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Aging and Asset Prices

Aging may well have an impact on asset prices. These are the findings in a Monetary and Economic Department of the Bank for International Settlements working paper which looked at the impact of our aging society on real estate, but then extrapolated that to other assets. It contends that the aging of populations in advanced economies “will lower real house prices substantially” over the next 40 years.

Bit Of A Blow

Of course, this is a bit of a blow to, for example, Statistics Canada which recently published a report that said home equity can represent a double-digit boost to retirement income for those that are mortgage free. Based on 2006 numbers, the value of home ownership could increase incomes in retirement by 10 per cent.

However, that assumes housing values stay constant. There is a real danger that housing prices could drop as boomers age and are eventually forced to leave their homes. The model was that as you worked and grew older and had more equity in your home, you moved up to a bigger, more expensive home. However, with virtually no population growth in this country and aging baby boomers being the largest age cohort, who is going to buy these houses when they come on the market?

That is the gist of the Bank for International Settlements working paper. It says “Though the results do not imply absolute real price declines, they suggest that in the next 40 years house prices in advanced economies will face a more difficult environment than in the past 40 years.”

The paper goes on to suggest that the impact of that aging population can be extended to other assets. Consider, as we age, the same factors which prompt us to sell our homes will see us liquidating other financial assets. What impact will this have on stock prices, for example, as we see them increasingly come on the market?

The working paper suggests that while the asset

Slow Economic Growth

Remember too, aging increases government expenditures, especially pension and healthcare spending. An aging population could slow economic growth resulting in fewer jobs which means fewer people paying taxes and, in Canada, fewer people contributing to the Canada Pension Plan. Contributions were the only thing that allowed the CPP Fund to finish in the black in its most recent quarter.

Clearly, there needs to be a change. New financial and economic rules, attitudes, behaviours, and expectations need to be encouraged. Growth of GDP as a measure of success needs to be replaced by something else, sustainability perhaps.

Otherwise, the value of our homes may be the least of our problems over the next 40 years.
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People

Buck
Claude Paquette is director, Defined Benefit administration, at Buck Consultants. He has more than 10 years of consulting experience in the area of retirement benefits and has a particular expertise on pension administration matters.

OBA
John Solursh, partner emeritus in the pension and employee benefits group at Blake, Cassels & Graydon LLP, has been awarded the Ontario Bar Association’s ‘Award for Excellence in Pensions and Benefits Law.’ It recognizes his distinguished career and contributions to the development of pension law in Canada. Cited in The Canadian Legal Lexpert Directory 2008 as a leading practitioner in pensions and employee benefits law, he is also listed as the only Canadian lawyer, specializing in the pension and benefits area in the Guide to the World’s Leading Labour and Employment Lawyers.’

PIpsc
John Starie is the pension and benefits advisor to the Professional Institute of the Public Service of Canada, a bargaining agent for more than 57,000 public service professionals. He provides professional and technical expertise on pensions and benefits to members, management, and elected officials.

Hewitt
Rob Lewis is a senior consultant in the Toronto, ON, office of Hewitt Associates. He is not new to the firm. His consulting career spans more than two decades, with the last 16 years spent in HR consulting, including 10 years with Hewitt in Boston.

Russell
John Formusa is director of institutional investment solutions at Russell Investments. Most recently, he was vice-president, pension fund, at Hydro One Inc. He will be based in its Toronto, ON, office.

AGF
Nadi Naderi is senior vice-president, strategic accounts management, at AGF Investments Inc. She has more than 22 years of experience managing both retail and institutional clients within the investment management industry. She will be responsible for business development and client service focusing on head-office relationships and strategic partnerships.

Teachers’
Robert Breckon is senior advisor with knowledge and expertise in the health and life sciences industry at Teachers’ Private Capital, the private equity department of the Ontario Teachers’ Pension Plan. He has 30 years of merger and acquisition, corporate development, and operating experience in the global health and life sciences sector, most recently as senior vice-president, strategy and corporate development, at MDS Inc. Olivia Steedman is vice-president, infrastructure, at the Ontario Teachers’ Pension Plan. She joined Teachers’ in 2002 from PricewaterhouseCoopers, where she was assistant vice-president in the project finance and privatization group.

Empire Life
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LAPP
Laurence Waring is vice-president, investments, at the Local Authorities Pension Plan in Alberta. He has extensive experience in the field of investment management, most recently with his own consulting firm Waring Advisory Services, Inc. Beth Spark is vice-president, policy and research. She was formerly the human resources advisor for pensions at the city of Calgary.

Submit your People items for consideration for publication in Benefits and Pensions Monitor to admin@powershift.ca
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**Rules Limit Quebec Private Plans**

Private plans in Quebec are prohibited from adopting the same drug cost control approach as the RAMQ, says Aon. In fact, private plans are obligated to reimburse an original drug at a minimum of 68 per cent of the amount claimed, even if the generic drug is sold to the pharmacist at a maximum of 25 per cent of the price of the original. The Quebec government intends to require manufacturers of generic drugs to sell their products at a maximum of 25 per cent of the price of the original drugs. Unless the government amends the act with respect to the minimum reimbursement of 68 per cent imposed by the rules governing the RGAM, and unless private plans introduce appropriate control measures, the benefits for private plans of reducing the cost of generic drugs to 25 per cent will be negligible compared to those enjoyed by the RAMQ.

**Fixed Income Trading In Canada Soars**

Institutional trading volume in fixed income soared in Canada in the past 12 months while slowing in the United States as investors, both domestic and foreign, directed new assets into Canadian bonds and global dealers that had retreated from the Canadian market during the global crisis returned in force, says a report from Greenwich Associates. Overall Canadian fixed income volume on a matched sample basis increased 42 per cent from 2009 to 2010 – a level of growth that included a 60 per cent increase in cash bond trading volumes. The spike in Canadian fixed income trading volume was driven by a surge in the trading of government bonds. Among a matched sample of 80 of Canada’s largest institutions, trading volume in government bonds increased 93 per cent from 2009 to 2010 and trading volumes in provincial bonds increased 50 per cent. Growth was also particularly impressive in Canadian mortgage bonds. Although these products make up only a small part of the overall Canadian fixed income market, institutional trading volume in mortgage bonds quadrupled from 2009 to 2010.

**Less Value Placed On Retirement**

Immediate gratification may be one reason Canadians are procrastinating when it comes to retirement planning, says a report from the BMO Retirement Institute. ‘Retirement Planning: Can I Get Back To You On That?’ explores the psychology and competing priorities that stand in the way of effectively saving for retirement and finds a disconnect between Canadians’ beliefs and behaviours. In addition to placing less value on a reward in the future than a benefit in the present, often encouraging procrastination, it says 36 per cent stated that they are overwhelmed by too much information and this has been an obstacle to their retirement saving plans.
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Home Equity Boosts Retirement Income

Home equity can represent a double-digit boost to retirement income for those that are mortgage free, says a Statistics Canada study. It says that by retirement age, 75 per cent of households are homeowners and, of those, 74 per cent own their homes without a mortgage. Looking at data from the ‘2006 Survey of Household Spending’ and the 2006 Census, the study estimates that when the value of home ownership was taken into account for households headed by individuals in the age group 60 to 69, it increased incomes by $5,500 or 10 per cent.

Canadians Bullish On Global Opportunities

Canadians are bullish about investment markets and global opportunities in particular, says national research from Franklin Templeton Investments Corp. Of Canadians surveyed who expressed an opinion, 54 per cent expect stock markets to rise, while only 19 per cent believe markets will fall. Emerging international markets such as Brazil and China were identified by 61 per cent as presenting the greatest investment opportunities in the next decade. The global sentiment reflects the bias of Canada’s major institutional investors. For example, publicly-listed global equities make up 78 per cent of the Canada Pension Plan’s equity portfolio, says Don Reed, president and chief executive officer.

Middle Class Faces Shortfall

There is a looming shortfall of retirement income for lower middle and middle class Canadians, says a research paper by the University of Calgary’s Haskayne School of Business. “Should Government Facilitate Voluntary Pension Plans?” calls on regulators to carefully consider the role of government in providing a new way for Canadians to save for retirement. It argues that the CPP and other programs provide adequate retirement income for low income earners and that high income earners use the opportunities they are afforded under the current system to save and invest adequately for retirement. However, those in the middle do not have sufficient disposable income to adequately save enough to provide a middle class retirement. It examines the benefits of creating a regulated Voluntary Pension Plan (VPP) that would allow earners and employers to contribute to a large, co-mingled investment pool.

Corrections

The listing for Mercer (Canada) Limited in the directory of consultants in the June issue of Benefits and Pensions Monitor was incorrect. The correct listing is:

MERCER (CANADA) LIMITED
Greg Fayarchuk, Partner; 161 Bay St., Box 501, Toronto, ON M5J 2S5 PH: 416-868-2638 Fax: 416-868-2136 eMail: greg.fayarchuk@mercer.com Web: www.mercer.ca

Benefits and Pensions Monitor apologizes for any inconvenience this may have caused.

The following was not available for the directory of consultants in the June issue of Benefits and Pensions Monitor:

LENNOX FINANCIAL GROUP INC.
Chris Lennox, President; 665 Amaretto Ave., Pickering, ON L1X 1M6 PH: 416-400-2929 Fax: 888-883-8427 eMail: clennox@lennoxfinancial.ca Web: www.lennoxfinancial.ca

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The traditional Canadian ‘core’ fixed income market – consisting of government of Canada, provincial, municipal, and corporate bonds – is a high-grade, poorly diversified market that is highly sensitive to changes in interest rates. Unlike the U.S. bond market, the corporate sector in Canada represents only a few industries and is concentrated in financials.

A Canadian Core Plus Fixed Income strategy expands the investable universe beyond traditional Canadian core fixed income into other fixed income asset classes, meaning the investor can benefit from increased diversification and the potential for higher risk-adjusted returns (see Chart 1).

Tailored To Fit

Canadian Core Plus can be tailored to fit an investor’s return objectives and risk tolerance. This means that clients should look for investment managers that have dedicated portfolio management capability in each of the various ‘plus’ components, including high yield, U.S. investment grade, or emerging market debt.

After determining the investable universe of fixed income asset classes, the manager should make an assessment of the relative attractiveness of each asset class. For example, we generate a six-month credit spread and total return forecast for each asset class based on top-down and bottom-up views by our portfolio management and credit research teams. Model portfolios are created to show results at various levels of risk. Each portfolio is then run through an optimizer based on economic and market scenarios, showing how each model portfolio will behave. This process reveals not only how much return a portfolio will achieve under various scenarios, but also how much volatility it will have.

Over the long-term, a Canadian Core Plus strategy should outperform a traditional Canadian Core fixed income approach. Broadening the investable opportunity set creates more opportunities to add value. However, clients should ensure that managers are not simply adding value by increasing the risk or beta in the portfolio. The goal, as portfolio manager, is to increase value-added or alpha through modest increases in risk and thus to increase the portfolio’s information ratio.

Is now the right time to invest in Canadian Core Plus? We think clients should consider Canadian Core Plus because it is an option that is not as sensitive to interest rates when compared to traditional Canadian fixed income. North America’s economic recovery should continue for the balance of 2010 and growth in Canada should be stronger than in the U.S., powered by a more resilient consumer, a buoyant housing market, and a strong resource economy. The Federal Reserve is likely to maintain the current federal funds rate for the balance of 2010, while the Bank of Canada will continue on its gradual course of normalizing its administered rate to slightly higher levels.

Canadian Core Fixed Income is a low-yield, interest rate sensitive strategy because of its large component in government of Canada bonds and high-grade nature. If clients wish to retain Canadian Core as their fixed income strategy, we believe they should consider an overweight position in corporate credit which would de-emphasize the low-yielding and interest rate sensitive government of Canada sector.

Additionally, at current valuation levels for fixed income markets – very low real government bond yields and relatively high credit spreads for investment-grade, high-yield, securitized, and emerging market debt – we favor an underweight in Canadian Core Plus because it is an option that is not as sensitive to interest rates and thus to increased diversification and the potential for higher risk-adjusted returns.

The Case For Canadian Core Plus

### Asset Class Correlation Chart

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<th>Asset Class Correlation Chart</th>
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<tr>
<td>Correlation of Monthly Index Returns - From 30JUN05 to 30JUN10</td>
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<tr>
<td>Canadian Money Market</td>
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<td>Government of Canada Bonds</td>
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<td>Emerging Market Debt</td>
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Stress can be a good thing in small doses – nervousness over a deadline often gives us the motivation to work a bit harder. When it becomes debilitating however, anxiety becomes a concern.

Clara was an on-staff receptionist and taking night classes when she had her first panic attack. She was feeling overworked, concerned about upcoming exams, and regularly arguing with her boyfriend. While doing some routine filing at the office early one morning, she was suddenly overcome by a barrage of scary symptoms – a racing heartbeat, difficulty breathing, waves of dizziness, and a terrifying fear that she was going to die. Worried that Clara was having a heart attack, co-workers called 9-1-1 and she was rushed to the hospital. After a number of tests, the doctor offered a diagnosis and an explanation – she’d had a panic attack.

More Common In Women
It’s not surprising that Clara and those around her didn’t know what was happening. Panic attacks are not well understood or publicized. According to the 2002 Canadian Community Health Survey, more than five million people in Canada, or 21 per cent of the population aged 15 or older, have had a panic attack at some point in their lives. For the record, incidents are shown to be slightly more common in women.

People who suffer from panic attacks are often ideal employees. They are committed to their jobs and pay close attention to detail. Experts suggest that sometimes it’s their perfectionism that can lead some folks to take on too much or worry unnecessarily. Other times, it’s just too many worries that pile up, often a combination of workplace and personal issues.

Panic attacks can seriously alter a person’s lifestyle. They can affect confidence and workplace performance, particularly if individuals begin to avoid meetings, social events, team activities, or conferences because they fear an attack might occur during a public event. Sufferers may also wish to avoid positions with a lot of traveling because they feel at risk on a plane, train, or bus. They also might shy away from leadership positions or additional responsibilities in case the stress causes an increase in the attacks.

There are many ideas that could contribute to making the workplace a more comfortable environment. One possibility is to move the anxious employee’s desk or workplace into a quieter area, away from high traffic, busy, or noisy areas. During meetings, doors could be left open so that when an attack begins, the person can easily step out of the room. Designating a peaceful place that the employee knows they can use to relax and practice breathing exercises would be beneficial as well.

Mental health professionals agree that communication and education are paramount in managing panic attacks. While respect for privacy and confidentiality is key, if both bosses and workers are open and honest, secrecy does not become an extra burden. When episodes are not discussed openly, co-workers may be under the impression that they are a sign of weakness or that the sufferer is choosing to have them. Dispelling myths and helping co-workers understand that panic attacks are a serious and often debilitating condition and that the person cannot suddenly make them go away is the best approach.

Help Themselves
It’s also important to find ways to share stress reduction tips and management with those who are vulnerable to panic attacks so that they can learn to help themselves. As we know, techniques such as muscle relaxation, yoga, and deep breathing can reduce stress. Focusing on simple tasks, such as counting backward, may also help when tension mounts.

And, of course, as we’ve said before, regular exercise, getting plenty of sleep, and avoiding alcohol and caffeine are often healthy lifestyle solutions to stress reduction.

Panic attacks can really have an impact on employees’ confidence and productivity. By discussing the issue openly, understanding the symptoms, and recognizing the signs, you can be ready to help and offer support and advice when it’s needed most.
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Given the amount of commentary related to plan sponsor fiduciary risks associated with Defined Contribution plans, one would think that the logical solution is just to steer clear of them. Fortunately, plan members have demonstrated that the lifetime value of this benefit is well worth the business resources required to ensure the risks are managed prudently. The ‘benefits’ definitely outweigh the ‘risks’ – provided you manage the risks well.

For DC plans, risk management starts with defining the responsibilities and reporting requirements for the various stakeholder levels. Typically, these levels include the board that holds ultimate responsibility for the program; the pension committee delegated with operational oversight responsibility; and, of course, plan members who are the beneficiaries of the plan.

Further Defined
Responsibilities are further defined for sub-advised or delegated functions such as record-keepers, custodians, and investment managers.

The next process, after identifying the requirements for various stakeholder levels, is delegation of responsibilities in managing risks associated with the plan. This includes having documentation and a structured process for monitoring items such as investments, suppliers, communications, funding, and compliance. While many organizations have the best intentions at heart for oversight, a lack of documented structure can undermine the best efforts of those charged with plan responsibilities. Develop, monitor, and follow the governance documents for your program – these documents are not static and should be updated at least annually. This ritual forms the process for annual oversight and documentation of this internal oversight process is what forms the governance history for the plan.

The documents that are used by all levels of stakeholders must be relevant, understandable, and provide direction. Plan member communication that does not appropriately describe the actions required by employees to join a plan, select an investment mix, or elect a contribution level is not altogether uncommon. Review of employee communication for new members and communication for those who have been in the plan for years is an important process which should be conducted regularly to manage the risks of not just what you say, but how you say it.

The same document requirement elements of relevance, understandability, and direction hold true for pension committee documents such as the investment policy. It is likely that the investment policy is not written by the user, but it most definitely should be a helpful document in the conduct of investment oversight by the pension committee member. There is no question that while not having a document poses a risk, having one that is not followed or reviewed periodically to see if it is still applicable is clearly a larger risk. Plan sponsors that do not have extensive resources dedicated to pension oversight structure and document needs would be well advised to find a consultant to assist in a holistic overview of the process.

The three levels of stakeholders – board, pension committee, and plan members – require feedback on delegated responsibilities. For the board, this can be in the form of a report summarizing the plan and its funding for the current and coming year as well as material changes for suppliers, legislation which could impact the pension plan, and confirmation compliance that governance documents have been followed and reviewed. For plan members, there should be an annual statement to members outlining the activities of the pension committee. This flow through of communication helps in the transparency needs of good governance and provides better value for the activities conducted.

Prudent Risk Management Pays Off

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Sound Governance
So, are there risks associated with sponsoring a DC plan? Absolutely, but one could argue that almost all of these risks can be managed through a sound governance structure. Some outcomes are not absolutely in control of the plan sponsor. For example, there is no requirement or expectation for a DC plan sponsor with a voluntary plan to ensure all employees join the plan – the expectation is that all employees have received the appropriate communication regarding the ability and benefits of joining the plan. Likewise, a volatile and protracted period of market volatility and declining asset values cannot be controlled by the plan sponsor – there is an expectation that members have received adequate resources to manage their accounts despite market volatility.

However, the most significant risks for plan sponsors generally stem from lack of oversight or poor documentation of the oversight process.

Jeff Gray is a vice-president at Proteus Performance Management Inc. (jgray@proteusperformance.com).
Is it necessary to change the way Defined Benefit plans are funded?

According to CFO Insights (published by Deloitte), during these unprecedented times, the availability of cash is one of the top concerns for every CFO. The challenge is to balance strategic investments in long-term growth against short-term management of cash constraints is critical.

Health Plan Sponsor

For companies that offer DB pension plans, the challenge is magnified since potentially significant contributions required to fund the DB plan may limit a company’s ability to make strategic or operational investments in the business that would enhance competitiveness and foster growth. As a result, future pension benefits may be at risk because a viable DB plan requires a financially healthy plan sponsor that continues to make steady contributions to the plan.

So, in order to promote DB plan coverage, funding of DB plans must be affordable.

However, the debate regarding funding and the issues contemplated is not new. The federal government has long recognized that the legislative and regulatory framework for DB plans needs to be strengthened. In May 2005, the Department of Finance released a consultation paper which acknowledged that:

“The combination of a significant decline in long-term interest rates, which correspond to higher pension liabilities, and poor investment returns have led to higher pension deficits.”

In the May 2006 Federal Budget, temporary measures were announced for sponsors of federally-regulated pension plans under the supervision of the Office of the Superintendent of Financial Institutions of Canada (OSFI). These measures included:

◆ Consolidation of all existing solvency deficiencies and re-amortization over the subsequent five-year period
◆ Extending the contribution schedule from five years to 10 years, with consent from members of the plan or with the use of a letter of credit

In 2008, companies faced unprecedented financial turmoil that saw a near collapse of the financial system, steep declines in equity markets, interest rates driven to historic low levels by central banks, and a declining economy. This economic crisis severely hurt revenues and resulted in significant downsizing and bankrupctcies of many corporations. In response, the federal and provincial governments took actions to provide pension plan sponsors temporary solvency funding relief. In Ontario, temporary measures were announced in December 2009 that allowed companies to consolidate existing solvency payment schedules into a new five-year payment schedule and to extend the solvency payment schedule to 10 years with the consent of plan members. These changes became law in June 2009.

The temporary solvency funding relief was helpful. However, while there is no shame in introducing temporary fixes every time a crisis arises or revisiting the funding issues every several years, well thought out and longer term solutions are critical to revitalize DB plans.

With this in mind, we present recommendations that serve to reduce the level of solvency funding contributions required with the objective that cash flow savings may be invested elsewhere in the business for growth and to secure future benefit accruals. While the concepts described are specific to Ontario-regulated plans, they have broader general application to federally-regulated and other provincially-regulated plans as well.

With Respect To DB Plan Funding

◆ Grow-in Benefits on Plan Termination

Under Ontario pension legislation, a pension plan member whose combination of age plus service is at least 55 is entitled to receive ‘grow-in’ benefits on plan termination. Essentially with ‘grow-in’ rights, the member will become entitled to an unreduced pension as if the member’s membership in the plan had continued past the date of termination.

Nova Scotia and Ontario are the only two provinces that provide ‘grow-in’ rights. ‘Grow-in’ benefits should be eliminated from any legislative requirements.
◆ Solvency Valuation

A solvency valuation provides a current financial position for a DB pension plan based on the premise that the plan is terminated on the valuation date. When solvency valuations were introduced in Ontario, virtually all pension plans had solvency liabilities substantially lower than going concern funding liabilities, reflecting the then-current interest rates available to settle benefits, expected investment returns, and inflation. Today, many private sector plans have solvency liabilities substantially higher than funding liabilities, reflecting the current financial climate.

Pensions are, by nature, a long-term liability, and, as such, the funding obligations should reflect that reality. A long-term outlook enables stable plan management and reasonable contributions. The original intent of a five-year amortization period for solvency deficits is no longer realistic given current financial realities. The government needs to appreciate that DB plans represent a very long undertaking and pension benefits are long-term obligations. Therefore, more time must be given to plan sponsors to fund solvency deficits which are really a ‘best estimate’ at one point in time assuming plan termination or business failure.

Systematic Funding

Systematic funding of pension deficits determined at a single point in time will be subject to significant swings caused by uncontrollable market events (such as asset returns and changes in interest rates). Allowance for such volatility would be provided by the use of longer term average rates and amortization periods, rather than short-term market related interest rates and the current five-year amortization period.

We recommend that the minimum funding requirements and amortization period be linked to the level of interest rates. That is, maintain the five-year amortization period for any solvency deficiency determined using a ‘normalized interest rate’ or the actual solvency interest rate, if higher, and increase the amortization period to 15 years for any additional solvency deficiencies. As well, the ‘normalized interest rate’ should be set at six per cent per annum.

◆ Solvency Discount Rate

The Bank of Canada has significantly lowered interest rates to stimulate economic recovery and increase available credit in the financial markets, resulting in a substantial decline in government bond rates. These bond rates serve as the proxy for determining DB plan solvency liabilities. Lower interest rates create significantly higher pension solvency liabilities and increased solvency contributions for plan sponsors, mitigating or offsetting the effects of the proposed relief.

Use of longer-term average discount rates will stabilize plan sponsor contributions for solvency purposes and better reflect the long-term nature of DB plan liabilities.

Table 1 shows the lowest yield, average yield, and highest yield of long-term Government Bonds published by the Bank of Canada.

Based on the observed data, the lowest average yield occurred for a 15-year period ending December 31, 1950. The observations range from 5.96 per cent to 6.6 per cent and suggest that the use of a stable interest rate of six per cent to 6.5 per cent would be appropriate.

Use of a stable interest rate, based on long-term observations, to determine solvency liabilities and contributions over a five-year amortization period, combined with additional funding over a 15-year period determined as a result of market interest rates would provide significant solvency contribution relief for plan sponsors and potentially enhance benefit security in the long term.

◆ Funding of Solvency Deficits

Contributions that would normally not be required except to finance an existing solvency deficit can be expected to give rise to future DB plan surpluses should interest rates return to higher levels. Plan sponsor access to these surpluses has been limited and many employers are, therefore, reluctant to contribute more than the minimum required contributions. If plan sponsors ‘own’ the deficit, they should also ‘own’ the excess. Policy makers must allow plan sponsors the right to re-establish a symmetrical risk and reward relationship.

We recommend that Ontario allow employers to establish a separate ‘Solvency Trust’ fund to hold ‘excess contributions’ resulting from a solvency valuation. All contributions resulting from a funding valuation would continue to be deposited to the original trust fund. Any contributions made to the Solvency Trust would be eligible to be refunded to the employer upon the advice of the actuary, subject to regulatory approval. Amounts from the Solvency Trust would be available to meet the plan’s obligations in the event of plan termination.

Benefit Security

What level of benefit security should a DB plan sponsor be required to provide? The current solvency funding regulations suggest that the benefit security provided by a DB plan sponsor approach the same level as an annuity purchased from a Canadian life insurance company. This comes at a very high cost. Will significant cash flow directed to an underfunded pension plan be a contributing factor to a company’s demise, putting potential future pension benefits at risk? Would the relief proposed allow companies to increase capital expenditures and future business prospects, ultimately providing a higher level of employment and pension security?

In documents filed with the Ontario Superior Court of Justice, Nortel cited, a number of times, that its significant pension liabilities and contributions, as one of the main reasons it needed to seek protec-

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<th>Summary Of Low, Average And High Yield</th>
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Winston Woo, CA, (winstonw@agsautomotive.com) is director of taxation and pensions at AGS Automotive Systems and John Deinum, FSA, FCIA, (jdeinum@re-a.com) is a partner at Robertson Eadie & Associates.
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The powerhouse of growth that is Emerging Markets (EM) is stoking the price of many industrial commodities, including two heavyweights – oil and copper. Even gold, considered a discretionary purchase rather than a manufacturing need, is benefiting from the rise of EM countries. And while demand rises, supply is growing scarcer and more expensive to bring to market.

The booming demand and supply needs stem from the evolving urbanization and industrialization of EM countries. Not bogged down by the debt crises affecting developed nations in the past few years, EM countries are leading the way when it comes to growth. The International Monetary Fund has predicted that by 2015, annual GDP growth in EM/developing economies will significantly outpace major developed economies at 6.7 per cent, and acts as an alloy, especially in brass.

The rising demand for many commodities and the subsequent growth in EM countries make the upside potential for investing in resources strong. With a long-term uptrend forecast for commodities, the sector offers both portfolio diversification and a way to participate in the growth of EM while owning developed world companies (many oil and mining companies are based in North America and Europe). Commodities are also seen as a buffer against inflation since commodity prices tend to rise with growing inflation.

Gold Prices
The result of increasing commodity demand has been a general rise in prices. However, another factor is declining production. Take gold for example. The U.S. Geological Survey estimates world gold production at 2,590 tonnes in 2000, but by 2008 that had tapered off to about 2,260 tonnes.

China leads the world in gold mining output and other EM countries, such as Peru and Indonesia, are considered medium-sized suppliers. This comes at a time when gold production in key developed countries, notably South Africa (for years the number one gold player), is dwindling. China produces about 285 tonnes annually and remains a net importer of gold.

The increasing wealth of middle-class Chinese plus recent relaxation of restrictions on holding precious metals has made gold an investment of choice in that country. Around the world, gold is also seen as a hedge against inflation, deflation, and domestic currency devaluation – a global benchmark for production at 2,590 tonnes in 2000, but by 2008 that had tapered off to about 2,260 tonnes.

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wealth preservation. Demand has been strong due to the uncertain economic times, particularly worries about sovereign debt and the threat of a double dip recession. Gold bullion’s ability to perform like a quasi-currency has led a number of analysts to believe we are in a multi-year bull run for precious metals.

At the end of June 2010, the price stood at US$1,242 an ounce, up almost 300 per cent from a decade ago.

Economic Uncertainty

Economic growth has also spurred the global demand for oil, but the price and supply story for oil is not a tidy one. Oil prices are generally cyclical in nature – strong demand leads to higher consumer prices; then, when an economic slowdown takes place, prices drop. Economic uncertainty also affects the price of oil – witness the significant oil price fluctuations in April and May during the Greece and eurozone debt crises.

However, by the end of June 2010, the price of West Texas Intermediate (WTI) stood at US$75.63 a barrel. That’s up from US$31 just a decade ago, although down from its historical high of almost US$144 during the panicky days of the 2008 financial crisis. Despite volatility in the oil price, fundamentals remain tight and some analysts estimate oil prices will increase to US$120 a barrel by 2013.

World oil consumption reached 85 million barrels per day in 2009, up from a mere 30 million million barrels per day in 1966. A proxy for growing oil demand can be found in the growth of car and truck sales in a number of EM countries. The Boston Consulting Group estimates that Brazil, Russia, India, and China will account for more than one-third of global automotive sales within the next four years. Car and truck sales in China alone this past March were up 63 per cent, according to the China Association of Automobile Manufacturers, and not surprisingly, China is now the world’s number one market for automobiles. Oil prices and car sales have risen almost in tandem for about the past four years.

The International Energy Agency revised global oil demand up in June 2010 on stronger-than-expected preliminary OECD data. It expects yearly global demand growth to rise marginally, mostly from non-OECD countries such as China, India, and Brazil. Meanwhile, the BP Gulf of Mexico disaster is expected to result in a delay or reduction of offshore drilling activity generally, with a corresponding drop in oil supply.

Multi-purpose Copper Demand Up

When it comes to metals, copper demand is on the rise in the EM countries where its use is widespread. China makes up almost half of the world’s demand for the base metal. An efficient conductor of electricity and heat, copper is also flexible, strong, and resistant to corrosion. As such, it’s used in everything from heating, air conditioning, and plumbing to wiring, adapters, motors, and transformers making it well used in industrializing nations. As an alloy, the uses for copper multiply. However, as with most commodities, the overall economic picture will help dictate the metal’s prospects in both the near and long term.

There are those who believe demand for copper may outstrip supply over the next decade. Andrew Harding, chief executive of Anglo-Australian miner Rio Tinto PLC’s copper division, believes that if global copper demand grows at even three per cent annually, the global copper market will face a supply shortfall of six million tons by 2020. The International Copper Study Group, in its latest forecast in April, expected industrial demand for copper in China, based on anticipated semi-manufacture production, to grow by about 7.5 per cent this year and five per cent next year.

The price of copper rose an astounding 109 per cent from February 2009 to February 2010, coming back from a major downswing caused by the 2008 financial crisis. Interestingly, the price of copper at its cyclical low in 2008 was about the same price as the peak of the previous cycle, indicating just how far the price of copper has risen. In January 1995, the peak average weekly price of copper stood at US$1.39 per pound. During the depths of the financial crisis in December 2008, it was US$1.29 per pound and by the end of June 2010, the price was US$2.95. While copper was hit with the recent eco-

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What are the current barriers and misconceptions surrounding ESG?

❖ How does incorporating ESG into business practice add value for companies?

❖ Why is ESG important for institutional investors?
What are the drivers of Sustainable Investing?

❖ What should institutional investors be preparing for?
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## Statistical Listing

### EAFE & Emerging Markets

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<th>Assets Under Management</th>
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### Statistical Listing

#### EAFE & Emerging Markets

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<th>COMPANY</th>
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<th>Regional Separate</th>
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<th>EM Separate</th>
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The current actuarial approach to private drug plan management which looks backwards at retrospective claims data will not protect your drug plan in the next five to 10 years. The modest drug plan cost increases over the past few years have nothing to do with active plan management. Rather, two significant environmental changes have moderated these increases – the ‘Patent Cliff’ and public drug system reform.

**Patent Cliff**

The much talked about Patent Cliff refers to the fact that several of the most prescribed brand drugs in Canada have either lost their patent, which means that lower cost generic drugs can enter the market, or will do so in the next two to three years. The grand-daddy of all patents and the number one prescribed drug in almost all private drug plans, Lipitor, lost its patent protection on May 19, 2010. It is estimated that this patent expiry alone represents more than $400 million in savings for Canadian drug plans over the next 12 months.

Much attention has been put on the fact that retail pharmacy makes more money by dispensing generic drugs than brand drugs as a result of rebates or professional allowances from generic drug manufacturers for stocking their products. For this reason, whether your drug plan has a generic drug interchange policy or not, plan savings will be immediate as retail pharmacies will move quickly to stock and dispense the generic version of Lipitor.

However, pressure by public drug plans has now been put on pharmacy to become more transparent with their pricing and reimbursement model. This leads us to the current situation of public drug system reform.

**Public Drug System Reform**

The introduction of the Transparent Drug System for Patients Act in Ontario in 2006, also known as Bill 102, was the beginning of significant drug system reform for government sponsored drug plans. This has been followed by the Alberta Pharmaceutical Strategy, the British Columbia Pharmaceutical Task Force Report, and, most recently, the changes in Ontario to ban professional allowances (for retail pharmacies) and to reduce generic drug prices to 25 per cent of the brand price. It is anticipated that the changes, which expand beyond the public drug system, will bring significant savings to private drug plans now and into the future.

Both Alberta and Ontario have included the private payer sector in their legislation that controls the prices of generic drugs. In Alberta, new generics introduced after April 1, 2010, will be priced at 45 per cent of brand prices. In Ontario, generics for public drug plan beneficiaries must be priced at 25 per cent of brand, whereas private drug plan beneficiaries will receive generics at 50 per cent of brand until April 1, 2011, at which point the prices will lower to 35 per cent of brand; and then finally down to 25 per cent on April 1, 2012.

As an interesting side note on the issue of high generic drug prices in Canada versus other countries around the world, generic Lipitor came onto the market in May 2010 at 70 per cent of brand price. The point to recognize is that public policies are having a direct and profound effect on private drug plans. Over the coming months, other provincial governments will undoubtedly seek to have generic drug prices that are comparable to those in Alberta or Ontario.

Although private drug plans are finally receiving recognition as an important stakeholder in drug coverage for Canadians, caution should be taken in these ‘wins’ since off-setting measures to counter the losses in revenue at the pharmacy counter will inevitably arise. These include increases to dispensing fees, increases in drug cost mark-up, and the expansion of professional services. Provincial public drug plans are beginning to reimburse pharmacists for professional services beyond drug dispensing, partly as a conciliatory move to compensate pharmacists for their loss in revenue as a result of lower generic drug prices.
prices and, in some cases, the removal of professional allowances. These expanded professional services are legitimate and represent good relative value to the way in which patients receive health management advice and treatments. The issue is that compensation for pharmacy services cannot be addressed within a revenue model that doesn’t include paying for activities such as patient counselling, medication management, initiating and/or changing prescriptions, and administering vaccines. This is the bone of contention between pharmacists and provincial governments, particularly in the province of Ontario at this time.

So where should private drug plans settle on this issue? Should some of the savings that are realized from generic drug prices be reinvested into professional services? Regardless of the actual or perceived value of pharmacy professional services, private drug plans may not yet be prepared to make that step. It may take years before some private drug plans are prepared to add specific professional services to benefits coverage.

Even though we are now in a period of time where savings are being realized under drug plans, private payers should not become complacent during this lull of modest drug plan cost increases. While the ‘Patient Cliff’ has now peaked, the ‘Specialty Drug Tsunami’ is just around the corner.

Looking Forward
Private drug plan managers need to look forward at what drugs are being developed in the specialty drug market. What is so ‘special’ about these drugs? These drugs are the result of many years of genetic and biotechnology research and development. They are typically prescribed by physician specialists such as rheumatologists, dermatologists, and oncologists who specialize in conditions such as rheumatoid arthritis, psoriasis, and cancer.

Specialty drugs make up a significant portion of the top 10 drugs in private drug plans today and will overtake all other drug classes in the next five to 10 years. While these innovative drugs have revolutionized treatment options and changed the lives of patients with these conditions, they have come with a steep price. While the ‘Patient Cliff’ has lowered drug plan increases, coverage for specialty drugs will take the cost of private drug plans to a whole new high.

The trial and error approach to drug prescribing will no longer be appropriate or cost effective. When drugs cost in the range of thousands of dollars per treatment rather than dollars per day, policies need to be in place to ensure the most clinically effective drug is tried first.

Private drug plans are starting to apply policies which encourage the use of certain specialty drugs before others in the same therapy class based on their approved indications. For example, in the treatment of rheumatoid arthritis, there are now nine specialty drugs approved for use in Canada. Each drug has been studied and approved for use in patients with varying degrees of disease severity. While Humira® may be used earlier in treatment by itself or in combination with disease modifying anti-rheumatic drugs (DMARDs), the newest approved product, Actemra,® is only to be used in patients with an inadequate response to one or more DMARDs and/or a drug like Humira. These drug plan policies try to ensure these drugs are used in the appropriate order.

In the U.S., Medco Health Solutions has implemented genetic testing policies to assess the likelihood that the prescribed drug would benefit the individual patient. Some patients have genetic differences which make them more likely to benefit from one drug over another. These tests save the drug plan money as the cost for such a test is less than a typical trial of the drug therapy which may cost thousands of dollars for a four-week trial. Perhaps these tests will be introduced in Canada in the near future.

Payer Or Buyer
Private drug plans are moving from being ‘payers’ to becoming ‘buyers.’ There is a significant difference and mind set needed in order to become effective financial managers in the administration of drug benefit plans. In addition, a new network of providers and partnerships are influencing how pharmaceuticals are being purchased and dispensed under private drug plans. This is already happening in the public drug plan markets. Each province is implementing policies that will limit drug prices and amounts allowable for payment or profit such as drug cost mark-up.

Treating drugs and health services as commodities might not be viewed as the best approach to achieving optimal health for patients, but the traditional roles of stakeholders in the private payer market are changing as plan sponsors begin to realize that they have bargaining clout in the reimbursement equation. For example, Towers Watson has introduced the Canadian Rx Coalition that will allow plan sponsors to access price/cost savings as a result of negotiated deals with drug manufacturers. Facilitating this service is certainly a new role for a major benefits consulting firm. Such an offering could be expanded to include other drug distribution models such as mail order delivery and/or preferred provider networks through designated pharmacies. This concept is being explored across Canada including the Health Plan Payers of Canada (for Atlantic region).

Don’t Be Complacent
Don’t be complacent with the fact that cost increases for drug plans may have been very modest over the past few years. These results, for the most part, have not been through effective plan management; rather, most savings have been a result of significant brand drugs coming off patent. In the next few years, specialty drugs that cost significantly more than traditional drugs will make up a greater portion of private payer drug plan costs.

Beware of the ‘unintended’ cost shifting from public to private drug plans as a result of public drug plan reform. For example, the introduction of the national Common Drug Review created another level of formulary decision-making, which has, in effect, shifted the cost to private drug plans for a longer period before the public plans pick up the tab.

Private drug plans have not undergone significant change since their inception – ask yourself when was the last time you reviewed the drug plan contract? You will see that the contract wording refers to conditions and plan exclusions that no longer make any sense such as ‘sclerosing agents’ and ‘paying for the lowest cost generic drug.’ In the future, plans may need to be re-designed to pay for the ‘lowest cost alternative drug’ and/or have specific policies regarding how specialty drugs will be covered and reimbursed. The current plan designs are vulnerable to public drug plan policies which shift costs to private drug plans by delisting coverage on government plans. Effective public/private drug plan coordination of coverage is needed.

Some plan sponsors are now looking at forward-thinking drug plan initiatives such as product listing agreements, employer buying groups, and preferred provider networks. These will likely be the emerging trends that will shape the private drug plan landscape in the future. By increasing your awareness of what is happening in the industry today and understanding that new partnerships with retail pharmacy and drug manufacturers will be needed to effectively manage the new drug benefit landscape of tomorrow, you will be ahead of the tide.

Gordon Polk is president of Drug Benefit Consulting (gpolk@drugbenefitconsulting.com). Johnny Ma is a pharmacist and president of Equilibrium Health Consulting Inc. (jma@equilibriumhealth.ca).
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L'Association canadienne des administrateurs de régimes de retraite

www.acpm-acarr.com
Harry Markopolous, the Madoff Whistleblower, will be a featured speaker at the ninth annual ‘World Alternative Investment Summit Canada.’ His book, ‘No One Would Listen,’ details the 10-year quest he and his team undertook to prevent the biggest financial disaster of the 21st century. He spent nine years trying in vain to alert the U.S. Securities and Exchange Commission to the Bernie Madoff scheme. It takes place September 13 to 15 in Niagara Falls, ON. Visit: www.waaisc.com

What Canadian asset managers need to know about Bermuda as the offshore jurisdiction of choice will be the focus of a Hedge Fund Hotel seminar. It will look into the practical considerations which asset managers must address when establishing a Bermuda vehicle. Speakers will include Thomas Caldwell, chairman and CEO of Caldwell Financial Ltd.; and Greg Wojciechowski, CEO of the BSX. It takes place September 16 in Toronto, ON. Visit: www.hfhto.com

‘Thinking Organizations … Succeed’ is the theme of the Health Work & Wellness Conference 2010. It takes place September 29 to October 2 in Vancouver, BC. Visit: http://www.healthworkandwellness.com

OMERS Plan for the Future

Warren W. Bell
Michael Nobrega, President and CEO of OMERS, is pleased to announce the appointment of Warren Bell as Executive Vice President and Chief Human Resources Officer.

Prior to joining OMERS, Mr. Bell held a variety of senior management positions in human resources over his progressive, 25-year career at TD Bank Financial Group. Most recently, he was Senior Vice President, Corporate Human Resources.

As a key member of the senior management team at OMERS, Mr. Bell plays a leading role in implementing the OMERS Global Human Resources Strategy as well as securing and developing the top-notch talent and intellectual capital that make OMERS one of the 50 Best Employers in Canada and a global leader in the pension and investment industries.

Mr. Bell is a graduate of The University of Ottawa from which he holds both Bachelor of Commerce (Honours) and Bachelor of Administration degrees. Mr. Bell is a Certified Human Resources Professional and a Fellow of the Institute of Canadian Bankers.

OMERS is a fully integrated global financial services organization and one of Canada’s largest pension plans. A jointly-sponsored, multi-employer defined benefit pension plan that provides retirement benefits to more than 400,000 members, OMERS has more than $47 billion in net investment assets. The OMERS Worldwide brand represents our investment entities, including OMERS Strategic Investments, OMERS Private Equity, OMERS Capital Markets, OMERS Investment Management Inc., Borealis Infrastructure, and Oxford Properties Group. OMERS was recently named 2010 Pension Fund of the Year, Canada by World Finance magazine.
As we Canadians continue to grapple with the question of change/adapt/ supplemental leave alone the Canada Pension Plan, it is instructive to look at other national pension systems around the world. Three pieces of research from Ben Koh, at Singapore Management University; and Olivia Mitchell, at the Wharton school; focus on the half century old Singaporean Central Provident Fund system.

This government plan, financed by mandatory levies on employee earnings, is an interesting one as it is a one-stop Defined Contribution plan which includes accounts for savings for home purchases and education, as well as for retirement. The investment options offered are broad and include hundreds of mutual funds, stocks traded on the Singapore stock exchange, guaranteed bonds, insurance products, ETFs, and even gold. It thus presents an opportunity to see how a large population of more than 1.5 million make their investment choices.

High Hurdle Rate
It turns out that the choice that most members make is no choice at all. About one-third of the plan’s assets have been left in the default option of the

plan’s savings account. Normal plan member inertia accounts for some of this, but so does plan design. On closer look, this option isn’t as bad as you might think. The risk-free rate of return paid by the plan’s board was 2.5 per cent in the home ownership plan component and four per cent in the retirement component, all at a time when all other fixed rate choices yielded hundreds of basis points less. In addition, the fund has often given extra bonus returns of one per cent for certain deposit amounts.

The investment results of those who looked at other than the default option for at least some of their assets have not been encouraging. During the 2004-2007 period (before the market crash), almost half of all of the plan members incurred an investment loss. Another one-third had registered a gain over the four years, but this was either equal to, or less than, the default rate that they could have earned by staying in the savings account. So only 22 per cent of the members registered a gain above the high hurdle rate of the default savings plan.

One reason for the poor investment performance comes from the impact of fees. Initial sales charges for funds offered a range from zero to five per cent. Back end loads, switching fees, redemption fees, and transaction fees add to this list. Within the funds, there are a dizzying array of management, trustee, administration, custodian, registrar, audit, accounting, and other fees. All together, the average sales load is 3.9 per cent (with the average equity fund having a load of 4.9 per cent). Average management fees and expenses came in at 3.2 per cent (with the average equity fund at 3.5 per cent). There is little transparency in this area. While initial sales charges are clear, to understand the rest of the fees involved an investor would have to wade through the prospectuses of each fund.

Aside from being a drag on performance, the bewildering array of expenses may make the default option all the more attractive. As the study authors note, “Being perplexed and risk averse, members may choose the path of least resistance.”

The returns of the investment funds available to plan members have been mixed. Over differing five- and 10-year periods, average fund returns ranged from 1.98 per cent to 16.3 per cent per year.

Returns for the funds were highly correlated with the performance of the stock market as a whole. While most funds reported positive returns for all holding periods (as of 2008), depending on the study period that was chosen, a significant number of funds could not beat the default rate. For example, in the five years ending in 2001, only one-third of the funds beat the default saving rate, although over the 10-year period ending 2007, this rose to 85 per cent of the funds beating the benchmark.

Worldwide Pension Lessons

By: Jim Helik

Jim Helik is a contributing author to the Managing High Net Worth and the Commodities As Investments courses published by CSI Global Education. He also teaches at the School of Business, Ryerson University in Toronto, ON.

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Returns for the funds were highly correlated with
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