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New Disclosure Rules
For Executive Compensation

Benefits Buck Stops Here

DC Developments In The US

Benefits and Pensions Monitor
Volume 19, Number 7
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October 2009

Money Managers
2009 Report & Directory

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thing at all, who to marry, and on and on, life is a series of deciding which choice to make.

And imagine for a minute what life would be like if we went to the car dealership and there was just one model to choose from or in the grocery store there was only a single brand of tomato soup?

So we are we talking about choice.

Flash back to the CPBI regional conference season, which is now over, there was a session at one where the topic was Defined Contribution plans. Curiously, the previous year at another region’s conference, there was a session on the one fund approach to DC plans.

So when the various types of approaches to DC were being discussed at the event this year with no mention of the one fund approach, a speaker was asked their views on it.

Now, this is the concerning part. Their response was that they did not see it as a viable option because that option was not being presented to plan sponsors looking at alternative ways to deliver a DC golden years, based on the premise that most will do little or nothing to set aside some funds for retirement until it is too late.

Misguided Views

Still, this is not about the misguided views of a magazine editor. It is about providing those plan sponsors who want a pension plan or a retirement savings program the some alternatives to choose from. In this country, sponsors are depending on their third-party providers to give them the best advice possible. That means letting them see a choice of alternatives, offering the pros and cons on each, and letting them choose. Perhaps we need to remember that these sponsors are relying on the experts to help them make the best choice, not lead them to a personal favourite.

Perhaps if we had that approach, private sector pension coverage might be a little bit better.
MB Lifeplan™ Retirement Funds: Investment Planning Made Easy. McLean Budden’s ten MB LifePlan Retirement Funds for defined contribution plan members are ideal default funds for your clients who want a low risk, low maintenance investment solution. The key to the success of these ‘end-date’ funds is that each one changes its benchmark asset mix every quarter. In effect, the fund becomes progressively more conservative as it approaches the retirement date. These funds are available through The Co-operators, CUMIS Retirement Services, Standard Life and Sun Life Financial. To learn more about them, and our wide range of investment solutions and services, contact institutions@mcleanbudden.com or call us at +1 416 862 9800.

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Legg Mason

Irene Goryn is director with Legg Mason Canada’s client service and marketing team, based in Toronto, ON. Most recently, she led the investment consulting arm of CIBC Asset Management’s investment manager due diligence team.

IPP

Mark Crawford is a vice-president at IPP Inc., an actuarial consulting firm that specializes in the design and implementation of individual pension plans. Throughout his career, he has assumed senior roles for several large actuarial and benefit consulting firms. Most recently, he was manager of pension benefits for a large private employer.

NT Global Advisors

David Lester is head of institutional sales for asset management at NT Global Advisors, Inc., Canada. Previously with SEI Investments, his primary focus will be on manager-of-managers investment products including total investment management and administrative outsourcing solutions for Canadian pension plans, charitable organizations, and other institutions.

Integra

Ron Sinnaeve is vice-president, operations, for Integra GRS. He is responsible for all operational and administrative teams, client member service support, the recordkeeping technology that supports the business and related risk management, and governance.

CPPIB

Paul Winslow is vice-president and head of external portfolio management in the public market investments group at the CPP Investment Board. He leads the team responsible for selecting and managing relationships with external managers across a wide range of active mandates. Previously, he was chief investment officer of fund and manager selection at Nordea Investment Management.

Cordiant

Graeme Johnson is managing director of Cordiant. He will lead its investor relations group and participate in the investment process. Previously, he worked for the Deutsche Bank Group as managing director, head of Europe, in the private equity funds group.

Eckler

Chris Brisebois is an investment consultant in Eckler Ltd.’s Toronto, ON, office. He has 15 years of actuarial, pension, and investment management experience, and has worked for a large cross-section of clients including corporate, public sector and not-for-profit organizations, as well as multi-employer pension plans.

AIMA

Gary Ostoich is chair of the Alternative Investment Management Association – Canada. He is president of Spartan Fund Management which manages a multi-strategy hedge fund. He has been associated with AIMA Canada since it was established in 2003 and played an integral role in its founding as one of the organization’s initial executive committee members.

PIMCO

Jafer Naqvi is senior associate in the Toronto, ON, office of PIMCO Canada. In this newly-created role, he will service institutional clients and investment consultants. He was previously with Hewitt Associates’ investment consulting practice.

OMERS

Mark Redman is senior managing director, Europe, of OMERS Private Equity, a division of the Ontario Municipal Employees Retirement System. He will oversee the division’s direct investment strategy in Europe and will establish and lead the investment team in the sourcing, execution, and post-acquisition management of direct private equity transactions.
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Global Markets Transitioning

Global markets are transitioning to a new set of norms in the aftermath of the financial crisis and the new norms will fundamentally change investing and the concept of asset allocation, says Mohamed El-Erian, CEO and co-chief investment officer at PIMCO. The author of the book ‘When Markets Collide: Investment Strategies for the Age of Global Economic Change’ told a Toronto CFA Society session that the financial crisis shocked the core of the global financial system and that global markets will, ultimately, have lower growth potential. As well, new norms will change the concept of asset allocation. Rather than designing portfolios around different asset classes, investors will build portfolios based on risk classes, classifying their investments in terms of their exposure to equity risk, default risk, inflation risk, public policy risk, and other types of risk.

Signs Show Economic Decoupling

Signs of economic decoupling are starting to be seen, says Patricia Perez-Coutts, of AGF. Speaking at 2009 Ontario Regional CPBI Conference on ‘The New Frontier of Emerging Markets,’ she said emerging market economies are starting to trade more amongst themselves and are finding opportunities for growth without relying on the U.S. and other developed economies. She said structural reforms of the mid-‘90s have made the investment environment in these countries more stable. As well, this foundation has helped them to better weather the recent financial crisis. Still, she said the markets have yet to respond and she believes this offers a winning combination from a long-term perspective.

Lehman Failure Huge Mistake

Allowing Lehman Brothers to fail as the credit crisis was escalating was a huge mistake, says George Klar, of Alternativ Solution Inc. In a session entitled ‘After the Credit Crunch: Lessons on Asset Mix and Institutional Investing’ at the ‘2009 CPBI Western Regional Conference,’ he said Lehman was a huge player in the credit default swaps field and allowing it to fail meant that there was no facility to make trades. This escalated counter-party risk and resulted in increased costs of borrowing and an end to inter-bank lending. As a result, the market seized up and, since there was no credit available, a liquidity crisis ensued.

Quebec Offers Nortel Retirees Help

The Quebec government is offering to help Nortel Networks Corp. retirees by taking over management of their pension plan. It says it will amend provincial regulations to give the Régie des rentes du Québec the ability to manage assets for Nortel pension plan members in Quebec, if they approve the option. Almost 6,000 Nortel pension plan members are in Quebec. At current funding levels, they would receive 69 per cent of their pensions if their plan were wound up today. The Nortel plan has about $2.5 billion in assets and roughly $800 million belongs to the Quebec members.

PSHCP Keeps Sun Life

Sun Life Financial will continue to administer the federal government’s Public Service Health Care Plan (PSHCP). It was the first ranked bidder under a competitive government tendering process. Sun Life has been the administrator of the plan since 1996. The PSHCP is the largest employee benefit plan in Canada, representing three per cent of the group market share with more than 580,000 active and retired plan members.
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Managers Bullish On Canada

It looks as if more bearish managers are hibernating, even as the Canadian equity market continues to forge ahead in the third quarter of 2009, says the quarterly Russell ‘Investment Manager Outlook.’ The Canadian market has risen fastest among the world’s developed economies this year, but that hasn’t dimmed the optimism of most investment managers. A solid 65 per cent remain bullish towards broad market Canadian equities, and bears have dropped from 26 per cent in the second quarter to just 18 per cent in the third quarter of 2009. Meanwhile, Canadian bonds are finding very few takers as 63 per cent of managers are bearish on fixed income.

Financial Community Grows

LeeSide Capital Management has joined the Atlantic Canada financial community. Based in Halifax, NS, with an office in Saint John, NB, it is led by three money management professionals with a track record that spans more than 20 years – Robert McKim, George Loughery, and Don Wishart. It has a risk-averse approach to investment and a philosophy that patience and continuous research are fundamental steps to success as it invests in high quality equities and holds them for the long-term.

BIMCOR Outsources Holdings

BIMCOR, manager of BCE Inc.’s pension fund, is outsourcing day-to-day management of its Canadian and U.S. equity and short- and mid-term corporate bond holdings as part of its efforts to cut costs. It has laid off about 12 money managers and traders as result of the change. It will continue to focus on investment strategy and oversight and will also retain responsibility for risk management and investment in long government bonds. BIMCOR manages about $13 billion in assets.

Addendum

The following listing was not available for the Socially Responsible Investment Directory in the September issue of Benefits and Pensions Monitor:

TD ASSET MANAGEMENT INC.* Robin Lacey, Head of Relationship Management; 161 Bay St., 34th Floor, Toronto, ON M5J 2T2 PH: 416-982-6585 Fax: 416-944-6158 eMail: Robin.Lacey@tdam.com Web: www.tdas- setmanagement.com Managed Since: 2007 SRI Philosophy/Style: Offers investors access to companies that are leaders in developing products and services that directly benefit the environment. Portfolio is a combination of stable global leaders in corporate sustainability, plus the growth potential of emerging environmental and technological innovators.

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For more information: www.mawer.com (800) 889-6248

PIAC Honours Bertram

Robert Bertram has received the Pension Investment Association of Canada’s highest honour — the Chuck Harvie Award for Distinguished Service. Bertram served on the PIAC board twice during his long career, once representing Telus and once representing Ontario Teachers, becoming chair of the board in 1997. He led the task force that documented its pension fund governance best practices which was presented to the federal government.

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\[
\sum_{i=1}^{11} \left( \max(\alpha_i) + \min(\sigma_i^2) \right)
\]

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Robert Leblanc, Vice President  
robert.leblanc@invesco.com | 514.350.1557

Chris Walker, Vice President  
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The need for comprehensive workplace wellness programs is certainly catching on among organizations. Out of a broad cross-section of 634 Canadian businesses surveyed for Buffett & Company’s ‘National Wellness Survey Report 2009,’ 91 per cent said they are currently offering wellness plans. The results also show that since 1997, there has been a 47 per cent increase in the number of organizations implementing such initiatives.

A Long Way
Wellness within the workplace has definitely come a long way, says Judy Middlemiss, Canada Post’s manager of employee health and well-being.

Above all, she says a workplace wellness plan should be based on employee needs and interests. This can be determined by a variety of ways — you just need to look for the best way in your organization. Prevention focused and targeted activities will help, in the long term, to address the issues of most concern. Participation is, of course, on a voluntary basis.

“Nobody’s arms are twisted to participate, but if you can raise awareness, peak curiosity, and help show employees that they can take advantage of certain things, then they may make those important lifestyle changes.”

Along with smoking cessation services, nutrition resources, and gym membership discounts, her group is keenly focused on mental health and stress management. In conjunction with the launch of the Canada Post Foundation for Mental Health in 2007 (a charitable Foundation which gives money for projects that have a direct impact right on the front-line, helping people learn to cope with and receive treatment for mental illness), Canada Post also launched several tools and resources to raise awareness and provide support for their own people, through their employee assistance program as well as community resources.

With more than 70,000 workers across Canada, however, one of the biggest challenges is communicating these initiatives equally to everyone, Middlemiss says. To connect with such a wide range of employees, in varying types of roles, she says it tries to deliver its health and wellness messages through “a combination of different vehicles,” including online resources and a number of print magazines and booklets, since many postal workers are mobile and don’t have ready access to a computer at work.

Generating participation among all parts of an organization also continues to be a challenge for Tina Jansons, senior HR advisor for BC Biomedical Laboratories Ltd. With about 700 employees located at one main lab, as well as various other patient service centres in BC’s Lower Mainland area, promoting wellness to everyone can be tricky.

Although it doesn’t yet have a formal health and wellness program in place, she says her company has been running campaigns – such as annual health fairs, walking challenges, and wellness newsletters – for three years now. According to ideas on the Internet, what other organizations are doing, and based on the majority of claims appearing, mental health seems to be a key area of concern, Jansons says. So minimizing stress by encouraging fitness, nutrition, and overall enjoyment at work remains the focus going forward for the company.

Focusing Approach
Calgary-based producer of natural gas, EnCana, has become “very focused in its approach” to its 6,000 employees, says Catherine Nelson, lead, health and wellness, corporate services for the company. Its program now varies from year to year according to new priorities and data drawn out from counselling, short-term disability trends, or specific work-group requests.

EnCana’s corporate constitution has emphasized work/life balance since its formation seven years ago, Nelson says, so wellness is a highly important element throughout the organization. Just as Jansons and Middlemiss point out, its main objective is also to provide equal access to as many employees as possible, “including those in our field offices,” Nelson says. It focuses on “self-responsibility” and involves providing the tools needed to support changes employees wish to make to improve their lives.

Those tools include a number of web-based health and wellness resources for self-assessments, a wellness portal, lunch’n learns, fitness classes, and schedule adjustments to accommodate its work/life balance philosophy.
Privately placed fixed income securities (or private placements) are typically issued as fixed rate bonds by public or private companies and are exempt from the reporting requirements associated with public securities. Generally not rated by the major rating agencies, private placements are usually structured as ‘club deals’ and syndicated by financial intermediaries to banks and life insurance companies, with limited participation by pension funds.

In recent years, several rated private placements have been purchased by money managers and pension funds. While the size of these rated issues tends to be relatively large, they are infrequently issued in the Canadian marketplace. However, as governments at all levels move toward a massive investment in infrastructure, the unrated private placement market represents a major investment opportunity for Canadian pension funds.

Vehicle Of Choice

The unrated private placement market is the vehicle of choice for project and infrastructure financing as it makes it easy to accommodate the structural and contractual arrangements between multiple parties. Investing in unrated private placements will allow pension funds to reap yield enhancement from BBB to A as the level of capital required by rating agencies to achieve an internal investment grade credit rating ranging from BBB to A as the level of capital required by financial institution regulators to hold below investment grade securities is quite onerous. Investing in private placements will allow pension funds to reap benefits such as:

- **Yield enhancement**: Private placements consistently yield 30 to 60 basis points or more than similarly rated public bonds with the same maturity due to the perceived illiquid nature of the instrument.
- **Asset/Liability Matching**: Project and infrastructure financings can offer maturities of up to 40 years, depending on the underlying assets and contracts. This provides pension funds with a steady stream of long-term cash flows to satisfy actuarial liabilities.
- **Diversification**: Private placements offer increased exposure to issuers and structures not available in the public bond market.

Pension funds have a few options to gain exposure to the private placement market. The ideal option will ultimately depend on the size of the funds’ commitment to the asset class. Pension funds with a large annual program may prefer to hire in-house specialists to conduct due diligence on transactions sourced either directly or through specialized investment dealers. Small to mid-sized pension funds may prefer to extend their Canadian fixed income manager’s mandate to include private placements provided that the manager has the necessary credit related skills. Otherwise, pension funds may prefer to invest in private placements through a fund or a dedicated manager.

Investment Process

Given that private placements are negotiated instruments, the investment process typically lasts several weeks from the moment the offering memorandum is issued to financial close. Significant due diligence is performed on the project and related material documents, but it is an interactive process with lenders having access to their legal counsel and independent consultants (insurance specialists, engineers, quantity surveyors, etc.) which helps them in their investment decisions.

This in-depth analysis leads to better performance versus public bonds, as clearly demonstrated by the results of a comprehensive private placement performance study conducted by the American Society of Actuaries. The study illustrates that public bonds lost an average of 82 basis points annually during the 12-year study period through defaults, while private placements lost 26 basis points annually on defaults, with lenders having access to their legal counsel and independent consultants.

Not only can private placements offer pension funds incremental yield and enhanced credit protection, they also provide more investment opportunities suitable for a fund’s long-term liability matching objectives.

**The Case For Private Fixed Income**

![Graph showing performance of FTSE RAFI Canada Index versus S&P/TSX 60 Index]

<table>
<thead>
<tr>
<th>Index Name</th>
<th>5-Year 10-Year 3-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>FTSE RAFI Canada Index</td>
<td>-1.40% 4.56% 9.32%</td>
</tr>
<tr>
<td>S&amp;P/TSX 60 Index</td>
<td>-16.70% 1.88% 9.31%</td>
</tr>
<tr>
<td>Outperformance</td>
<td>15.29% 2.68% 0.62%</td>
</tr>
<tr>
<td>FTSE RAFI US 500 Index</td>
<td>-8.54% -6.70% -2.44%</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>-15.68% -7.61% -4.19%</td>
</tr>
<tr>
<td>Outperformance</td>
<td>7.54% 0.91% 1.39%</td>
</tr>
<tr>
<td>FTSE RAFI Developed ex US 1000 Index</td>
<td>-10.54% -3.17% 3.67%</td>
</tr>
<tr>
<td>MSCI EAFE Index</td>
<td>-17.99% -6.56% 1.02%</td>
</tr>
<tr>
<td>Outperformance</td>
<td>7.45% 3.38% 2.66%</td>
</tr>
</tbody>
</table>

Because of the nature of the investors, Canadian private placements are typically structured to generate an internal investment grade credit rating ranging from BBB to A as the level of capital required by financial institution regulators to hold below investment grade securities is quite onerous. Investing in private placements will allow pension funds to reap benefits such as:

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Benefits and Pensions MONITOR

Benefits CANADA
Good oral health goes beyond the notion of just having a nice smile. While a healthy mouth does not guarantee overall wellness, it can often safeguard against diseases and infection. Over the years, medical research has shown that our mouths actually work to protect us from harmful bacteria entering our bloodstream. In fact, research has shown that 90 per cent of systemic health problems are actually identified as a result of dental symptoms.

The Rising Costs Of Dental Coverage

In 2000, the cost of dental care in Canada was estimated at $6.4 billion, but only 14 per cent of these costs were paid by public funds, the rest fell on companies and private individuals. In 2009, when the provincial and territorial dental associations released their annual fee guides, there were new increases of between two per cent and 4.95 per cent. It’s no surprise that Canadian Institute for Health Information (CIHI) reports now show that total employer dental plan costs have recently increased by seven per cent or more.

The main cost contributor remains the high rate of utilization. More people are visiting the dentist for both routine work, as well as cosmetic oral purposes. However, it has also been suggested that cost increases may have been driven by marketing efforts of dentists which have initiated consumer desires for whiter teeth and a more cosmetically pleasing smile. While the affects of promoting dental care in the workplace may seem indirect, ensuring access to adequate dental coverage can, by virtue of its impact on good health, ultimately result in a decrease in lost time due to illness. Indeed, employers play a major role in protecting the oral health of their workers with their contributions to employee dental plans. Research actually shows that people with dental coverage are 2.7 times more likely to receive dental care and treatment. Correspondingly, a lack of access to dental benefits has been shown to increase an individual’s health risk.

If your company is able to offer a dental plan, one of the key issues is to help employees understand the type of information and funding assistance that is available to meet their needs. Dental plans often vary in terms of coverage and explanations are often critical to understanding treatment and obtaining compliance. Dental check-ups that include regular examinations, X-rays, and cleaning are encouraged for every six to nine months so that dentists can provide the best possible care. Even if a co-pay is required, other treatments should be identified, explained, and encouraged to promote overall employee wellness through good oral hygiene.

Although dental plan cost increases may parallel overall health plan trends, there are important differences in how the dental plan is viewed by both employees and employers. Whereas health benefits are more often seen by the consumer as insurance, triggered into action to a health incident such as a sore throat or an ache or pain, dental coverage is generally viewed as a benefit used primarily for diagnosis and prevention. From the employer’s perspective, dental plans often have a broader impact and more frequent participation. Experts suggest that this can lead to a higher perceived value of the benefit by employees and certain contribute to the overall wellness objective of reducing health risks company-wide.

More Reluctant

This explains why many employers are more reluctant to reduce dental plan provisions than other health plan benefits, despite the obvious difficulties in cost containment and management. Employers are also aware that dental care is highly prized and it can be utilized as a component in their human resource strategy for attracting and retaining skilled employees.

In today’s workplace, employees are increasingly aware of the range of treatments and specialists available for dental care, but they often procrastinate or lack the understanding of the inherent risks of poor dental care. Regardless of the type of coverage available, employers and HR professional can encourage good individual oral health habits by inviting dental hygienists or dentists to conduct workplace clinics and include materials in newsletters or on simple bulletin board postings. Simple tips can be sent via email or friendly reminder postings to spread awareness on the importance of oral health to employees and their families.
an administrators are often consumed by the search for superior investment performance. This is the Holy Grail of the pension investment business and, like the search for the Holy Grail, it is potentially dangerous and possibly self-destructive.

The search for superior investment performance, or alpha as we like to call it, is founded in mythology in the same way as any other treasure hunt. The myth is, firstly, that such treasure actually exists and, secondly, that we have the means to find it.

With regard to the existence of a reliable source of superior investment returns, we know at the outset that most investors must be frustrated in their search. William Sharpe pointed this out some time ago in a brief article entitled ‘The Arithmetic of Active Management.’ Outperformance relative to the market is a zero-sum game. Since all investors, collectively, are the market, we would expect that only half the investors could ever beat the market on a value-weighted basis before fees. After fees, we would expect active management to be a losing proposition for most investors.

Superior Investor

Of course, the fact that most investors will fail to beat the market does not disprove the existence of a superior investor. The existence of a superior investor – one who consistently outperforms the market – is questionable, however, since for the superior investor to exist, we will need a continuous stream of inferior investors willing to underperform so that the superior investor might profit at their expense. Over time, one would think that the inferior investors would become discouraged and stop handing over their money or at the very least eventually have less money with which to fund the

The Myth Of Outperformance

the market to be evidence of investment manager skill.

If manager skill does exist as a significant factor in explaining investment returns, it is dwarfed by style and sheer randomness. We are unlikely to ever have enough performance data to statistically prove an investment manager’s skill.

In their textbook ‘Investments,’ Bodie, Kane, and Marcus have provided a calculation to illustrate this fact. They assumed an investment manager who consistently provided added value of 0.2 per cent per month and calculated how many months of data would be required to statistically prove that the outperformance was not just a random occurrence. The answer was 384 months (32 years) of data. And to achieve this, they had to assume constant added value, stable population parameters, and the fact that we are sampling from the same population over
the entire period – complete organizational stability, no personnel turnover, no one ages or becomes less motivated, etc.

Clearly, we can’t really prove anything about an investment manager from its performance numbers. So even if the superior investor does exist, there is no reason to believe that a plan administrator will be able to find this superior investor.

Of course, in any given period, some investment managers will outperform others and, from the plan administrator’s point of view, it really does not matter whether the outperformance comes from style, skill, or luck. Superior investment performance will still help the pension plan’s funded position. However, plan administrators who expect to be able to regularly beat the markets and, worse yet, are counting on this outperformance to bail their plans out of funding difficulties, are kidding themselves.

Expecting to achieve superior investment performance is not only delusional, it is also potentially harmful. It frustrates proper planning by creating unrealistic expectations and it wastes the plan administrator’s time. The decision-making body overseeing the management of the pension fund typically only meets monthly or quarterly, and sometimes less often. This committee’s time is a very scarce commodity.

Some of the larger pension plans now delegate manager search, hiring, and monitoring functions to staff. Yet, many plan administrators still believe the myth of outperformance and, therefore, allocate too much of their scarce resources in a never-ending search for more brilliant investment management. If precious time is wasted meeting with investment managers and chasing outperformance, then other, more important, investment issues are likely to receive less than an adequate amount of attention. Specifically, the top decision-making body’s focus should be on policy and on fund governance.

In the long run, a greater focus on investment policy is more likely to achieve the plan’s objective of minimizing funding costs by maximizing returns, while keeping the shorter-term funding volatility within an acceptable range. In an article entitled ‘Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance,’ Ibbotson and Kaplan concluded that, on average, asset allocation policy explained 100 per cent of the level of returns in both pension funds and mutual funds.

Of course, some managers outperformed and some underperformed over the specific periods examined. Only 35 and 40 per cent of return differences between pension funds and mutual funds, respectively, were explained by asset mix policy differences. However, since many other studies have demonstrated that performance differences between managers based on market timing and security selection tend to be unreliable, these differences are likely to wash out over time. In the long run, deciding in which markets to invest is clearly the most important, if not the only important, performance factor.

Proper Due Diligence

The decision to hire an investment manager, as with any investment decision, requires a reasonable basis and, therefore, must be supported by an appropriate level of due diligence. Given the time and expertise required, this task is best delegated either to staff or to an external agent. The primary focus of the plan’s governing committee should not be on trying to pick the most brilliant manager, but rather on ensuring that the delegation process is appropriate. This includes ensuring that there has been proper due diligence, that the standard of care of the new hire supports the plan administrator’s standard of care, that the role of the new hire is clearly defined (including performance expectations, reporting requirements, fees, and other costs), that the termination provisions are acceptable, that proper controls are in place to safeguard the assets, and that there are no unacceptable risk exposures to the plan that might arise from this new hire.

The Cost

The result of chasing investment performance, in a few worst cases, has been Ponzi schemes or assets disappearing in other ways, either fraudulently or more subtly, through exorbitant fees and expenses. Anecdotally, I heard of a U.S.-based hedge fund of funds whose total fees and expenses exceeded 11 per cent per annum. The investors in this fund were clearly blinded by their desire to achieve superior performance.

In general, belief in the myth of outperformance impedes the effective management of the pension plan in the area of cost control. While a double-digit management expense ratio may be an extreme example, there are many plans in Canada that have increased their overall management fees in the last several years in an attempt to achieve higher investment returns. The increase in fees may be justified if it is necessary to achieve exposure to different markets that better enable the plan to achieve its objectives. However, if increased fees are motivated by an attempt to employ more brilliant investment management within the asset classes, it is a dubious strategy.

The view that the brilliance of the investment manager is really not that important is likely to remain a minority position. A large number of market participants have a vested interest in convincing investors that superior investment performance does exist and that their firm offers it, or can help you find it. In an industry that appears to be more than 90 per cent sales effort, and less than 10 per cent substance, plan administrators will continue to be constantly bombarded with the view that superior investment performance does exist, and everyone else’s pension fund is taking advantage of it. In the same way as winners at the casino appear to be more prevalent than losers, outperforming investment managers always appear to be much more prevalent than those who are underperforming.

Paradoxically, the reason why superior investment performance will likely not provide any long-term benefit to pension funds is that the entire industry believes it will. If we actually ever get to the point where most investors give up trying to outperform the markets, this could create inefficiencies that intelligent investors might actually be able to exploit, at least temporarily.

Until that day comes, it is best if plan administrators focus on investment policy and fund governance and keep the distraction of seeking outperformance to a minimum.

Design an investment policy that will achieve the plan’s investment objectives through proper exposure to various market returns. Do not look to superior investment performance to fill in the gap between what the actuary says you need and what the markets are expected to provide. And ensure that the plan is well-managed, with effective delegation and appropriate controls.

The myth of outperformance will always be with us. It is the wise plan administrator who chooses to ignore it.

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A Cost-Efficient Method of Maintaining Market Exposure and Raising Cash

By Ross McLellan and Andrew Carrington

Mid turbulent markets, investment plans must be able to reallocate their portfolios to meet unforeseen contingencies. This means raising cash as expeditiously as possible without doing damage to their meticulously constructed portfolios.

Even in normal trading markets, raising cash to meet routine funding requirements can be problematic. But, this function grows more complex in times of high turbulence.

As the equity indices plunged in late 2008, asset owners seeking to raise cash found themselves unable to access traditional sources of liquidity. Turbulent trading rendered fixed income markets illiquid, particularly those for asset-backed securities. Only the safest sovereign debt and high grade corporate and mortgage products found a ready market.

Equity index funds, another traditional source of cash-raising, also faced issues during the market turmoil. Most pension funds with holdings in equity index instruments were participating in securities lending programs to increase returns in compliance with their fiduciary responsibilities.

The traditional method of instructing managers to liquidate investment holdings can create significant explicit transaction costs when trading at market rates. This type of liquidation can also incur substantial implicit costs, in the form of market impact, when shares are executed too quickly, as well as opportunity costs, while funds wait for trades to settle. In volatile markets, with prices often swinging by hundreds of basis points per trading day, these opportunity costs can, in only a few days’ trading, wipe out expected returns for an entire year.

Cost-Efficient Derivative Overlay

For investment plans that need to access cash on a timely basis while maintaining their market exposure, derivative overlays are a cost-efficient solution.

The object of the derivative overlay is to develop an exposure management process that allows for optimized exposure to markets and beta opportunities, along with the flexibility of raising cash on a systematic basis to use for benefits payments, spending requirements or for private equity cash calls. The structure also allows for efficient maintenance of desired exposures in times of sudden market correction.

Comprised of both real and synthetic securities, this portfolio allocation structure includes dedicated liquidity accounts sufficient to cover expected cash requirements for short to medium-term needs. Asset owners should determine optimal exposure amounts, specific trading instructions and investment benchmarks, with portfolio managers determining the composition of derivative baskets based on the desired benchmark.

Derivative overlay programs have the additional advantage of allowing investment funds to focus on best execution. For example, it is understood that off-exchange crossing of equity securities is a cost-efficient means of portfolio reallocation or liquidation. But, crossing takes time and can be less available during periods of market turbulence and herding.

The derivative overlay structure allows funds to cross as many trades as possible, thereby controlling transaction costs, including commissions, spreads and market impact. As crossing takes place during the initial liquidation process, exposure is constantly maintained by the simultaneous purchase of derivative contracts and sale of physical instruments.

The challenge of balancing desired portfolio allocations with flexible access to cash is not likely to disappear any time soon. Many defined benefit pensions at a mature phase of their growth must undertake substantial and regular cash payments to beneficiaries. And as asset owners dedicate increasingly large proportions of their portfolios to such less-liquid alternative investments as hedge funds and private equity investments, they will struggle with diminishing investment volumes in the sectors that have historically been tapped for cash.

Perhaps the greatest benefit of derivative overlay strategies is that they provide investment funds with time and space to focus on their fiduciary responsibilities. Funds that use these techniques can liquidate their assets in a measured and rational manner, judiciously considering asset classes, managers and trading methodologies while complying with their cash-based responsibilities, all without the distraction of illiquid, herding markets.

Derivative overlays impose rigorous operational efficiency on routine cash-raising and render turbulent markets more “normal,” thereby allowing asset owners to focus on their long-term goals, not the tactical challenges of illiquid and volatile markets.

With global markets more interconnected and faster-moving than ever, no one can afford to discount the possibility of new market shocks and liquidity crises that can wreak havoc on traditional methods of raising cash for complying with periodic funding requirements for endowments, benefit payments for pension funds and capital calls related to growing alternative allocations. Derivative overlay strategies can do much to prepare portfolios for the next over-the-horizon market dislocation.

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ROSSÉAU ASSET MANAGEMENT LTD.

RUSSELL INVESTMENTS CANADA
Mike Sandrasagra, Senior Client Executive, Americas, Institutional (Canada); 100 King St. W., Ste. 5900, Toronto, ON M5X 1E4 Ph: 416-362-8411 Fax: 416-362-4494 email: msandrasagra@russell.com Web: www.russell.com/ca Investment Professionals: 252 Established: 1986

SCEPTRE INVESTMENT COUNSEL LIMITED
David Pennycook, President; 26 Wellington St. E., Ste. 1200, Toronto, ON M5E 1W4 Ph: 416-601-9898 Fax: 416-367-8716 email: dpennycook@sceptre.ca Web: www.sceptre.ca Investment Professionals: 18 Established: 1971

SCHRODER INVESTMENT MANAGEMENT NORTH AMERICA, INC.

SCOTIA CASSELS INVESTMENT COUNSEL LTD.
Ed Calicchia, Director & Portfolio Manager; One Queen St. E., Toronto, ON M5C 2W5 Ph: 416-933-2238 Fax: 416-933-7481 email: eddie_calicchia@scotiacassels.com Web: www.scotiacassels.com Investment Professionals: 41 Established: 1877

SEAMARK ASSET MANAGEMENT LTD.
Darren Kosack, Senior Vice-president, Client Relations & Marketing; 1801 Hollis St., Ste. 310, Halifax, NS B3J 3N4 Ph: 902-303-5055 Fax: 902-423-1518 email: dkosack@seamark.ca Web: www.seamark.ca Investment Professionals: 8 Established: 1982

SEI INVESTMENTS
Terry Cameron, Marketing Director; 70 York St., Ste. 1600, Toronto, ON M5J 1S9 Ph: 416-777-9700 Fax: 416-777-9093 email: tlicameron@seic.com Web: www.seic.com Investment Professionals: 94 Established: 1968
SSQ FINANCIAL GROUP  
Martin Leclair, Vice-president, Business Development; 121 King St. W., Ste. 730, Toronto, ON M5H 3L9  
PH: 416-580-9916  
Fax: 877-669-1881  
etail@ssq.ca  
Web: www.ssq.ca  
Investment Professionals: 53  
(includes US Equity Team in Boston)  
Established: 1973

TD ASSET MANAGEMENT INC.*  
Robin Lacey, Head of Relationship Management; 161 Bay St.,  
34th Floor, Toronto, ON M5J 2T2  
PH: 416-982-6585  
Fax: 416-944-6158  
etail@tdcm.com  
Web: www.tdcm.com  
Investment Professionals: 68  
Established: 1987

TETREM CAPITAL MANAGEMENT LTD.  
Robert Veloso, Manager, Consulting Services (Twenty-First Century Investments);  
1450-201 Portage Ave., Winnipeg, MB R3B 3K6  
PH: 416-364-9993  
x113 Fax: 416-364-1218  
etail@invest21.com  
Web: www.tetrem.com  
Investment Professionals: 8  
Established: 2004

WELLINGTON MANAGEMENT COMPANY, LLP  
Susan Pozer, Vice-president; 75 State St., Boston,  
MA 02109  
PH: 617-790-7441  
etail@willington.com  
Web: www.wellington.com  
Investment Professionals: 486  
Established: 1928

WISE CAPITAL MANAGEMENT INC.  
Samuel Wiseman, Chief Investment Officer; 1305 - 2200  
Yonge St., Toronto, ON M4S 2H4  
PH: 416-483-1900  
Fax: 416-483-1930  
etail@wisecapitalmanagement.com  
Web: www.wisecapitalmanagement.com  
Investment Professionals: 3  
Established: 2001
AWARD-WINNING PRIVATE EQUITY DEALS

2009 & 2008 DEAL OF THE YEAR

CLAIRVEST

Investments returning much more than expected. Investments delivering far beyond the reward for the risk assumed. Truly superior investments earning coveted “alpha returns” that measure performance and define success of active managers in Canada’s private equity industry. Every year, CVCA – Canada’s Venture Capital & Private Equity Association recognizes and celebrates the achievements of CVCA members achieving outstanding investment success. The CVCA’s annual “Deal of the Year Award” competition in the private equity category selects winners with the most significant return during the twelve months ending June 30th.

2007 DEAL OF THE YEAR

The company with the best return in 2007 was HSBC Capital (Canada) Inc. The merchant banking subsidiary of HSBC Bank Canada won CVCA’s 2007 “Deal of the Year Award” in the private equity category for its investment in Encore Group. HSBC Capital’s March 2004 investment, divested in February 2007, generated an internal rate of return of 230.69% and a multiple of 10 times investment.

CVCA

Representing the industry for over 35 years, CVCA - Canada’s Venture Capital & Private Equity Association represents more than 1800 individual members. Its member funds manage the majority of Canada’s pool of capital designated to be committed to venture capital and private equity investments. CVCA members collectively manage over $75 billion.

Discover why investing in CVCA members has been the smart move for many pension fund managers – and find new Canadian investment opportunities that can achieve those truly superior “alpha returns.”
<table>
<thead>
<tr>
<th>Company</th>
<th>Investment Assets</th>
<th>Other Assets</th>
<th>Foundation/Non-Profit</th>
<th>Private Client</th>
<th>Retail Mutual Fund</th>
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# 2009 Statistical Report Money Managers

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<th>Canadian Fixed Income</th>
<th>US Equity</th>
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Benefits and Pensions Monitor – October 2009
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<th>Minimum Investment</th>
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1. All dollar amounts in C$M, unless otherwise indicated.
2. "Other Manager Assets" includes all assets not specifically allocated to other categories.

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**Investment Assets**

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**Manager**

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| LONDON CAPITAL MANAGEMENT LTD.              | $12,066.2M| $5M        | $25M            | $1,458.1M            | $394.90   | $523.6M       | $182.6M | $1,086M | $73M                  | $884M                   | $122M      | $530M      | $452.6M   | $12,066.2M $5M $25M $1,458.1M $394.90 $523.6M $182.6M $1,086M $73M $884M $122M $530M $452.6M |}

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Benefits and Pensions Monitor – October 2009
### 2009 Statistical Report

#### Money Managers

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<tr>
<th>Company</th>
<th>Investment Assets</th>
<th>DC Pension</th>
<th>Other Manager Assets</th>
<th>Foundation/Non-profit</th>
<th>Private Client</th>
<th>Retail Mutual Fund</th>
<th>Other Total</th>
<th>Minimum Investment</th>
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For additional information, please contact Kevin O’Neill at 416-507-3221 or kevin_onell@standardandpoors.com.

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## 2009 Statistical Report

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<td>$36M</td>
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Sustainable and responsible investment (SRI) is an investment strategy that systematically and proactively takes into consideration environmental, social, and governance (ESG) criteria in making investment decisions.

Over the years, SRI has evolved substantially, as have the different approaches to it. One of the most widely used these days is the ‘best-in-class’ approach, which involves selecting the best companies in any given sector with regard to sustainable development.

**Engagement Approach**

The thematic approach, on the other hand, is designed to select the best companies according to specific sustainability themes. The engagement approach involves a willingness to bring about change by voting at general meetings or dialoguing with companies on sustainability-related issues. The norms-based approach aims to select companies that comply with major international treaties and conventions whereas the ethical approach consists of filtering out companies embroiled in controversial activities or issues such as tobacco, gambling, and animal testing.

On the funds front, the micro-credit approach contributes to the growth of micro-lending institutions in emerging markets and help small entrepreneurs become self-sufficient whereas the solidarity approach invests in solidarity projects.

Generally, SRI solutions entail a combination of the approaches mentioned above. However, we believe it is not only purely financial criteria – such as turnover and margin growth – that influence a company’s long-term value. By taking into consideration criteria that are not purely financial, we can identify elements that have an impact on a company’s long-term value and competitive position, but are not always captured in traditional financial analysis. At the same time, the sustainable management of funds also relies on traditional financial analysis to identify the very best opportunities.

The combination of sound financial performance and sustainable criteria makes SRI a solid way of investing for the long term for any type of investor who wants a true and valuable alternative to traditional management.

**Sustainable Criteria**

The marketplace has become increasingly aware of these sustainable criteria and has made SRI investments grow at a stellar pace over the past few years. And very importantly, numerous studies have shown that sustainability does not compromise returns in the long run and might even have some positive impact on performance.

We believe two major trends are important in the current environment. First of all, the need for increased transparency and secondly, in view of the Copenhagen summit, climate change.

In these torrid times, asset owners are – rightfully so – demanding more from corporations. We believe the financial crisis and the ensuing problems we have experienced on global capital markets, has raised investors’ awareness on three key levels, with regard to corporations.

First of all, investors will require higher standards of transparency from corporations in terms of financial, but also in terms of ESG, reporting. For instance, it will become of paramount importance for companies to disclose key performance indicators (KPI) such as how they score with regard to ESG criteria such as CO2 emission, water consumption, training, and career management, to name but a few. The way companies disclose what they do enables other market participants to get a grip on their initiatives and be able to analyze them. This increases companies’ accountability.

Next, the crisis will spur better corporate governance, for instance through enhancing incentive policies. We believe remuneration and executive bonuses...
must clearly be linked to long-term value creation and not to short-term performance. As we have seen in the past, short-term approaches cause a disconnect between the interests of management and those of the company and its stakeholders. The challenge is, therefore, to define relevant criteria and key performance indicators (both financial, operational as ESG) to be implemented. Long-term KPI will be an incentive for management executives to align the interests of management, shareholders, and other stakeholders in the company to create long term success.

More Salient

Finally, the emphasis on sustainable business model will become more salient. This dovetails with the tenet of sustainable development – making sure companies grow without compromising the interests of current stakeholders and future generations.

We believe there are two dimensions to reaching this goal. First of all, companies should position themselves to long-term challenges such as climate change, aging populations, and resource depletion. Secondly, they must make sure the interests of their stakeholders (employees, investors, suppliers, the community, etc.) are respected. Only if these criteria are met, can true sustainable value be generated in the long run.

SRI funds perfectly address these challenges because they take into account the requirements of sustainable development. We believe SRI will grow and become more and more relevant going forward. The popularity of sustainable investing has not suffered under the crisis, on the contrary!

Climate Change

Between December 7 and December 18, 2009, the 15th United Nations Climate Change Conference will take place in Copenhagen, Denmark. Nearly 200 states are to meet to draft the international treaty which will replace the Kyoto Protocol, expiring in 2012. Also, many third parties – including industrial lobby groups, NGOs, unions, climatologists, etc. – will join the debate. The stakes are very high as the new protocol will determine the world’s objectives in order to mitigate climate change and to decarbonize the world economy.

In 1997, while the United States signed the Kyoto Protocol, Bill Clinton’s administration never succeeded in getting the support of the U.S. Congress to ratify it. The following U.S. president, George W Bush, maintained a stance that the protocol would significantly hamper the U.S. economy and that emerging economies should make more efforts. Fortunately, the current president, Barack Obama, seems to be more favourable towards tackling climate change. The House of Representatives passed an historic American Clean Energy and Security Act in June that plans to reduce U.S. greenhouse gas (GHG) emissions by 17 per cent below 2005 levels by 2020.

Less Ambitious

While this is clearly a move in the right direction, these targets are less ambitious compared to other developed economies which have also committed to progress on this issue. For instance, the European Union’s goal is to cut GHG emissions by 20 per cent below 1990 levels by 2020 (and by up to 30 per cent if an international agreement is reached).

Let’s not forget that developing nations have a large stake in curbing greenhouse gas emissions as well. The emergence of China as an economic powerhouse should not be discarded. The booming Chinese economy has recently overtaken the U.S. as the largest emitter of carbon dioxide in the world. Nonetheless, China, like the majority of developing economies, argues that it has the right to foster its economic development and that the U.S. has historically
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been a much larger emitter than China. It is clear that tensions between developing countries that feel they have the right to advance their economies and developed nations are a continuing threat to reaching an international climate agreement. One challenge of defining the new protocol will, therefore, be to strike the right balance between economic interests and ensuring sufficient action to mitigate climate change. The framework and the incentives the Copenhagen summit should provide are great stimuli to low carbon future. It is in the interest of all parties and particularly human kind.

From an investor’s point of view, climate change is a serious long-term challenge with a material impact on all kinds of business models. The investment community, and particularly the Sustainable and Responsible Investment (SRI) community, has already made some positive steps to promote the integration of climate change in its investment decisions – first, by encouraging transparency of company GHG exposure through initiatives such as the Carbon Disclosure Project since 2000 and, secondly, by educating corporations through highlighting the sound business case for addressing climate change such as energy cost savings.

Now, in order to go further, business and investors need a common playing field with clear long-term rules of the game in terms of GHG. We strongly believe the Copenhagen summit is of importance as public policy needs to create market-based frameworks that promote the integration of externalities linked to climate change challenges into companies’ strategies and investment decisions. Particularly, we are in favour of:

◆ a global agreement based on the latest IPCC (Intergovernmental Panel on Climate Change) study that indicates that developed countries should reduce their emissions by 25 to 40 per cent by 2020 (against a base year of 1990)

◆ a global framework for GHG pricing through, for example, a global carbon market

◆ a global agreement which encourages countries to offer continued incentives for investing in existing low carbon technologies, including those that improve energy efficiency and increase the share of renewable energy

Also, in terms of strategic allocation, investors should favour two types of investments. On one side, they should invest in funds that systematically include climate change challenges in investment decisions in traditional companies. On the other side, investors need to consider investment in niche green-tech companies offering sustainable and innovative products/services to climate change. Thus, investors can size market opportunities created by climate change challenges but, at the same time, provide capital for the development of ever-more needed small emerging green-tech companies.

**Necessary Framework**

We strongly believe in factoring in climate change into investment decisions and hope that the Copenhagen summit will draw up the necessary framework providing businesses the necessary market incentives to integrate climate change into their long-term strategies and investments.

As a matter of conclusion, we can say that these two trends are here to stay. Furthermore, we strongly believe that SRI addresses the needs of investors wishing to capitalize on them.

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The economy has thrust U.S. 401(k) plans and their role in funding retirement income into the spotlight. It has also placed U.S. 401(k) plans in the crosshairs of legislative reformers. Since 401(k) plans have become the main employer-provided retirement plan for a majority of U.S. employees, this heightened review can be expected to continue. The most significant of the new developments relate to plan investments, fiduciary and plan design ‘safe harbours,’ and recession-related relief.

‘Safe Harbour’

‘Safe Harbour’ 401(k) plans are exempt from testing of contributions for violations of the U.S. non-discrimination rules. The testing process can be complicated and expensive, so safe harbour plans gained popularity before the recession. A plan failing testing will be required to either refund excess contributions made for highly compensated employees or receive additional employer contributions. The price of this testing exemption is that safe harbour plans must commit in advance to provide minimum required employer contributions for a 12-month plan year.

However, plan sponsors adversely affected by the economy have sought to discontinue their contributions mid-year. IRS regulations permitted this if employers satisfied their contribution requirement by making matching contributions, without regard to whether the employer suffered financial hardship, but they did not permit employers in financial difficulty to stop making non-elective contributions (made automatically for all eligible participants) mid-year.

In May, the IRS issued proposed regulations that permit 401(k) plan sponsors who have a substantial business hardship to also end their non-elective contributions mid-year after giving advance notice to participants. Employers may rely on these regulations now so that it is not necessary to terminate any safe harbour plans in order to discontinue employer contributions as a result of business hardship.

Automatic Enrolment

The Pension Protection Act of 2006 (PPA) contained several provisions encouraging the automatic enrolment of participants into 401(k) plans at predetermined contribution levels in order to boost participation and savings rates. The PPA created a new ‘safe harbour’ 401(k) plan which provides for automatic enrolment of employees at contribution levels which increase each year. However, any 401(k) plan is permitted to enrol employees who have not made affirmative elections at a pre-determined contribution level set out in the plan and, prior to the recession, this was an increasingly popular plan design.

The IRS recently issued final regulations on automatic enrolment which clarify the rules and permit new flexibility. In particular, these regulations permit automatic enrolment to apply only to new hires and permit certain rehired employees to be treated as new employees for purposes of determining required contributions. They also permit plans to set expiration dates for affirmative elections so that they may require that participants make new elections each year in order to avoid default participation. Since automatic enrolment may increase employer contribution costs, the full impact of these regulations may not be felt until the economy begins to recover.

Default Investments

If participants are automatically enrolled in a 401(k) plan under the rules described above, then how should their contributions be invested in the absence of participant directions? In order to protect fiduciaries from liability for investing contributions for automatically enrolled participants, a safe harbour qualified default investment alternative (QDIA) was created by the Pension Protection Act. The Department of Labor issued regulations providing that QDIAs could not be short-term investments such as money market or stable value funds, but had to be investments with a long-term horizon such as balanced or target date funds. Plans that permit automatically enrolled participants to opt out of coverage during the first 90 days after enrolment and have extra time for excess contribution refunds were even...
required to have a QDIA.

The recession has resulted in a re-evaluation of these rules because the most common QDIAs, target date funds, have performed poorly. Congress amended the PPA retroactively to eliminate the requirement that certain automatic enrolment plans had to use a QDIA and the Department of Labor recently held joint hearings with the U.S. Securities and Exchange Commission on the performance of target date funds with a focus on the need for greater disclosure of how these funds work. The Department of Labor may be reconsidering its QDIA rules.

**Investment Fees**

Most U.S. 401(k) plans have participant-directed investments. Fiduciaries of these plans rely on a safe harbour in Section 404(c) of the Employee Retirement Income Security Act (ERISA) that makes participants responsible for investment losses resulting from their investment choices. Under the Department of Labor’s interpretation of this safe harbour, fiduciaries remain responsible for selecting a prudent and diversified investment menu for participants and for making required disclosure about available investments, including fees.

A large number of lawsuits have been filed challenging 401(k) investment fees and undisclosed ‘revenue sharing’ with service providers and questioning availability of the safe harbour. Plaintiffs have lost an appeal of the first decision dismissing excessive fee claims against the John Deere Company. In the Deere case, the plan offered 23 Fidelity funds and 2,500 additional funds in a brokerage window, and the court found that since all of them couldn’t have excessive fees, a participant’s fund choice included the fees.

In denying a rehearing of its decision upholding the decision in favour of John Deere on June 24, the U.S. Court of Appeals for the 7th Circuit went out of its way to clarify that it had not been trying to establish an interpretation of Section 404(c) that would protect any fiduciary that simply provided a very large number of investment alternatives to participants.

In another case involving the Wal-Mart plan, plaintiffs had suggested that fiduciaries are obligated to choose low cost index funds as investment choices since managed funds do not outperform index funds over time, and challenged the use of retail, rather than institutional, funds. These claims were also dismissed, though an appeal has been filed.

**Investment Advice**

The prevalence of 401(k) plans in which participants select their own investments makes it important for employers to make available investment advice and education without worrying that they will be held accountable for losses. The PPA enacted an exemption from statutory self-dealing rules permitting plan fiduciaries to give investment advice to participants even if they recommend funds from which they or their affiliates receive fees. The Department of Labor issued regulations in accordance with the PPA permitting this advice if the investment choices all have level fees or the advice is provided by an objective computer model. The Department of Labor has repeatedly delayed finalization of these regulations.

**Where Are We Going From Here?**

If the economy does not pick up soon, be on the lookout for more congressional proposals to control 401(k) investments and bolster the use of 401(k) plans to provide for retirement security. In addition to the investment legislation discussed above, one proposal which appears to be gaining traction is a requirement that 401(k) plans pay out benefits in the form of annuities to guarantee a lifetime income stream.

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Canadian public companies are subject to numerous executive compensation disclosure obligations. The disclosure of executive compensation, at first glance, appears to be at odds with an individual’s privacy rights. In most instances, an individual’s compensation constitutes sensitive, identifiable personal information deserving of privacy protection. However, there are important policy and legal reasons why disclosure of this information is necessary by public companies, reasons which supersede an individual’s privacy rights.

This article explains the purpose of requiring public companies to disclose the compensation provided to their executives. It also provides an overview of the new executive compensation disclosure rules that were recently brought into effect.

**Purpose Of Compensation Disclosure**

Canadian securities regulation exists to protect investors and provide efficient capital markets in which investors can have confidence. Without efficient capital markets, investors would have limited investment opportunities and companies would have limited sources of funding. To achieve efficient capital markets, Canadian securities regulators:

- impose high standards of conduct on market participants
- restrict fraudulent and unfair market practices
- require timely, accurate, and efficient continuous disclosure of numerous corporate activities

Executive compensation is one of the elements of the continuous disclosure obligations. How a company compensates its executives is said to provide insight into the stewardship and governance of an organization. Simply put, from the shareholders’ perspective, they want to know how the money they provide a company in exchange for a share of the company will be used. Specifically, shareholders want to know how much money will be used to fund the company’s activities versus funding the executives’ compensation. Shareholders also want to know the terms and conditions for the executives’ compensation, including the degree to which the executives’ pay is aligned with the company’s performance.

Recently, shareholder interest in executive compensation has heightened. In fact, shareholders have successfully brought forward several ‘say-on-pay’ proposals. Say-on-pay proposals can generally be described as proposals that seek an annual non-binding advisory vote by shareholders on various aspects of executive compensation.

In May 2009, the Ontario Teachers’ Pension Plan (Teachers’) went further than seeking an advisory vote in protest against the alleged excessive pay package awarded to the chief executive officer of Chesapeake Energy Corp. Teachers’, a shareholder of Chesapeake, filed a derivative complaint in Oklahoma State Court against Chesapeake alleging the CEO and the board of directors breached their fiduciary duties in approving excessive expenses. The disclosure of the compensation provided to the executives at Chesapeake revealed that the CEO’s employment agreement had been revised to provide him a US$75 million bonus, despite a decrease in the company’s profits by 60 per cent and stock price...
by 50 per cent. Moreover, Chesapeake purchased the CEO’s private art collection that had been displayed in the company’s offices for US$12.1 million. As this case unfolds, it will be interesting to see how a company’s compensation disclosure will be used to hold executives and boards of directors personally accountable for their compensation decisions.

**Evolution Of Compensation Disclosure**

Executive compensation disclosure rules were first introduced in Canada in 1994. The rules were harmonized across jurisdictions in Canada with the introduction of National Instrument 51-102 Continuous Disclosure Obligations in 2004. It requires public companies to complete and file, on an annual basis, certain disclosure forms including the statement of executive compensation. Recently, the statement of executive compensation was revised significantly. The new statement of executive compensation, Form 51-102F6, applies to companies with fiscal years ending on and after December 31, 2008 (Compensation Form). The form sets out the most comprehensive executive compensation disclosure obligations in Canada and brings Canada more in-line with the disclosure obligations in the United States. It is the focus of this article, although other sources of compensation disclosure obligations exist. These compensation disclosure requirements include, among others, insider reporting obligations, prospectus requirements, and the requirements of the Toronto Stock Exchange.

**NEO Compensation**

Section 1 of the Compensation Form requires the annual disclosure of the compensation of a company’s named executive officers (NEOs) – the CEO, the chief financial officer, and the three most highly compensated executive officers whose total annual compensation exceeds $150,000. The objective of the disclosure is to disclose all direct and indirect compensation a board of directors intends to provide the NEOs. To meet this objective, the Compensation Form sets out numerous aspects of compensation that must be disclosed, as described below. If an element of compensation is not expressly provided for in the Compensation Form, but should be disclosed to meet the disclosure objective, it must be disclosed.

**Compensation Discussion And Analysis**

Section 2 of the Compensation Form introduces a new disclosure section, ‘Compensation Disclosure and Analysis’ (CD&A). The CD&A requires an in-depth explanation of each element of compensation provided to the NEOs. This includes:

- The objective of each compensation program
- The elements of each program, the amount for each element, and why each element was chosen
- How each compensation program fits into the company’s compensation objective
- Any peer group comparisons, including the names of the companies in the peer group and the criteria for selecting the peer group
- Any performance goals tied to the compensation program, unless a reasonable person would consider the disclosure to seriously prejudice the company’s interests
- The role of the executives in determining the compensation

There is an express obligation to explain how pay is tied to performance. Simply setting out the process for determining compensation already awarded will be inadequate. Furthermore, the disclosure must satisfy a ‘reasonable person’ test. Specifically, the disclosure must allow a reasonable person to understand the disclosure elsewhere in the Compensation Form.

The next section of the CD&A requires the disclosure of a performance graph. The performance graph includes two line graphs. One line graph sets out the company’s cumulative total shareholder return over the five most recently completed fiscal years. The other line graph sets out the cumulative total return of at least one broad equity index that would be an appropriate comparative index, such as the S&P/TSX composite. These trends must be compared against the five-year trend in compensation provided to the NEOs, which may be in the form of a line graph or narrative analysis.

The final section of the CD&A requires the disclosure of the process used in granting option-based awards. This includes describing the role of any compensation committee, the role of the officers, and whether prior awards were considered in making new grants.

**Summary Compensation Table**

Section 3 of the Compensation Form sets out the new summary compensation table (SCT) for the disclosure of the compensation of the NEOs, as described below. Historically, the SCT required the compensation information for the three most recently completed fiscal years. However, given that this is a new form, the first year the new SCT is in effect, there will be no comparative data for prior years and, in the second year, there will only be one year of comparative data in the chart.

One of the new features in the SCT is the addition of the column for total compensation. The addition of this column assists in understanding the total compensation that the board of directors intends to provide the executives.

Another new feature in the SCT is the inclusion of the fair value of the share-based and option-based awards for a covered financial year. This will require additional work in determining the fair value of the awards on the date of the grant, which was not required by the former SCT. If the valuation model used in the SCT is different from the valuation model used in the company’s audited financial statements, the reason for the difference must be explained.

**Incentive Plan Awards**

Section 4 of the Compensation Form requires the disclosure of the incentive plan awards granted to the NEOs.

It requires the disclosure of outstanding option-based and share-based awards, including awards granted before the most recently completed financial year.

It also calls for the disclosure of the value of option-based awards and share-based awards that vested during the year, along with the value of any non-equity incentive plan compensation that was earned during the year.

**Pension Plans**

Section 5 of the Compensation Form requires the disclosure of all retirement benefits, including Defined Benefit and Defined Contribution pension plan benefits. Additional information necessary to understand the information in the tables must be included in a narrative following the tables. This includes the terms and conditions of payments and benefits on normal and early retirement, the benefit or contribution formula, and any policies on credited years of service.

The new Compensation Form mandates the most comprehensive executive compensation disclosure ever required of public companies in Canada. Providing the additional disclosure will require additional preparation time and increase the costs to companies. However, it is expected that the benefits to shareholders and other interested stakeholders will outweigh the additional costs. These benefits include gaining a greater understanding of a company’s stewardship and better governance.

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Imagine a world where you go to the mall on a regular basis and buy a pair of shoes without comparing prices with the other five shoe stores right next door. In fact, no money changes hands. Then you wander over to the drug store and buy toothpaste, shampoo, toilet paper – everything you need – again without hesitation. No worries; it’s ‘covered.’ Sounds like something right out of a fairy tale. And, sounds like how benefit plans currently work.

However, there is no magical healthcare money tree. As consumers of healthcare, we have been insulated from the actual costs of healthcare products and services because we do not typically pay for them like we do in traditional seller/buyer transactions. In almost every type of consumer transaction, we shop around for the best price. When was the last time you bought a TV without knowing the price? The traditional publicly and employer-funded approach to healthcare has resulted in a mindset where we have not trained ourselves to ask the usual purchasing questions, “Is that a good price?” and “Do I really need this?”.

With 2009, we have to say hello to many new concepts. Organizations across all industry sectors are taking a good hard look at their financial situation. At the individual level, each of us is also examining our behaviour both as producers and as consumers. The plan member is no exception. The plan member mindset that, ‘I’m not paying, so why shop around?’ needs to change in order to ensure the long-term sustainability of funded healthcare. And changing that mindset is all part of the bigger reality we face as organizations, as provinces, as nations and globally.

Overuse Of Benefits

Lack of education around healthcare and benefit plan costs is also an issue sometimes connected to misuse and overuse of benefits. For example, plan members sometimes access services they don’t really need for their health and well-being. Again, their mindset is, “I might as well get another pair of glasses, since it’s covered by my plan and I don’t have to pay.”

Plan member = consumer/buyer/customer is the equation that needs to be embraced by the new enlightened plan member. When accessing benefits, the plan member can weigh the cost/benefit just as they would when making any other purchasing decision. ‘Employee accountability’, ‘shared responsibility,’ and ‘personal choice’ – whatever industry buzz words come to mind, the key message is the concept of consumerism. The plan member is positioned as a consumer or ‘purchaser’ who takes personal responsibility for, and is actively involved in, benefits selection and spending. And the plan sponsor takes responsibility for providing a quality offering and educating its “customers” (plan members) about its merits.

New Mindset

Plan members need their plan sponsors to help them understand their role and responsibility as a healthcare consumer. Not only does showing the value of benefits potentially engage the plan member to take a closer look at their usage, it also highlights opportunities. Through education, plan members realize how it is in their best interests to control costs. They realize that not only can they help ensure the long-term sustain-

The Buck Stops Here:
Changing Times... Time To Change

ability of their benefit plan, but they can also save themselves money if their plan has an element of cost sharing built in. For example, the new mindset would be, ‘If I have to pay 20 per cent out-of-pocket, I should shop around for the best price.’

For many plan members, learning about their benefits can be a real eye-opener. In the past, perhaps they’ve taken their benefit plan for granted. By learning the true costs of healthcare, hopefully they will develop an appreciation for how fortunate they are to receive coverage. Similarly, it can be an eye-opener for the plan sponsor who realizes just how far education can go to positively influence their bottom line – especially in today’s tough times, this kind of mindset shift is critical.

Sometimes, however, plan members don’t know what they don’t know.

As is the case with any behaviour change, awareness is the key to getting the behaviour change ball rolling … rolling toward changing expectations and, in turn, toward adopting new behaviours. Given today’s current economic situation, the timing couldn’t be better to develop educational initiatives.
focusing on creating a consumer mindset through topics like:
◆ Explaining to plan members how benefit plans work – how we all pay one way or another – and making the costs as transparent as possible to the plan member.
◆ Showing plan members how it is in their best interest to shop around to learn all the options and price points available.
◆ Reminding plan members of the range of services available in their benefit plan.

Education helps shift plan members away from a sometimes passive approach to accessing benefits to becoming a new and improved lean, mean benefit shopping machine. In addition, the plan member also receives an important message about the organization. Educational initiatives highlight that the employer is actively concerned about employee health for the long-haul.

So, now what?
Unfortunately, as we know all too well, sometimes even the very best ideas have trouble getting off the ground. The time, energy, and budget thresholds can sometimes just seem too high. Fortunately, educating plan members about their plan can be simple and inexpensive. For example, developing a ‘Did you know...’ series is an eye-catching and simple way to provide plan members with information that is engaging and easy to understand. It leaves the subject matter wide open, so as your objectives change, so too can your focus in terms of conveying topics related to any aspect of your benefits plan.

This format also lends itself to numerous communication vehicles. For example, it could be inserted in pay stubs, incorporated into internal employee newsletters, or become a standing feature on the company intranet. It may even be time to try out some online social media tools.

To get started, here are some educational topics, see Figure 1, that you could adapt, or use as is.

New Reality
Changing both plan member and plan sponsor expectations is the new reality. In the near future, we could all be looking at more cost sharing to ensure the long-term sustainability of publicly and employer-sponsored health plans. It is in everyone’s best interest to start educating now – so the bite of reality doesn’t leave scars.

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Figure 1

**SPOTLIGHT ON:**
Medication costs vary, so shop ‘til you drop

**Did you know...**
◆ Medication costs can vary widely by pharmacy.
◆ If you pay a portion of your prescription costs out-of-pocket (i.e., with a 10 per cent co-pay), try to shop around to get the best bang for your buck.

<table>
<thead>
<tr>
<th>Drug Name / Treatment</th>
<th>Cost differences between pharmacies</th>
<th>% Difference – High and Low Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lipitor 10mg / cholesterol-lowering</td>
<td>$161.74 - $221.20</td>
<td>36.8%</td>
</tr>
<tr>
<td>Pantoloc 40mg / stomach ulcers and reflux disease</td>
<td>$184.68 - $266.62</td>
<td>36.8%</td>
</tr>
<tr>
<td>Novo-Venlafaxine XR 75mg / Treatment of depression</td>
<td>$86.93 - $137.56</td>
<td>58.2%</td>
</tr>
<tr>
<td>Apo-Ramipril 10mg / high blood pressure</td>
<td>$45.32 - $88.40</td>
<td>95.5%</td>
</tr>
</tbody>
</table>


**SPOTLIGHT ON:**
Demystifying ‘COB’

**Did you know...**
◆ COB is an abbreviation of the term ‘Co-ordination of Benefits’ which refers to co-ordinating benefits between different carriers if you are also covered by your spouse’s plan.
◆ If you have less than 100 per cent coverage with your primary plan, co-ordinating with your spouse’s plan may provide you with up to 100 per cent coverage by accessing both plans.
◆ First, submit your claims to your primary carrier and, if there is any uncovered portion, next submit the unpaid balance to your spouse’s plan as your secondary carrier.

**SPOTLIGHT ON:**
Preferred Provider Network – What the heck is it?

**Did you know...**
◆ Preferred Provider Network (PPN) is a group of healthcare providers who all provide discounts on products or services to plan members who belong to specific group or individual benefit plans.
◆ PPNs are good for everyone: you receive a discount on the product or service which in turn, helps lower costs for the overall benefit plan and the health service providers’ business volume rises.
‘EAP and Disability Management’ is the topic of the next ISCEBS Toronto Chapter program. Karen Seward, senior vice-president, business development and marketing, at Shepell-fgi will discuss leveraging EAPs in an effort to mitigate disability costs and assist employees in the challenges they face in the return to work process. It takes place November 4 in Toronto, ON. Visit: http://www.iscebs.org/PDF/chapters/091104_tor.pdf

The ‘7th Annual Summit on Corporate Social Responsibility,’ organized by Canadian Business for Social Responsibility, will take place November 5 in Toronto, ON. This year’s summit is themed ‘Transformational Corporate Social Responsibility: The Next Wave of Business Leadership, Innovation and Performance.’ It will highlight new, creative ideas to transform business and propel companies into the post-recession economy. Through a series of panel sessions (including a CEO panel), presentations, and interactive discussions, conference attendees will focus on topics including leadership, people and product innovation, and the future of government policy. Visit: www.cbsr.com

‘In the Wake of the 2008 Market Decline, How are we coping? What’s on the Horizon for 2010?’ is the focus of the ACPM Ontario Regional Council’s ‘impACT 2009.’ Sessions will cover topics such as the future of employer sponsored retirement plans and investment policy responses to the Defined Benefit funding crisis. It takes place November 19 in Toronto, ON. Visit: http://www.acpm.com

‘Value Investing After the Financial Crisis’ will be discussed at a Rotman School of Management session. Irwin Michael, president, I.A. Michael Investment Counsel; Kim Shannon, president and CEO, Sionna Investment Managers; and Jonathan Wellum, CEO and chief investment officer, Portland Investment Counsel; will share their expertise and views on value investing. It takes place November 10 in Toronto, ON. Visit: http://www.rotman.utoronto.ca/events

Chris Caswell, manager, compliance of benefit plans, at Rio Tinto; and Eleanor Marshall, vice-president and treasurer, Bell Aliant; will be on the panel of plan sponsors at the CPBI Ontario Region’s ‘Pension Investment Forecast 2010.’ Other panelists are Leo de Bever, chief executive officer, AIMCO; and William W. Moriarty, president and CEO, University of Toronto Asset Management. The session will also feature presentations from Jonathan Tetrault, of McKinsey & Company, who will set the stage with an overview of the investment trends in the industry; Dr. Marlene Puffer, managing director, Twist Financial Corporation, who will talk about the trends in liability driven investing (LDI) and some practical considerations in this environment; and Malcolm Hamilton, of Mercer, who will offer his thoughts on the Defined Contribution plan challenge. It takes place January 13 in Toronto, ON. Visit: http://www.cpbi-icra.ca/en/event_details.ch2?event_id=812

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Super MEPPs Not Be-all-to-end-all

Sir:

It is sad to see you too have been lured into the super MEPP camp. MEPPs are not the be-all-and-end-all regardless of what the various “expert commissions” tell you. In fact, as a group they are relatively the most expensive, poorly governed, and most misunderstood plans.

The vast majority of non-pension covered employees work for small employers. I can tell you from extensive personal experience these employers do not know we have a fractured regulatory system, do not feel that the administrative burden would be too much, and have never heard of FSCO, nor do they understand the ins-and-outs of investment management fees both institutional and retail.

What they do understand is that any benefit is a cost that hits their bottom line.

The real answer lies in ensuring there is an incentive for the small employer to offer a program and for the plan member to save. That will require tax policy changes, both provincial and federal.

The other effective options, as you state so eloquently, involve increasing CPP or making a supplemental plan mandatory. In either event, this will either increase employer costs or reduce employee wages, unpopular options at best in today’s economy.

Ontario’s finance minister is right about one thing, it’s not the next generation of workers coming up that are the issue. The real issue now is the adequacy of pensions for the mass of Boomers hitting retirement age. This will not in any way be addressed by endorsing and creating some kind of MEPP, there simply is not enough time.

Neil T. Craig, BA, RPA
Stevenson & Hunt Insurance Brokers Ltd.
A s pension funds and hedge funds continue to suffer declines in their asset bases, one group of players continues to get noticed as they invest their money – sovereign wealth funds. Unfortunately, very little of this notice has been good. In Canada, China Investment Corporation’s $1.5 billion investment in Canadian mining company Teck Resources made headlines, while south of the border, this same fund has been on a buying spree of U.S. distressed real estate.

Sheer Size
The economic nationalism arguments surrounding these purchases (we don’t want foreigners buying ‘our’ companies, but look forward to the opportunity for our funds to purchase ‘their’ companies) are old and the battle lines are well drawn. However, one of the complaints about sovereign funds is true – these funds are typically highly opaque, which stands in sharp contrast to our ideas on transparency in the public sector and its agencies. When you combine this with the sheer size of many of these funds, you have all the ingredients for conspiracy theorists.

There has been little academic examination of these pools of capital. The first attempt to try to more fully examine these funds is found in a paper by Olivia Mitchell, at Wharton; and John Piggott and Cagri Kumru, both at the University of New South Wales. ‘Managing Public Investment Funds: Best Practices and New Challenges’ raises almost as many questions as it answers in attempting to understand these relatively new sources of funds.

The authors note that there are three basic types of public funds:

- Foreign exchange reserve funds, which is the largest category of public investment funds with an estimated total of US$4.5 trillion. They are the oldest type of public fund and have been established to further a central monetary authority’s desire to smooth out currency fluctuations.
- Public pension funds (such as the Canada Pension Plan or the U.S. Social Security Trust Fund)
- Sovereign wealth funds

Sovereign wealth funds are typically created from natural resource taxes or from fiscal surpluses and are managed separately from foreign exchange reserves or other pools of income. They have broad investment mandates, often to offset any currency price fluctuations portion in foreign assets (ranging from 50 per cent to up to 100 per cent), a high weighting to equities (of at least 50 per cent), and a large proportion of non-traditional assets such as real estate and infrastructure.

While public pensions tend to score high in terms of management practices and accountability, sovereign wealth funds do not. The authors use three criteria to assess these public funds:

- Governance – the way the fund manages its affairs to maximize the welfare of, and resolve conflicts of interest among, its stakeholders.
- Accountability – the way governance outcomes and decisions are disclosed to stakeholders.
- Investment Practice – the development of investment policies that balance risk and return.

Wide Variation
The results show a wide variation with larger funds tending to be most opaque (which is somewhat counter intuitive). While one might assume that some of the fund’s characteristics towards governance and transparency may, in turn, be determined by its country characteristics (coming from countries where transparency in the public sector simply doesn’t exist), this isn’t reflected in the statistics. There is little statistical association between a sovereign wealth fund’s governance and its own country’s business sophistication, regulatory quality, and rule of law.

While sovereign wealth funds are growing, the authors note that “they appear to be demonstrating an increasing risk appetite, very little transparency, and virtually no clarity of objectives.” This is one area where the governance structure of most public pension plans can lead the way.
To be successful in any business, attention to detail is crucial. And this is especially true when it comes to providing retirement services for your employees. At Great-West Life we are completely committed to the highest principles of accountability and providing superior, reliable group retirement services. If you want your group retirement plan to run as smoothly as you wish everything else did, give us a call at 1-800-452-0025 or visit www.grsaccess.com
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