership of an investment.

M

Market Value—The price an investor pays (or receives) for an investment at any given time. Market value is determined by the laws of supply and demand.

Master Trust—A pooling of directed and/or discretionary trusts (a discretionary trust is one in which the bank is trustee and also has investment responsibility for all or part of the assets). The "pure" definition is pooling of one sponsor's assets that include multiple managers and multiple plans under one trust agreement.

Median—The midpoint of a sample that represents the same number of results above and below that result.

Modigliani Risk-Adjusted Performance (M^2 , $M2$ or RAP)—measure of how well the return on an investment portfolio rewards an investor for the amount of risk taken, relative to a market index (or other benchmark) and the risk-free rate of return. Derived from the *Sharpe ratio*, M^2 is easier to interpret. If two investment portfolios have M^2 values of 4.3% and 4.8%, the portfolio with the M^2 of 4.8% provides 0.5 percentage points more return per year for the same risk.

Money Market—Short-term investments such as Treasury bills and commercial paper.

Money Purchase Plan—A type of defined contribution plan. that is considered the reverse of a defined benefit plan. The cost in a money purchase plan is fixed, and the pension benefit is variable. The contribution to the plan is normally expressed as a percentage of salary with the employer making a fixed contribution or a proportionate matching contribution (subject to statutory limitations). Contributions are accumulated with investment returns and are used to purchase an annuity from an insurer when pension age is reached or to provide a life income from a nonguaranteed vehicle.

Mortgage—A loan to purchase real estate. Repayments usually include both principal and interest.

Mortgage-Backed Security—A loan to a financial institution. The interest and principal payments are tied to mortgages held as collateral.

N

Net Income—The profit, after all costs and expenses, of a corporation or other entity. Also called net earnings.

P

Passive Management—A style of investment management that seeks to attain average risk-adjusted performance.

Pension Plan—A plan organized and administered to provide a regular income for the lifetime of retired members; other benefits that may be provided include payments on permanent disability, death, etc.

P/E, Price to Earnings Ratio—Equity price per share divided by the annual earnings of the company. Used by value managers to help measure whether an investment is expensive or cheap.

Performance-Based Fees—Investment manager charges which are, at least in part, based on the investment rates of return produced by the investment manager.

Pooled Fund—A fund that combines the assets of several investors to hold as a group.

Portable Alpha—The transfer of the alpha, or rate of return above the market, from one asset type to another. The investor receives the alpha from one investment and the beta from another.

Preferred Share—A share whose dividend is paid before common share dividends.

Present Value—Amount of money that, if invested today at a given rate of compound interest, would provide a defined benefit commencing at a specified future date.

Private Equity Investments—Companies that are not listed on a public exchange.

Proxy—A written authorization given by a shareholder to someone else to vote his or her shares at a stockholders' annual or special meeting called to elect directors or for some other corporate purpose.

Prudent Person Rule—A common law standard applicable to the administration and investment of trust funds. Briefly stated: All that can be required of a trustee in the administration and investment of trust funds is that he conduct himself faithfully and exercise sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, or those of others, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested.

Q

Quartile—A splitting of results into four groups of descending amounts.

R

Real Estate Investment Trust (REIT)—A pool of different investors' money for the purpose of investing in real estate or mortgages.

Real Return Bonds—Bonds whose principal and interest payments are indexed to inflation.

Registered Pension Plan—An employment pension plan accepted for registration for tax purposes under the Income Tax Act, and for registration under applicable federal or provincial pension benefits legislation.

Registered Retirement Savings Plan (RRSP)—A contractual arrangement registered under Section 146 of the *Income Tax Act* between an individual and an insurer, trust company or corporation authorized (as prescribed in Section 146(1)(j)) to accept payments (contributions) from an individual (the "annuitant") or his or her spouse for the purpose of providing a retirement income for that individual or his or her spouse by, upon maturation of the plan, purchase of a prescribed form of annuity or transfer of the plan assets to a registered retirement income fund (RRIF). Subject to prescribed maximums, such contributions made by a resident of Canada having (Part I) earned income are deductible for income tax purposes.

Relative Return—The difference in the money gained or lost on an investment over a period of time compared to an index or other benchmark. Relative returns are most often used when reviewing the performance of an investment manager. Because investors pay management fees, they expect managers to achieve returns higher than the benchmark index. See also *absolute return strategy*.

Revenue—Money received by a company or entity, usually from sales of the company's products and services, before any costs or expenses are removed.

Risk—The possibility of losing money on an investment. The volatility of rates of return. The possibility of not meeting a requirement.

Risk Budget—A process that focuses on how risk is distributed throughout an investment portfolio. The goal is to identify, quantify and spend investment risk in the most efficient manner possible. The investor calculates how much different assets in a portfolio contribute to the total risk of a portfolio. If the investor is uncomfortable with the amount of risk an asset in the portfolio represents, some of the money invested in the asset is moved to another investment option. The risk exposure of a portfolio can come from various factors including inflation, economic growth, steepness of the yield curve and changes in short-term interest rates.

S

Securities Lending—A practice whereby owners of securities either directly or indirectly lend their securities to primarily brokerage firms for a fee, and against which either cash, securities or a letter of credit is pledged to protect the lender. Securities are borrowed to cover fails of deliveries or short sales, provide proper denominations and enable brokerage firms to engage in arbitrage trading activities.

Security—In finance, a negotiable instrument representing financial value. Securities are broadly categorized into debt securities (e.g., bank notes, bonds) and equity securities (e.g., stocks). The company, government or other entity issues the security is called the issuer. Securities may be represented by a certificate, or more typically, by an electronic book entry.

Segregated Fund—Assets of a pension plan held by an insurance company for investment management only; funds are segregated from assets of the insurance company, and principal and interest are not guaranteed.

Self-Directed Investment—Any plan in which plan participants control the investment of their accounts.

Sharpe ratio—Developed by Nobel laureate William F. Sharpe, a measure of an investment's risk-adjusted performance. In other words, whether the return on a portfolio is the result of smart investment decisions or excess risk. The greater the Sharpe ratio, the better the return for the same risk. A negative ratio indicates a portfolio with less risk will perform better than the one analyzed. Also referred to as the Sharpe index, Sharpe measure and reward-to-variability ratio. See also *Modigliani Risk-Adjusted Performance*.

Short—The sale of a security that is not owned. Delivery is made with a borrowed security.

Small Cap or Small Capitalization—Stocks of smaller corporations.

Socially Responsible Investments—Generally considered to include those investments that (1) carry a lesser rate of return and/or, (2) have a lower credit rating and quality and/or (3) have less liquidity or marketability than other forms of investment or specific investments readily available in the marketplace, but that will (1) create employment opportunities for plan participants and/or (2) have a greater social or moral quality. Also includes "socially sensitive" investments that otherwise are equal to other investments when compared by traditional financial analysis, but have favourable noneconomic characteristics. Socially responsible investments are known as *divergent*, *target* and *political investments*.

Soft Dollars—The portion of a plan's commissions expense incurred in the buying and selling of securities that is allocated through a directed brokerage arrangement for the purpose of acquiring goods or services for the benefit of the plan. In many soft dollar arrangements, the payment scheme is affected through a brokerage affiliate of the consultant.

Solvency—In a pension plan, the ability of the plan to meet its present and future obligations; the adequacy of provisions for funding.

Split Funding—The use of two or more funding agencies for the same pension plan. In some cases, part of the contributions to the plan is paid to a life insurance company and the remainder is invested through a corporate trustee, generally in equities.

Stock—Common stock or share. A part ownership of a company.

Strip—An interest payment that has been separated from the original debenture.

Subordinated Debt—Debt securities that ran after other debts for payment should a company be liquidated or fall into bankruptcy.

Surplus—The excess of the value of the assets of a pension fund related to a pension plan over the value of the liabilities under the pension plan, both calculated in the prescribed manner. The assets of a pension fund minus its liabilities, the latter being the present value of all accrued pension benefits promised under the plan.

T

Time-Weighted Rate of Return—The rate of return on an investment excluding the effect of cash flow timing.

Treasury Bill—Short-term loan to a government.

Trust—A legal entity that is created when a person or organization transfers assets to a trustee for the benefit of designated persons.

U

Unfunded Liability (Unfunded Actuarial Liability)—Generally, any amount by which the assets of a pension plan are less than its liabilities. An initial unfunded liability exists when benefits are created in respect of prior service, e.g., and not provided for in current service contributions.

Universe Bond—A large collection of bonds that represents all possible investments in bonds.

V

Value Investing—An investment style that looks for good companies valued at low prices.

Y

Yield—The rate of return on a fixed income investment if held to maturity. The yield of a fixed income investment is inversely proportional to its price.

Yield Curve—A line representing the maximum interest rates for bonds of the same credit quality but different maturity dates at a given point in time. The most frequently reported yield curve compares the 3-month, 2-year, 5-year and 30-year U.S. Treasury debt. This curve is used as a benchmark for other debt in the market such as mortgage rates and bank lending rates. A normal yield curve has higher yields on bonds with longer maturities. A curve that is inverted has yields higher on shorter-term than longer-term maturities and may be perceived as sign of a recession on the way. A flat (or humped) curve with shorter- and longer-term yields very close to each other is considered a predictor of an economic transition. The greater the slope of the yield curve, the greater the gap between short- and long-term rates.