

Policy Sponsor: CIO and Investment Risk Management

Summary: This Policy sets out a general framework for measuring and managing investment risk across the enterprise. The Investment Entities are responsible for managing their investment risks and ensuring that returns are commensurate with the amount of risk taken. **This policy must be approved annually by the Investment Committee.**

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1. INTRODUCTION

The OMERS Enterprise Risk Management (ERM) framework provides four general categories of the risks faced by OMERS: Investment; Operational; Strategic; and Legal & Compliance and provides a general framework for managing those risks.

The Funds' ability to meet their pension funding obligations is driven in large part by their ability to deliver superior investment returns with acceptable investment risk over the long term. The Investment Risk Policy establishes a framework and provides guidance for managing OMERS Investment Risks.

2. INVESTMENT RISK MANAGEMENT PHILOSOPHY

The future values of OMERS investment assets and liabilities are not known with certainty and change over time. Investment risk reflects the possibility that the value of the Funds' investments will deviate from plan as a result of changes in market conditions, whether those changes are caused by factors specific to the individual investment or factors affecting all investments traded in the market.

The assumption of investment risk is necessary to meet the Plans' benefit obligations at a reasonable cost. Further, the Plans' obligations (i.e. liabilities) are not known with certainty. As a result, the value of the Funds' assets could differ from the value of the Plans' liabilities.

The goal of Investment Risk management is not to eliminate risk but to find a balance between expected returns and the risks needed to generate those returns. Further, it is generally accepted that expected investment returns (positive or negative) increase with the amount of risk taken. The higher the risk involved in an investment, the higher the expected return (or potential loss) from that investment. As a result, risk is neither good nor bad – it is needed to generate investment returns. Similarly, there is no right level of risk – the greater the risk taken, the higher the expected return or loss. Through various policies, delegations and the long-term strategic asset mix, the OAC Board defines the amount of risk to be taken by the Funds. The amount of risk assumed by the OAC Board is also influenced by the SC's approach to managing pension benefits. The OAC's risk culture and this policy provide the general framework for managing Investment Risk at the OAC.

3. INVESTMENT RISK PRINCIPLES

For the purposes of this Policy, Investment Risk includes market risk, credit risk and the subcategories of Strategic Risk that impact the investment decisions of the Funds (concentration, funding and benchmark; collectively, "Investment Risk").

- Market Risk is the risk of loss as a result of changes in market conditions, whether those changes are caused by factors specific to the individual investment or factors affecting all investments traded in the market (eg. interest rate risk, equity risk, asset liquidity risk, fund liquidity risk, etc.).
- Credit Risk is the risk of loss arising from the failure of a counterparty or partner to fully honour its financial obligations.

Strategic Risk as it relates to investment decisions is included within the context of this Policy.

- Strategic Risk is the risk of loss arising from adverse investment decisions that affect the ability of the Fund to meet its short- and long-term objectives (eg. concentration risk, funding risk and benchmark risk).

This policy sets out the principles for managing OMERS Investment Risk in order to mitigate the Funds' main long-term risk that it cannot meet the obligations of the pension promise. Other risks inherent in OMERS investments, namely Operational, Strategic (other than concentration, funding and benchmark risk) and Legal & Compliance are managed as part of ongoing operations and assessed as part of the ERM program.

The link between risk and return implies that the search for investment returns and the management of Investment Risk cannot be separated. Indeed, the management of both is required to ensure the OAC is able to meet the Plans' benefit obligations at a reasonable cost and to ensure reasonable contribution rates over the long-term. Portfolio, investment and asset managers are responsible for understanding the Investment Risk in the various strategies and assets that they manage and invest in. Furthermore, they must ensure that the returns from those assets and strategies are commensurate with the risks involved. As a result, the Investment Entities are responsible for managing their Investment Risk and ensuring that the returns are commensurate with the amount of risk taken.

4. INVESTMENT RISK MANAGEMENT FRAMEWORK

The OAC's Investment Risk Management Framework is established through this policy and is expected to evolve over time to reflect enhancements in the measurement of Investment Risk for the Investment Entities and the Total Fund. The Investment Risk Management Framework, identified by the following five steps, allows the OAC to effectively manage its Investment Risk.

- Identify – Investment Risk inherent in assets must be identified both in absolute terms and relative to the objectives and strategies of each portfolio (i.e. what objective yardstick is the investment to be measured against).
- Measure/Assess – Investment Risk must be consistently and objectively measured or assessed.
- Manage – Investment Risk must be managed on an ongoing basis and returns should be commensurate with the risks taken.
- Report and Monitor – Investment Risk must be reported and monitored on a regular basis.
- Review – The effectiveness of the Investment Risk Management Framework must be reviewed in order to improve the OAC's ability to manage its Investment Risk.

Sections 5 to 9 expand on the five steps identified in the Investment Risk Management Framework.

5. INVESTMENT RISK IDENTIFICATION

Investment Risk must be identified relative to the objectives and strategies of each portfolio.

Total Fund

Investment Risk is identified at the Total Fund level as part of each Asset/Liability Study (“A/L Study”).

Public Markets

Investment Risk in public market assets is identified through fundamental assessment at the time of the initial investment and on an ongoing basis as part of the asset management and risk measurement process. Risks are further considered by establishing investment policies and investment guidelines.

Non-Public Markets

Investment Risk in non-public market assets is identified through an in-depth assessment during the due diligence/underwriting process and ongoing as part of the asset management process.

6. INVESTMENT RISK MEASUREMENT/ASSESSMENT

Risk measurement is an integral part of the Investment Risk Management Framework. Investment Risks are measured (quantitatively) and/or assessed (qualitatively) using an appropriate and consistent methodology established by each Investment Entity. The methods and factors used in the measurement or assessment of Investment Risk are reviewed on an ongoing basis. The Investment Entities are responsible for putting in place procedures for measuring (or assessing) and evaluating their Investment Risk.

Total Fund

Investment Risk is measured through the calculation of asset class and Total Fund volatility as part of each A/L Study.

Public Markets

Investment Risk in public market assets is measured on a regular basis through fundamental, credit and scenario analyses of portfolio investments and the analysis of financial and economic conditions. In addition, risk-based metrics (e.g. volatility, value-at-risk, duration, etc) and other variables are measured on a regular basis using internally and externally developed risk analytical tools.

Non-Public Markets

Investment Risk in non-public markets is assessed by financial and economic analysis by each Investment Entity. The assessment is performed during the initial due diligence and reviewed regularly as part of the ongoing asset management process. The assessment includes an analysis of, for example, factors such as industry dynamics and trends, geographic and industry diversification, historical performance of partners and co-investors, vacancy rates, capacity utilization rates and expected cash flows, as applicable.

7. INVESTMENT RISK MANAGEMENT

The objective of Investment Risk management is to help minimize unanticipated losses, to optimize the reward-risk trade-off for the Funds and to enhance the ability of the Plans to meet their respective obligations.

The Investment Entities are responsible for managing their Investment Risk and for ensuring that returns are commensurate with the risks taken.

The OAC utilizes a number of tools to manage its Investment Risk and achieve its desired level of risk at the enterprise, public market and non-public market levels.

Total Fund

Enterprise-wide Investment Risk management tools include:

1. Enterprise-Wide Policies. Enterprise-wide policies include the Statement of Investment Beliefs, the Statement of Investment Authorities (and related Sub-Delegations), the Statements of Investment Policies and Procedures, the Debt Policy, the Currency Hedging Policy, and this Policy. Enterprise-wide policies are reviewed and approved annually and monitored on a monthly basis with reporting to management.
2. Investment Performance Evaluation. All asset classes are evaluated against measurable investment objectives approved by the OAC Board adhering to the standards and guidelines set out by the CFA Institute. Investment performance is reported daily to management.
3. A/L Studies. Each A/L Study determines a long-term asset mix that is expected to generate a real rate of return necessary to meet the Plans' benefit obligations at a reasonable cost and is diversified among asset classes in order to reduce the variability of returns. An A/L Study will be completed no less frequently than every three years and take into account multiple factors such as the liability, economic and investment environment and incorporate stress and scenario testing of inputs and assumptions.
4. Actuarial Valuations and Projections. Fund actuarial valuations are used to determine the funded status of the Plans and are completed annually. Similarly, actuarial projections are completed annually to determine the sensitivity of the funded status of the Plans to various economic assumptions.
5. The OAC Economic Outlook. The OAC Economic Outlook, generated by the OAC Economic Outlook Committee, provides a projection of economic variables (e.g. Gross Domestic Product, Consumer Price Index, etc.) over the medium-horizon. On a semi-annual basis, the Economic Outlook identifies the major Investment Risks facing the Funds over the medium-term and can be used as an input into strategic and operating plans, A/L Studies and investment decisions such as portfolio rebalancing.
6. The Quarterly Investment Risk Report. The OMERS Quarterly Investment Risk Report, generated by the Investment Risk Management Committee ("IRMC"), provides OAC management and the Investment Committee ("IC") of the OAC Board with a consolidated view of the key investment risks (market, credit and key strategic risks that impact investment decisions) and exposures facing the Fund.
7. Liquidity Report. The Liquidity Risk Report provides a consolidated view of total Fund liquidity over a three-month to one-year period and incorporates scenario and stress testing.

Public Markets

Investment Risk in public market assets is managed through the following tools:

1. OCM Policies. Policies relating to investing in public markets set out Investment Risk management guidelines such as counterparty exposures, credit concentration limits, trading limits, approved credit issuers, the use of derivatives and risk limits for programs and asset classes. Policies are monitored daily with regular reporting to OCM management.
2. Risk Measurement. Volatility-based and other measures of risk are used on an ongoing basis and regularly reported to portfolio managers and OCM management.
3. Diversification. Public market investments are diversified by asset class, country, industry, sector, asset holding periods, currencies and securities, as appropriate in order to manage the variability of returns.
4. Asset Management Process. Fundamental, credit, scenario and other analyses of investments are reviewed regularly. These reviews are done as part of the ongoing management of an investment and also include periodic meetings with the management of investee companies and periodic updates to OCM management. A summary of key Investment Risks is incorporated into the Quarterly Investment Risk Report.

Non-Public Markets

Investment Risk in non-publicly traded assets is managed through the following tools:

1. Investment Entity Policies. Investment Entity policies, such as their debt policies which set out the degree to which non-publicly traded investments are levered, and the Enterprise Valuation of Private Investments Policy which sets out the valuation guidelines and principles for non-publicly traded investments, are reviewed and approved annually.
2. Due Diligence/Underwriting Process. Investment Risk assessments are reviewed as part of the due diligence process when evaluating potential new investments.
3. Diversification. Non-publicly traded investments are diversified by asset class, country and sector in order to manage the variability of returns.
4. Asset Management Process. Once the Investment Entities have completed the investment, Investment Risks are assessed quarterly or on an as needed basis depending on the economic/business environment and are reported in the quarterly reporting packages distributed within each Investment Entity. Information included in these assessments is based on information obtained by the Investment Entity from its periodic update calls, Board and co-investor meetings, as applicable and annual valuations, as the case may be. A summary of key Investment Risks is incorporated into the Quarterly Investment Risk Report.

8. RISK REPORTING AND MONITORING

IOA prepares and distributes:

- daily performance reports for all asset classes. Return calculations follow the standards and guidelines set out by the CFA Institute;
- monthly and quarterly risk reports for OCM, as required, with respect to limits for counterparty exposures, credit concentration limits, trading limits and approved credit issuers. Performance reports are prepared and distributed to management on a daily basis; and
- in collaboration with Investment Risk Management (“IRM”) and the Investment Entities, quarterly risk reports for the Enterprise Senior Leadership Team and the IC with respect to Total Fund exposures and compliance with Policies.

Where applicable, Investment Risk that is outside the approved range or limit must be reported as appropriate, with a rationale for the exception and a plan for bringing the investment back on-side or a recommendation to maintain the position in accordance with the applicable investment policy.

9. REVIEW OF IMPLEMENTATION OF INVESTMENT RISK MANAGEMENT FRAMEWORK

OAC and the Investment Entities must review the effectiveness of their implementation of the Investment Risk Management Framework regularly and implement changes, where appropriate. The effectiveness of the Investment Risk Management Framework is also integrated with the ERM program.

10. ROLES AND RESPONSIBILITIES

All investment-related employees are responsible for managing Investment Risk as appropriate. The key stakeholders responsible for implementing this policy include the CIO, the Investment Entities, IOA, IRM, the IRMC and the IC.

The Investment Entities identify, measure, manage and monitor their investment risks within prudent ranges commensurate with their investment objectives. The results of their Investment Risk management process are reviewed regularly and recommended changes, where appropriate, are implemented.

IOA produces and disseminates performance reports, ensures data integrity, monitors against limits and escalates any breaches to management of the Investment Entities as appropriate.

IRM, in collaboration with the Investment Entities, develops, reviews and recommends enterprise policies, risk measurement methods, the long-term strategic and annual asset mix targets and ranges,

currency hedging requirements and restrictions on the use of debt. IRM facilitates the preparation of the OAC economic outlook. IRM, together with IRMC members, regularly updates management of the Investment Entities of the development of Investment Risk management methods or procedures.

IRMC members participate in the research and development of Investment Risk methods (i.e. measurement) and the analysis of Investment Risk across OAC. IRMC members, together with IRM, also ensure their respective management is kept informed of the development of Investment Risk management methods or procedures.

The CIO ensures an appropriate and prudent level of Investment Risk is maintained.

The IC approves the Investment Risk Policy on an annual basis.

HISTORY

Effective Date: June 1, 2011
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