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ith so much depending on them, the financial market crisis really brings into question whether stock markets still work. Beyond initially allowing companies to raise capital, what purpose does the existing system really serve?

Here’s the premise:
The world has grown too complicated, too connected, too global, and too fast to let what a stock sells for depend on the whims of an individual investor. The case in point is the Standard & Poor’s downgrade of the U.S. rating. Most in the industry dismiss it as kind of irrelevant. The U.S. is not going to default so what is the point?

Smoke And Mirrors

Plus, if you buy into what people like Roger Martin, dean of the Rotman School of Business, say about the ratings agencies, then the S&P action was mostly just smoke and mirrors. Martin took the ratings agencies to task after the downgrade over their qualifications to set ratings. While he agreed with downgrading the U.S., he questioned that if their analysts are that good, why aren’t they in the private sector making the big bucks?

Remember too, while they were not entirely to blame, the ratings agencies did take a lot of heat for giving the CDOs and other mortgage-backed securities, that included subprime loans in their mortgage pools, a ‘AAA’ rating and look how that turned out.

Yet, the recent downgrade and subsequent fears about France and other European nations being downgraded because of debt problems prompted a flurry of selling and drove markets down by as much as 16 per cent.

Here, in my opinion, is the problem. Any frightened, ill-informed investor can sell a stock for any price. Yet, at any given time, individuals own no more than 17 per cent of the world’s stocks, (that’s according to my Back Page colleague. Jim Helik, in his June piece in Benefits and Pensions Monitor, ‘What Happened To Shareholder Democracy?’) So is a small minority influencing the entire financial system?

If anybody believes it was the pension funds, sovereign wealth funds, mutual funds, asset managers, banks, and insurance companies that were panicked and selling off their stocks, have another thought. Those folks are the vultures, picking up the bargains that fell to them as panicked individuals sold off their holdings. It is also why individual share ownership has fallen from more than 90 per cent as recently as during World War II to the levels of today.

Now, if stock prices were a unique entity, detached from the rest of the financial world, it wouldn’t mean a thing. But, as we saw with this crisis, the decline in the markets prompted the U.S. to promise to keep interest rates down until at least 2013. Canada then had to reassess its plans to reduce interest rates which had an impact on the Canadian dollar.

Lower interest rates mean Defined Benefit pen-

Does Stock Market Still Work?

Yes, as a way to move cash around and help pension funds and individuals earn returns, it works. But as a foundation for the global economy, letting a handful of individuals determine the course of our future well-being is absurd.

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Meridian
Christina Medland is joining Meridian Compensation Partners. She will be consulting with the management teams and boards at companies across Canada in areas such as performance alignment, incentive and equity plan design, executive compensation/compliance, employment contracts, corporate governance, and other board-level issues. She was previously with Torys LLP.

Desjardins
Denis Berthiaume is COO of Desjardins Financial Security. This new role is in addition to his current position as senior vice-president and general manager, wealth management and life and health insurance, for Desjardins Group, a position he has held since September 2010.

Templeton
Julie Caron is vice-president, business development, institutional investment services, at Franklin Templeton Investments. She is responsible for business development in Quebec and Atlantic Canada. She has more than 14 years of experience in the financial services industry. Dean Liotta is vice-president, institutional investment services. He is responsible for the investment servicing of its institutional clients. He has more than 13 years of experience in the financial services industry.

Buck
Joseph Ricciuti is managing director for Canada for Buck Consultants, A Xerox Company. He was previously with Morneau Shepell, where he served as partner, benefits consulting.

Pal
Allison Brown is business development consultant at Pal Benefits Inc. She has held a variety of leadership and technical roles both in and out of the industry during her career.

Aon Hewitt
Greg Durant is chief actuary for the national health and benefits practice at Aon Hewitt. In this role, he will be responsible for the actuarial aspects of the health and benefits practice and will also consult with clients. He has 20 years of experience in insurance and consulting management and leadership positions, encompassing a wide range of strategic and operational initiatives.

Eckler
Karen DeBortoli is director of pension and benefits research at Eckler. She will provide its consultants and clients with the knowledge they need to adapt to relevant changes in legislation. Prior to joining the firm, she worked for another international consulting firm as well as a law firm that specialized in pension and benefits law. August Cruikshanks, MBA CFA, is head of investment research. With more than 15 years’ experience in Canada and the United States as both a consultant and plan sponsor, as head of investment research he will manage its Canadian investment research platform. He will integrate that platform with its worldwide partner – Abelica Global. Jill Taylor Smith, CFA, is a senior consultant. Before joining Eckler, she held senior roles with another global consulting firm and investment management firms.

Williamson
Lee Ann Birch is senior consultant, group benefits, at the Williamson Group. Previously, she worked for several Canadian insurance companies and benefits consultancies. She is responsible for delivering service and consulting support to group benefit clients.

Russell
Dexton Blackstock is director, head of institutional business development at Russell Investments Canada. He was most recently with State Street Global Markets, where he was responsible for delivering research and solutions-based products and services to the institutional investor community in Canada.
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Canadians More Committed To DB

Despite the challenges Defined Benefit pension plans have faced in Canada over the last two decades, Canadian employers that sponsor these plans seem more committed to maintaining them than organizations in the United States and the United Kingdom, says the third annual ‘Global Pension Risk Survey’ by Aon Hewitt. It found while there has been a decline in the number of Canadian organizations with DB plans over the years, there are more ongoing DB plans, relatively speaking, in this country than there are in other economies. In the 2011 survey, 39 per cent of Canadian respondents had closed their DB plans for existing members. That figure is close to 80 per cent in the U.S. and the UK.

Mental Health Business Issue

Mental health in the workplace is costing Canadian organizations a lot of money and much of it is unnecessary, says a study by Morneau Shepell. ‘EAP Improves Health Status and Productivity, and Demonstrates a Positive ROI’ says that intervention through Employee Assistance Programs translates into improved employee mental health and higher productivity, as well as a 25 per cent reduction in costs due to lost productivity. It found 44 per cent of employees surveyed had experienced a mental health issue, but only 26 per cent of surveyed employees felt that their supervisor effectively managed mental health issues, and 44 per cent of managers had no training in how to manage employees with mental health issues. The Mental Health Commission of Canada estimates that mental illness costs the Canadian economy $51 billion a year in terms of healthcare service use, lost workdays, and work disruptions.

Savings Not Always Assured

Private plans shouldn’t necessarily favour simple generic substitution to ensure savings, says Green Shield Canada’s ‘Drug Trends Study 2010.’ It says history has demonstrated that a generic may not always be the lowest cost drug available. This has occurred in Canada when some brand manufacturers experimented with dropping prices below generic equivalents in order to maintain a share of the market. When this type of pricing anomaly happens, plans that automatically defray generics risk paying significantly more, sometimes for widely prescribed medications.

Frame Your Euro

If you have a Euro, frame it because it is not going to be around much longer, says Bruce Campbell, of Pyrford International. Speaking at a BMO Asset Management seminar, he said the currency makes no sense. In the past, countries could devalue their currencies to get out of default situations since interest rates reflected sovereign risk. Between 1978 and 1999 when the Euro arrived, countries such as Spain, Ireland, Greece, and even France all used currency devaluation to get out of default positions. When the Euro arrived, and all European nations using it had the same short-term interbank rate, it allowed some governments to go on a spending spree. He expects sovereign defaults (disguised as restructuring or repurposing) will occur within the Euro-zone and investment in European banks should be avoided because they will be hammered.

Employers Need To Care For Employees

Employers cannot depend on the primary care system to look after the mental health of their employees, says Larry Myette, an occupational medicine consultant at Healthy Horizons Corporate Health Consulting Inc., they need to provide it to their employees themselves. He told the Conference Board of Canada’s ‘Workplace Mental Health 2011’ session ‘Preventing Needless Work Disability from Common Mental Disorders: The Role of Employers in Health and Productivity Management’ that mental disorders are a leading cause of disability in working age employees. In fact, cancer and cardiac disease should not be considered as important by employers because mental diseases start at an earlier age and can reoccur many times during a person’s career unless measures are taken to prevent relapses. As a leading cause of disability, it is not being addressed by plan design.

Ambachtsheer Earns Lifetime Award

Jane Ambachtsheer, partner and global head of Mercer’s Responsible Investment business, has been chosen as the honourary recipient of the Social Investment Organization’s ‘2011 Canadian SRI Lifetime Achievement Award.’ The award recognizes those committed to the promotion of ESG (Environmental, Social, Governance) in the Canadian investment space. Through this award, the SIO is recognizing Ambachtsheer’s leadership and commitment to the industry. She established Mercer’s global RI practice in 2004, the first of its kind in a global consulting organization.

Funds Surpass Trillion Mark

The value of Canadian employer pension funds surpassed the $1 trillion mark ($1.05 trillion) for the first time during the fourth quarter of 2010, a 5.1 per cent increase from the third quarter, says Statistics Canada. Employer pension funds have not only recovered from losses experienced during the 2008 financial crisis, they have also posted two consecutive years of double-digit gains. After falling 13.1 per cent in 2008, pension fund assets rose 10.5 per cent in 2009 and 14.4 per cent in 2010. The proportion of total pension fund assets held in bonds edged down to 35.5 per cent, while the proportion held in stocks increased to 33.8 per cent.
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**OPTrust Exceeds Benchmarks**

The OPSEU Pension Trust (OPTrust) had investment results of 13.9 per cent for 2010, outperforming its 10.9 per cent benchmark and significantly exceeding its funding target of 6.75 per cent. Total investment earnings were $1.53 billion, up from $1.35 billion in 2009, and net assets available for benefits rose to $13.3 billion at year-end. Its performance in 2010 built upon the continued broad-based recovery in global investment markets. Each of OPTrust’s major portfolios achieved double-digit returns with public equity, real estate, and infrastructure portfolios accounting for more than 90 per cent of outperformance relative to its benchmark portfolio.

**Next Wellness Step Taken**

Equitable Life of Canada has taken the next step in its health and wellness solutions by introducing an online health assessment tool to help plan members better understand and manage their health. With the tool, plan members respond to a series of questions regarding health indicators as well as their health preferences (nutrition, exercise, and/or workplace sponsored events) through a user-friendly online platform. This feedback can then be used to support group benefit and wellness resource decisions and efforts. This can strike an effective balance between the employer’s need for benefits cost management while providing practical and useful health tools that show plan members that their health is valued.

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**Administrator Determines Division Of Assets**

Ontario’s amendments on the division of pension assets on the breakdown of a spousal relationship have been proclaimed and will come into force January 1, says a Mercer ‘Communiqué.’ Under the new rules a pension entitlement will continue to be a family asset for purposes of determining net family property. However, the value of the entitlement and of the pension available for division between separated spouses from a registered pension plan must be determined by the plan administrator. Valuation and division will be standardized and plan administrators will be entitled to rely on the information provided to them in approved application forms.

**Half Of Plans Converted**

Just over half (51 per cent) of private sector Defined Benefit plan respondents have now converted their plans to Defined Contribution arrangements for current or future employees, up from 42 per cent in 2008, says a survey of Canadian plan sponsors by Towers Watson. And, the study suggests that this trend shows no sign of relenting. It also reveals that recent improvements in economic conditions have had virtually no impact on executives’ perception of a DB funding crisis. The percentage of respondents who agree that there is a pension funding crisis has remained at historic highs since the financial downturn of 2008. The survey found that more than half of respondents (56 per cent) believe that the funding crisis will persist for the long-term compared to 34 per cent who held this view in 2008 before the onset of the recession. Just under one-third (32 per cent) perceive funding challenges to be a cyclical phenomenon.

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**Letter to the Editor**

**Why Not One Big Personal Credit?**

I agree that the idea of a lifetime accumulation plan (see ‘Lifetime Accumulation Plans,’ the editorial on page 4 of the June issue of Benefits and Pensions Monitor) would be fairer in some respects than the current state of affairs.

However, it still favours those who are able, at any point during their careers, to save for retirement versus those that can’t. So, it’s still a tax break for some people and not for others.

Wouldn’t it be far better to eliminate all tax breaks and let people manage their own affairs without behaviour targeting tax incentives?

What I’d like to see is all credits (yes, including sacred cows such as RRSPs, charitable donations, CPP, EI, tuition fees, old age security, child tax credits, disability, medical) replaced by one big personal credit per adult, say $25,000. Then, make it transferable between spouses with a single rate (35 to 40 per cent combined federal/provincial) on all income over that (yes, including dividends and capital gains – with capital gains adjusted by CPI so you’re not paying tax on inflation).

That one deduction could be thought of as a proxy for all the deductions they currently get at various stages in their lives such as, for example, tuition, children, retirement savings, and old age.

This way, everybody has the same starting point. Let them decide for themselves where they want to put their money on an after-tax basis and make sure they pay the same rate of tax regardless of where the money comes from.

Just another simple solution that isn’t going to happen.

Mark Tilley, CMA
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For more information, contact Duane Green, Senior Vice President, Institutional Investment Services, at 416.957.6165 or dgreen2@franklintempleton.ca

*As of June 30, 2011, total global Franklin Templeton Institutional assets.
Calvin Jordan is chief executive officer at the NSAHO Pension Plan. In 2005, he joined the plan after having provided consulting services to it for most of the prior decade as a consultant in the retirement and investment practices at Mercer.

The NSAHO Pension Plan is a $3.7 billion pension fund that provides pension benefits for about 33,000 healthcare workers in Nova Scotia.

Q. Where was the plan prior to the decision to use leverage to de-risk?

Going back perhaps a dozen years, our investment strategies started to move away from the traditional 60/40 per cent asset mix. We started to expand into various alternative strategies. That decision was really taking place through 2007 and early 2008, before the financial crisis had occurred.

It had been awhile since we had done a comprehensive review of our investment strategies and we started off with an investment policy review without really knowing in advance where we were going to end up.

Q. So how did you end up going in this particular direction?

A very key part of our review was to go through an asset liability study. We modeled several different alternatives relative to what we were currently using. One of those alternatives was to include a fixed income overlay. In the past, we had already done what some people are referring to as ‘LDI version one.’ We already had fixed income which was long duration with the idea of it matching fairly well with our liabilities, but it was just in our physical exposures. We had not gone into synthetic or unfunded or leveraged exposures.

Part of our asset liability study was to extend that into the synthetic or unfunded realm and look at what it would do to our expected risk and to our expected return and to include additional fixed income exposure without being constrained to using physicals.

And the results, as least on a model basis, were remarkable. Most of us are used to thinking of anything that gives you higher expected returns as having higher risk attached to it. The model results were quite convincing of it going in the opposite direction. It was higher expected returns and lower risk. It was a rather disorienting result, but it came from having more fixed income exposure without taking away our asset allocation from any other exposures. We were not investing in more fixed income at the expense of some of our allocations. We were investing in more fixed income in addition to our other exposures, something that, obviously, leverage allows you to do.

Q: Why is this approach within reach for small plans?

When we implemented all of this at the end of 2008, we were only about $2 billion at that time. I will also say that our staffing levels are much less than what you would tend to see in plans of $2 billion. At the time when we implemented all of this, there were only three of us involved on the investment side – myself and two other individuals that are very involved in terms of back office function. None of the three of us worked on a full-time basis on investments.

There would be a lot of plans that are much smaller than we are, that would have more internal resources than what I just described. Beyond that, even if a plan is really quite small, and I am talking maybe $100 million or so, there are various approaches that are different than what we used which are simply to outsource a lot of the implementation.

In our case, all of the derivative exposures that I described for the fixed income – the bond forwards, the late settlement bonds, and the repos possessed bonds – was implemented by our fixed income manager.

They do charge a fee for that, but the fees that they charge are very, very minimal. Some of your readers might be under a $50 million dollar range, $100 million dollar range, or $150 million dollar range, and there are several different service providers, investment managers, out there that do offer a turnkey solution that offers many of the same elements that I described. You have to pay for it, but nonetheless, it is a way of implementation for the pension plans that do not even have the three part-timers that I described in our case.

For a complete transcription of the interview with Calvin Jordan, visit www.bpmmagazine.com
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Epilepsy – a chronic, neurological disorder distinguished by recurring seizures – affects approximately 0.6 per cent of the Canadian population. On average, there are 15,500 new cases annually (that’s about 42 people per day). However, despite the prevalence of this condition, popular misconceptions abound leading to misunderstanding, often-unnecessary challenges, and discrimination against those affected.

While about 60 per cent of all new diagnoses of epilepsy are young children or senior citizens, anyone, even animals, can experience a seizure at any point in their lives. Although the root cause is unknown in 50 to 60 per cent of all cases, some common ones include stroke, head trauma, infection (such as meningitis), or alcoholism.

During A Seizure
Seizures are categorized as either distributed/generalized (affecting the whole brain) or partial (affecting part of the brain). A simple partial seizure is not characterized by loss of consciousness, while a complex partial seizure is.

The most common forms of treatment are the prescription of anti-seizure medication, brain surgery, an implanted medical device, or an extremely specialized ‘ketogenic’ diet which has been significantly successful for some people.

Sadly, the unemployment rate among people with epilepsy is double that of the general population. Of those who are employed, about 40 per cent claim to be in occupations that do not make full use of their skills. Experts suggest the cause of this is a misunderstanding of the condition and its perceived negative effect on workplace productivity.

Epilepsy is all too often assumed to be an illness that can severely affect an employee’s ability to work. In reality, it often doesn’t affect a person’s ability to work at all. It is a treatable physical condition and employees with epilepsy are just as efficient, stable, co-operative, and productive as others. In fact, studies have shown that accident rates and rates of absenteeism are actually lower among them than among other employees.

Another commonly held belief is that liability is higher for employees with epilepsy than it is for others. In reality, liability need not be a concern. All employees are covered by the Workplace Safety and Insurance Board (WSIB), whose rates are tied to the type of company and the claim rate, not to employees’ health conditions. Plus, it has a Secondary Injury and Enhancement Fund which reimburses both the employer and the employee for losses in the event of an injury caused by a seizure, as long as the employer knows about the employee’s condition beforehand. Moreover, this type of claim is processed separately from regular accident claims so there is no impact on the yearly WSIB rates.

Rights And Legal Obligations
While it’s illegal for an employer to ask medical questions on an application form or in an interview, it’s okay to ask if a person has any medical condition that may prevent them from performing the job adequately. If it’s revealed during the interview that a prospective employee has epilepsy, the employer may request details about the types of seizures a person experiences and whether or not any adjustments would be required. A work-related medical examina-

Workplace accommodations of this sort are undemanding and inexpensive. With a little creativity and a desire to increase awareness, employers can ensure that employees with epilepsy feel safe and comfortable at work and are able to contribute at their full potential.
Pensions and benefits.

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Martin Leclair, CFA
Chair, 2011 CPBI Ontario Regional Conference

Gala Evening - October 20, Paul Summerville

At a 2,000 plus person gala dinner in Toronto in 1998, Paul Summerville, drawing on his years working and studying in Canada, Israel, Switzerland and Japan plus his experience in radio and at Yuk Yuk’s performed a light hearted comedy routine with a very serious message that among other things exposed the duplicity of economists, politicians, central bankers, and the financial industry that stunned the audience.

The memorable performance was written up in Macleans’ Magazine and the editorial pages of the Globe and Mail that still resonates on Bay Street more than a decade later.

After considerable arm twisting, we have enticed him for a second-in-a-lifetime performance where now he can also draw on the new found experiences of managing a credit derivatives business in Asia, running for the NDP in the 2006 federal election, and working for one of the world’s leading investment management firms in Boston.

Hold on to your hats and leave at home all your expectations about how the economy really works.

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Academics have made notable progress over the past 50 years understanding both the risk and return of various financial assets. They have produced the Capital Asset Pricing Model (CAPM), the Arbitrage Pricing Theory (APT), and the Black-Scholes option model to mention a few. One of the general lessons that emerges is that, over long periods, a ‘consensus’ investor cannot consistently earn above-average returns without incurring above-average risks. This relationship is generally observed when one compares among various asset classes over a long investment horizon.

However, the relationship is notably absent when one looks within the stock market. On average over long periods of time, stocks with higher volatility do not earn higher returns to compensate investors for their higher level of risk. Looking back over the past 15 years, higher volatility stocks have actually, on average, delivered lower returns than the broad market. The anomaly part of the ‘Low Volatility Anomaly’ is really the reason why higher volatility stocks underperform the market.

Surprisingly, this observation is not new. Academics noted almost 40 years ago that the relationship exists in many different equity markets outside of North America.

So why do high volatility stocks consistently underperform? Several lines of research have emerged to explain these findings. The first line of research is generally described as behavioural, as it relates to the behaviour of individual investors.

- The Lottery Effect – Research has shown that individual investors show a preference for situations that have a small probability of an extremely large gain, similar to the payout of a lottery ticket. In the world of stocks, investors may view high volatility stocks as their ‘lottery ticket.’

- Uncertainty and Optimism – Stocks with high volatility tend to be ‘story’ stocks that have a higher degree of uncertainty surrounding their business. As such, it is much easier to build an investment case that relies on overly optimistic future projections.

- Glamour Preference – Investors are drawn to trendy, exciting, or glamour stocks. In addition, investors typically have a preference for ‘big winners’ versus slow, steady performance.

In addition, there are several structural constraints that have been identified as possible origins for, or contributors to, this anomaly.

- Benchmark sensitivity and the long-only constraint – Academics have also argued that the preponderance of long-only institutional investors, who are very focused on active risk relative to a capitalized weighted benchmark and rarely employ leverage, amplifies this anomaly. Their argument is essentially that low volatility stocks generate too much tracking error for these types of mandates, which cause managers to give a preference to higher volatility stocks.

- Focus on return instead of risk – Many investors, particularly retail investors, still focus purely on returns. Strategies built around the low volatility anomaly generally deliver returns that are in line with the broad market, but with a reduced risk level. This important point is often lost.

With every investment strategy, hindsight is 20/20. Yet, the key question faced by the pension trustees of today and tomorrow is ‘Will it last?’ Many of the behavioural and structural arguments presented are not expected to change in the next few years. Individual behaviour, while fickle and unpredictable in the short run, tends to repeat itself over the longer term. And while institutional inves-
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¹ As at December 31, 2010, Invesco Ltd. has US$221.1 billion institutional assets under management.

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The past two decades have been an illustration of extremes for companies that sponsor pension plans. The 1990s were golden years for pension plans. Defined Benefit pension plans experienced years of surpluses that funded both contribution holidays and benefit improvements. Defined Contribution plans earned good returns, almost regardless of how the assets were invested. In the 1990s, good pensions cost very little.

The first decade of the 21st century was far different. We experienced a combination of poor investment returns and falling interest rates – a painful combination for companies that sponsor DB pension plans. This is also a painful combination for individuals that are saving for their own retirement in DC plans as not only have investment returns been below expectations, but the amount of retirement income that can be provided by the assets that have been accumulated is also reduced as a result of the low interest rate environment. In the 2000s, good pensions were very expensive.

**Long Horizon**

The goal of the traditional DB pension plan was to try to provide employees with adequate pension benefits while insulating them from the uncertainties of being personally responsible for investing their own retirement income. Risky investments and short-term volatility were supposed to pay off over the plan’s long horizon and across multiple generations of employees. However, the last two decades have shown us that guaranteeing a lifetime pension and backing that promise with investments in the stock market can be risky, even in the long term. Sometimes this risk pays off … sometimes it doesn’t … and these cycles can last decades.

Pension plans have also become much more mature over the past two decades. The maturity of these plans means that most companies can no longer accept the same level of risk as in the past. The combination of risk and maturity has led some companies to ask themselves if they should continue to offer a pension plan. Do employees really value pension plans?

To help answer that question, Mercer’s ‘What’s Working’ survey asked almost 30,000 employees in 17 countries (2,000 in Canada) what they value about working for their current employer. A good retirement savings or pension program ranked as the second most important element to employees. Perhaps surprisingly, a good retirement savings or pension program ranked in the top four for age groups between 25 and 45. With an aging workforce, the importance of pensions is unlikely to fall.

**Control Risk**

So where do we go from today, knowing how important retirement programs are to employees? In short, the answer is control risk. Controlling pension plan risk will drive pension plan design much more in the future.

For many companies, a decision has already been made to control risk by changing the plan design from a DB pension plan to a DC pension plan. For these companies, the plan’s design must answer the following questions:

- Are contributions sufficient to provide employees with an adequate retirement income?
- Is sufficient investment education being provided while employees accumulate their retirement savings?
- Are sufficient education and retirement options available to help employees manage their retirement savings in their retirement period?

For other companies, maintaining a DB design remains an important part of their human resource strategies. These companies must look to other plan design strategies to help control costs and risks.

For companies that are comfortable with the risks associated with their DB pension plans, but wish to reduce the cost of offering a pension plan, increased cost-sharing is an option to consider. Increased cost-sharing is accomplished by either introducing or increasing the level of employee contributions. While increased contributions do not reduce the risk of offering a pension plan, it recognizes the increased cost of offering a DB pension plan in a low interest rate environment. Alternatively, benefits can be reduced in respect of future service.

For most companies, managing the pension plan is about more than just cost, it is also about helping to manage risk.
Within a traditional DB plan design, one change that can help manage both risk and cost is a combination that includes both a restructuring of the plan’s investments to significantly reduce the exposure to equity investments with a corresponding reduction in the level of plan benefits. This combination can result in a similar company cost, but with less risk to the company than the current arrangement. While investment risk is reduced, other risks still remain as guaranteed pension benefits continue to be provided for life. Employees may also question the value of this pension strategy as it would be similar to forcing employees to invest retirement savings in long-term bonds and buy annuities at retirement – potentially leading to safe, but inadequate, pension benefits. This is an investment and annuitization strategy that few employees are willing to adopt for themselves in a DC plan.

**Investment Risk**

If employees are willing to accept investment risk in DB plans, perhaps they are also willing to accept a similar risk in respect of future service in a less traditional target DB pension plan.

A target DB pension plan is a pension plan in where contributions are set to provide a given level of ‘target’ retirement income (similar to a traditional DB pension plan). However, unlike a traditional DB pension plan, accrued benefits can be reduced for both active and retired plan members if the plan has insufficient assets to pay the ‘target’ benefits.

If benefits can be reduced, how does a target benefit plan differ from a DC plan? The difference is in how risks are shared among plan members.

In a DC plan, all assets are allocated to individual plan members and there is no sharing of risks. In a DC plan, each plan member’s account balance immediately reflects any gains or losses on plan investments and each plan member’s account balance is used only to provide their benefit at retirement.

In a target benefit plan, there is risk-sharing among plan members. Pensions are still paid for life as a sharing of mortality risk exists between plan members that die young with those that live past current life expectancies. There can also be a sharing of investment gains and losses as gains and losses can be phased in over a period of time to help manage retirement planning. However, the period of time used should balance the competing desires to help manage large changes in retirement income and to minimize intergenerational transfers of cost.

The current ability to adopt target DB pension plans varies by jurisdiction. For example, in Ontario, union negotiated pension plans can currently adopt target benefit plan designs. Similar plan designs (while in the process of being passed into legislation in Ontario) are not yet available for non-negotiated pension plans.

**Likely Numbered**

Employees may prefer a traditional guaranteed DB pension over a DC plan where they bear all of the risks individually. However, the days of companies guaranteeing safe, adequate pensions in a world without safe, high yield investment options are likely numbered. It may be time to find out if employees prefer DB pension plans that provide a target benefit most, but not all, of the time or a DC plan where employees bear all of the risk and/or reward with personal investing and longevity.

Regardless of whether a company decides to maintain a traditional DB pension plan or convert to a DC pension plan or a new risk shared DB pension plan, the availability of a good retirement savings plan continues to be valued by employees.

Scott Clausen is a partner in Mercer’s retirement, risk, and finance practice (scott.clausen@mercer.com).
When financial and capital markets are stressed, it is not unusual for the performance of traditional and most mainstream hedge fund strategies to converge. So are there assets and strategies that have, can, and will likely continue to buck this trend?

If the assumption is that risk-bearing is compensated by returns, then, if the source or origin of the risk (return driver) could be isolated and were to reside outside of financial markets, it should be insulated from the vagaries experienced by the markets. Further, if made investable, it could provide exposure to a specific, non-replicable, unique risk premia that could deliver a stream of distinct returns. For instance, neither the biological growth of trees nor the occurrence of natural/weather phenomena are influenced by events playing out in either the financial and capital markets. Quite simply, trees will continue to grow in volume and value provided they have adequate sunshine, water, air, and the appropriate soil conditions. Natural catastrophes such as earthquakes will continue to strike without our ability to accurately time and or predict their occurrence.

Extracting Performance

Besides, the process of actually extracting performance from the source of such risks or the wrapper/instrument that make it an investable proposition (an investment vehicle – for example, in the case of earthquakes, Cat ‘bonds’ which have a component of interest rate-related risk, or weather derivates based on daily shifts in temperatures), unfortunately means, by default, that market (risk) contamination starts creeping in.

It is also important to recognize that even though the source of risk resides outside the financial and capital markets, the risk is real as are the prospects of being compensated for it. For an exposure to such risk is not immune to a performance pull-back, as its risk profile is different and its return drivers or triggers are idiosyncratic. But an exposure to such risk can be calibrated and, if taken on, offers access to a source of partially inhomogeneous return.

Idiosyncratic Risk

Similarly, research I have undertaken reveals (affirmed by the occurrence of the credit and sovereign debt crisis) that select sources of idiosyncratic risk, although not originating in nature, are equally capable of offering unique risk-return profiles, provided the risk transfer process has been structured ‘correctly.’

As described above and in my book,1 I have classified such asset classes and strategies as ‘Alternative Alternatives.’ The working definition for which is unconventional, non-traditional, non-mainstream hedge fund investments and strategies whose risk profiles and return drivers are atypical, unique, and/or idiosyncratic in nature. These include timberland investing, insurance risk transfer, asset/loan based lending (aviation, shipping, trade, entertainment, litigation financing, etc.), collectables, and extraction strategies such as volatility and behavioural finance.

‘Alternative Alternatives’ can also be classified based on their characteristics, such as their non-replicable source of risk or risk that cannot be replicated easily. For example, it is difficult to replicate the actual occurrence of a natural catastrophe, such as a specific earthquake, or the biological growth of a given 25-year-old tree. Their risk is idiosyncratic in nature. For instance, in the case of asset based lending strategies such as in trade finance, each loan is unique for a specified purpose and period in time.

However, in practice and in the real world, it is virtually impossible to get ‘exclusive’ exposure to naturally occurring sources of risk – as in, ‘just’ being able to invest in an earthquake or ‘in’ a certain degree of climatic temperature. Even though one can invest in a physical tree (the biological growth), the inherent assumption being made here is that the ‘price’ of that tree is not zero as it conforms to the laws of demand and supply.

Alternative Alternatives
Hence, it needs to be analyzed, assessed, and evaluated for its risk-return profile on an individual basis.

Their markets tend to be inefficient and are driven by factors such as, in the context of investing in collectables, who is looking for which painting or rare wine bottle? How much are they willing to pay? Who is a distressed seller? Is it a verified ‘original’? How scarce is it? They are also heterogeneous, as in the context of micro life settlements – longevity/mortality risk – with each policy being unique or, in the case of asset-based lending strategies, each loan needs to be evaluated and structured individually. Amongst a particular asset class/strategy – for example, naturally occurring catastrophes, winds in Europe, and an earthquake’s occurrence in the U.S., Japan, etc. – each is independent of each other.

Steady Cash Flow

In the context of investing in alternative alternatives, the concern that gets voiced most often relates to their ‘liquidity,’ respectively their illiquidity. Clearly, if the biological growth of a tree is intended to be the main return driver, it is unlikely to trade as a stock would. But, if desired, an investment in timberlands could be structured to generate steady cash flows. This could be achieved, for instance, by investing in different aged forests to optimize the harvest-window led return cycle and also meet cash flows requirements through geographical diversification, across species with shorter and longer rotations, and different uses for the timber (as in bio fuels, as hydro poles, etc.). In fact, based on my research and as deduced post the credit crisis, alternative alternatives have not only shown resilience in performance, but have also proved they can be ‘liquid’ when really required.

Valuation of these assets and strategies is also considered a challenge and draws investor scepticism, particularly in the context of investing in collectables such as art, wine, vintage cars, etc. One way of lowering such risk is to work with experts in the field. The other rule that applies not just when investing in alternative alternatives, is that there is no substitute for doing your homework and conducting a thorough due diligence. For some investors, the costs of the latter often do not justify the amount to be allocated. Still others view headline risk and capacity constraints as a deterrent.

In Their Nascency

Alternative alternatives might remain out of bounds and off the radar screen for some and as asset classes/strategies are still considered to be in their nascency. This means that statistically significant data is often incomplete, lacking, and scarce. Assuming it were available, caution needs to be exercised in its interpretation as by definition a lot of these asset classes and strategies are characterized by idiosyncratic risk – measuring and pricing those occurring in nature, regulatory, legal, valuation, illiquidity, related risk, and others.

Hence some of these strategies might never assume ‘mainstream’ status; it is possible that some may remain supply constrained and, on a relative basis, may continue to be more illiquid than their traditional asset counterparts. In addition, the underlying risk in some instances could prove to be deceptive and more complex than bargained for. To go full circle, however, I believe it is these very characteristics that will enable alternative alternatives (as an asset class/strategies) to afford a distinct risk return profile than that offered by traditional assets and mainstream hedge fund strategies.

Sona Blessing is a research specialist, consultant, and author of ‘Alternative Alternatives’ (blessing@opalesque.com).

I s risk management for Defined Contribution pension plans as straightforward as seeing to it that an employee has sufficient assets at retirement? If so, then employers should simply increase contribution levels in hopes that everyone will be happy with more money and the problem would be solved, the risk managed – right? Oh, if only it were that simple.

In fact, the risk that DC plan sponsors should really be managing is that of an employee perceiving that he or she was misled or mistreated.

Uncertainty Mounts
As the number of DC pension plans grows, so does the number of Canadian households exposed to financial markets and the attendant retirement income uncertainty. And as the amount of dollars invested in conventional DC plans increases, so too does the risk exposure for individuals and their families.

The conventional approach to managing DC pension risk has been to first put together a plan design – primarily around a fund line-up and default fund option – and then focus on employee education. Often education means that plan sponsors and their advisors bombard employees with information in hopes that they will ‘get it.’ In practice, this approach is ill-suited to individuals who, quite frankly, don’t want to read about how to save, why to save, and what happened in the markets last month.

Some propose enhancing financial literacy among DC members as the means to narrow the gap between employee expectations and outcomes. As the recently-tabled report of the federal Task Force on Financial Literacy makes clear, however, financial illiteracy is a widespread, long-term challenge that calls for a wide range of long-term solutions. Often, the lack of financial literacy stems not from a lack of available resources, but from a lack of interest and aptitude to manage DC pension assets and make decisions including how much equity to hold in relation to bonds, which funds are most suitable, and what rebalancing, diversifying, emerging markets, Greece, and inflation actually mean.

Beyond the questions of how to invest, members need to consider retirement planning questions, such as:

♦ how much do I need to accumulate for an adequate retirement income?
♦ what is a reasonable assumption for future inflation?
♦ how much risk can I tolerate?
♦ how does the time value of money fit into the picture?

These questions are challenging for experts to ponder, never mind an average DC member. The industry makes a multitude of planning and projection tools available, but for these to be of any use a member needs to be engaged, have some comfort with ambiguity and financial assumptions, and be willing to take time out from work and family to sit down and run the numbers.

Dose Of Perspective
No wonder so many individuals are disengaged when it comes to their responsibilities as a member of a DC pension plan. For a dose of perspective, it is helpful to consider the level of expertise that goes into a well-managed ‘traditional’ Defined Benefit pension plan, including consultants, investment experts, and actuaries who monitor, assess, and advise on the health of the plan and utilize sophisticated models to determine the level of contributions required and the optimal investment mixes that are expected to deliver the correct ultimate benefits.

Plan members only have to remit contributions, receive an annual statement, and collect a pension when they retire – that’s it. Are we really asking lay individuals in DC pension plans to replace the training, knowledge, and experience of investment and actuarial experts?

The DC pension plan needs to move closer to the DB model. That doesn’t need to mean a promise of monthly pension amounts within DC plans, but rather a focus on the DB delivery mechanism. Some actions to consider include:

♦ Take matters out of the hands of employees
♦ Manage towards a particular outcome
♦ Hire professionals where appropriate

Traditionally, DC plan sponsors have declined to take on too much on behalf of employees out of fear that it will ‘get it.’ In practice, this approach is ill-suited to individuals who, quite frankly, don’t want to read about how to save, why to save, and what happened in the markets last month.

Technology Can Succeed Where Individuals Fall Short

Technology Can Succeed Where Individuals Fall Short

Technology Can Succeed Where Individuals Fall Short

Technology Can Succeed Where Individuals Fall Short
of the potential liability for being deemed to be providing investment advice to individuals. However, by focusing on designing retirement programs that are well and thoroughly explained, that help individual employees set a target retirement income, and help them achieve their targets, the less likely it is that individual employees will feel misled or mistreated in the first place.

So what are the risks that make DC plans so much more problematic than DB? These include:

- **Not saving enough** – This is often cited as the single biggest factor to the success of any pension program. As a rule of thumb, many experts suggest that annual savings of 10 per cent of pay, or more, is necessary.
- **Not earning enough** – This is commonly referred to as investment risk, that of investments losing money in a given year, but, more significantly, that investments fail to earn enough over time, after fees, to fund a desired monthly pension amount in retirement.
- **Withdrawing too much** – This risk has caused many individuals to retire much later than they otherwise wished. The fear of withdrawing too much money too early and subsequently running out of money is a difficult proposition to face. Purchasing an annuity with DC pension assets at retirement is a simple option for handling this risk, provided the amount of the monthly payout is sufficient, but few DC members elect to do this.
- **Living too long** – Also referred to as longevity risk, it asks what happens if you budget your retirement assets based on living to age 80, but, in fact, you live to age 85? Since, by definition, half of people will outlive their life expectancy, something more sophisticated is needed. Again, purchasing a monthly annuity with DC pension assets is a great solution to mitigate this risk, but these are not very popular.

So the question that needs to be asked, recognizing that DC plans are here to stay, is: how do we build some of the useful characteristics of DB plans into a DC plan?

First, pension committees need to take on more responsibility. Second, plan sponsors, advisors, and members need a reminder of the purpose of a pension plan – to provide a stream of income sufficient for an individual to leave his or her full-time job at retirement age. Finally, we need to leverage technology to monitor DC pension savings progress and to make most decisions on behalf of individuals based on rules and processes that support their overall goal.

In the end, we can have a dynamic DC program that actively makes decisions for individuals who would otherwise not make a decision or may make a poor decision.

### Dynamic DC Pension Solutions

The components of a dynamic DC plan – an ‘individual target benefit plan’ – would look something like the following:

- **Auto enrolment** – All plan members are enrolled in the pension plan upon hire, with a default employee contribution rate of five per cent of gross salary and the employer contribution rate matches the employee contribution.
- **Auto escalation** – Employee contributions increase with pay raises, up to a pre-defined maximum amount (for example, 10 per cent of pay).

#### Table 1

<table>
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<tr>
<th>Key Employee Risks</th>
<th>Defined Benefit</th>
<th>Defined Contribution</th>
</tr>
</thead>
<tbody>
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<td>Not saving enough</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Not earning enough</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Withdrawing too much</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Living too long</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

- **A target monthly pension is automatically calculated for each individual based on retirement at age 65 with a default replacement ratio of 70 per cent, including CPP/QPP and OAS; the member can define a different replacement ratio if they choose.
- **A default risk tolerance and investment allocation is determined based on the duration to default retirement age (similar to a target date fund).**
- **Individual progress towards the target is monitored by the recordkeeping platform. Automated adjustments would be made annually by the recordkeeping platform. If the member’s projected income is falling short of the target monthly pension and the investment allocation is more conservative than would be indicated by the member’s duration to retirement, then the risk allocation is increased and employee contributions are automatically increased up to a pre-defined maximum.**

If the member’s projected income is exceeding the target monthly pension, the investment allocation is automatically adjusted to a more conservative portfolio and employee contributions are automatically reduced up to a pre-defined minimum.

If the member is within 10 years of retirement, they are sent a special notice offering the option of purchasing an annuity with a portion of their savings.

At retirement, the member is offered the option to purchase an annuity or transition to an automated withdrawal program which automatically manages the member’s income and investments in the de-accumulation phase based on a 90th percentile life expectancy calculation.

The process described above can be thought of as an individual target benefit plan model. It is a program that uses expert assumptions and analysis and modern recordkeeping platforms to manage retirement savings in a way that we all wish DC plan members would, but that we all know most won’t.

Ultimately, plan sponsor risk will be reduced once individual plan members start to enjoy better pension outcomes and see that more is being done in support of their retirement goals. Technology can aid this effort where individuals fall short.

Kevin Sorhaitz (ksorhaitz@morneaushepell.com) and Idan Shlesinger (ishlesinger@morneaushepell.com) are partners with Morneau Shepell.

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**DC Meets Needs Better By 2015**

Automatic enrolment with automatic escalation will make the Defined Contribution plans of 2015 better-suited to help participants achieve a successful retirement, says Diversified Investment Advisors’ ‘Prescience 2015: Expert Opinions on the Future of Retirement Plans.’

It predicts automatic enrolment, now available in 50 per cent to 60 per cent of large plans, will be available in nearly three-in-four plans.

Automatic escalation, available in one-quarter of plans today, will be available in 43 per cent of plans. The experts believe that pairing automatic enrolment with automatic escalation is critical to participants’ achieving a funded retirement.

By 2015, more than one-third of plan sponsors will outsource all retirement plan functions to a single vendor. Total retirement outsourcing to Defined Benefit plan administration outsourcing will remain most popular among employers with frozen plans. However, by 2015, 40 per cent of U.S. employers with 5,000 employees or more will offer a DB plan, active or frozen. Thirty-six per cent of plans today will be frozen by 2015 and an additional 14 per cent will be terminated.

Among the surviving plans, cash balance and pension equity plan types will prevail.
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A decade ago investors saw the beginnings of a secular growth trajectory for emerging markets that has firmly established itself since the beginning of the financial crisis in 2008. Slowly but surely, emerging markets have become drivers of growth for the world economy, a trend we expect to continue over the foreseeable future.

Structural adjustments and economic reforms in the 1990s positioned emerging markets to be better able to weather the current crisis. Stronger macro-economic policies and rising consumer demand have accelerated trend growth rates and, perhaps more importantly, allowed emerging economies to cast off their historical high dependency on the G10. This has been clearly demonstrated by data showing that emerging market economies have done better than their developed peers – posting flat GDP growth in 2008 (while the G10 economies declined by 4.5 per cent), positive GDP growth in 2010, and forecast growth of six per cent in 2011 (four per cent higher than the G10).

In the last two decades, those who invested in emerging market equities have been rewarded with annualized equity returns of 12 per cent versus five per cent for developed markets. Yet, many institutional investors’ exposure to emerging markets remains underweight relative to the benchmark 13 per cent allocation of the MSCI All Country World Index.

While emerging equity markets this year have been reintroduced to volatility, the current pause may offer an entry point. We believe that emerging market equities continue to offer a potentially valuable investment opportunity over the long-term.

**Resilience In 2011**

The first half of 2011 proved challenging for emerging equity markets as a troika of issues dominated equity investor expectation:

- Improving prospects of developed economies (led by the U.S.)
- Rising fears of a growth slowdown due to moderation of growth in China and concerns about inflation
- Political turmoil in North Africa and the wider Middle East region

However, despite these headwinds, emerging market equities proved to be resilient declining by 0.45 per cent (as measured by the MSCI Emerging Market Index). Indeed, at the halfway point for the year, we see these headwinds waning.

While developed economies seems to have entered a temporary growthpause driven by a confluence of forces – earthquake in Japan, slower inventory accumulation, weaker consumption, a growing sovereign crisis in Europe’s periphery, and the increasingly intensifying problems of Greece. Real economic activity in emerging markets is robust bolstered by strong (if moderating) growth in China, a sharp rebound in global trade, and highly stimulative monetary policy.

Inflation has been a key preoccupation for emerging market equity investors manifested in lower growth expectations for economies and emerging market stocks. In our view, while inflation remains at a high level, monetary tightening, a drop in commodity prices, and base effects should all contribute to a gradual reduction in inflation and inflation expectations.

These changes have not gone unnoticed by equity market investors. Data from EPFR shows a sharp pickup in equity flows into emerging markets in the second quarter. Still as of July 1, 2011, emerging market equities had experienced $5 billion in outflows (after $78 billion in inflows in 2010). This type of cyclical moves in flows are bound to continue with investors’ changing risk appetite, differential expectations of emerging and developed economic growth, and overall geopolitical stability in emerging markets. However, flows of assets over the long-term are dominated by structural changes to investor’s portfolio allocation. This secular shift is inevitable. Over the last two decades, emerging markets’ share of world equity markets as measured by MSCI has increased from four per cent to 15 per cent. The average holding amongst institutional investors though still is a woefully low seven per cent of their equity assets. According to Merrill Lynch estimates, the allocation to emerging market assets is likely to rise to 15 per cent over the next two to three years. This shift has broad implications as the true challenge for emerging market equities may be one of sufficient absorptive capacity for these impending flows. In the short term, however, this provides a good support for asset prices.

**Potential For Growth**

Emerging markets represent 80 per cent of the world’s population, 30 per cent of global GDP, 75 per cent of the world’s land mass, and 66 per cent of its foreign exchange reserves. Yet, in aggregate, they make up less than 13 per cent of world equity market capitalization in institutional benchmarks. The potential for growth in these markets is considerable, given that per capita GDP is 10 per cent to 50 per cent of the level observed in most developed countries. Economists predict that emerging markets will deliver the bulk of the world’s GDP growth in 2011/2012, driven by continued and growing internal demand. If the corporate share of GDP remains constant, this could translate into potentially superior stock market returns.

Emerging markets are more stable, robust, and independent than in the past. The macroeconomic risks of investing in emerging markets have declined as several countries have improved their economic performance and continue to implement greater transparency, corporate governance, and common accounting standards. In addition, a considerable share of the world’s production is now based in the developing world and emerging markets have signifi-
icantly increased their exports to developed economies. These markets also look set to benefit from a substantial increase in domestic consumption in the coming years. The rising significance of emerging markets in the future growth of world trade and global financial stability has positioned them well to become critical players in global politics.

In an attempt to kick-start growth and provide economic stability, developed countries have accelerated their pace of borrowing. This growing debt burden provides significant headwinds for developed countries as they grapple with cutting both debt and significant fiscal deficits in an environment of constrained growth.

Greece has become a flashpoint for this dynamic. While developed countries face highly levered consumers and governments, emerging markets are enjoying growth cushioned by strong sovereign balance sheets and under-levered consumers. In 2010, the developed market (DM) average per capita income stood at $38,100 in purchasing power parity (PPP)-adjusted dollars (US$39,500). Russia recorded GDP per capita of $15,900* ($10,400), just 40 per cent (26 per cent) of the DM average. Brazil’s per capita income was $11,200* ($10,700) in 2010, while China and India lagged even further behind, with GDP per capita of just $7,500* ($4,400) and $3,300* ($1,400) respectively. Most economists expect the BRICS, particularly China and India, to continue to experience among the fastest GDP per capita growth rates in the world as they try and converge to DM levels. This should provide significant support for global growth.

After strong performance in 2010 and subsequent underperformance in 2011 (MSCI EM relative to MSCI World), emerging market equities are cheaper than their developed market peers. Emerging market stock returns have been driven by strong earnings expectations and look attractive in the context of the growth expected in 2011 and beyond. IBES consensus* expects earnings per share growth of 16.4 per cent (in U.S. dollars) for emerging market equities in 2011, followed by 13.4 per cent in 2012. At the current price to book value of 1.9,* this offers an attractive return on equity of 14.7 per cent. On price to earnings, emerging market valuations seem reasonable in the context of their history at a current forward price to earning ratio of 10.2. At this level MSCI Emerging Market is nearer to one standard deviation below its long-run average.

Well Rewarded

In summary, over the past 20 years, investors in EM have been well rewarded by equity returns that have far outstripped those of developed markets. Today the macroeconomic risks of investing in EM have fallen as several countries have improved their economic performance and continue to follow a path of greater transparency, corporate governance, and common accounting standards. As we look to a future with strong and stable EM governance balance sheets, combined with forecast GDP growth of four to five per cent greater than G10, this could continue to translate into potentially higher stock market returns. Investors should consider whether their current allocation to EM is suitable given the risk/return trade-offs.

Greater transparency and higher standards of corporate governance mean that it has never been easier to invest in emerging market assets to capitalize on the attractive investment opportunities these markets present.

Gaurav Mallik is a vice-president of State Street Global Advisors and a senior member of the global active quantitative equity team.

2. As at 30 June 2011.

*In purchasing power parity terms
MONEY MANAGERS

20th Annual Report & Directory in October

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* Starch Research February 2011
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<th>COMPANY</th>
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*As of March 31, 2011
a) 1 in International ex-US portfolio, 6 in Global portfolio
b) Institutional Clients, not including those with EAFE & Emerging Markets assets within a balanced portfolio
c) Canadian Institutional Clients
d) Does not include clients from network of approved fee-only financial advisors
e) 1 EAFE, 3 Global SC (Global & US)
f) Approximately 290 (includes Balanced accounts)
g) Includes EAFE assets managed in Balanced and Equity mandates
FRANKLIN TEMPLETON INSTITUTIONAL
Duane Green, Senior Vice-president, Institutional Investment Services; 200 King St. W., Ste. 1400, Toronto, ON M5H 3T4 Ph: 416-957-6000 Fax: 416-364-6643 eMail: dgreen2@franklintempleton.ca Web: www.franklintempletoninstitutional.ca

GUARDIAN CAPITAL LP
Joyce Hum, Vice-president, Consultant Relations; 199 Bay St., Commerce Court West, Ste. 3100, Toronto, ON M5L 1E8 Ph: 416-947-4096 Fax: 416-364-9634 eMail: jhum@guardian-capital.com Web: www.guardiancapitallp.com

HEXAVEST INC.

HSBC GLOBAL ASSET MANAGEMENT (CANADA) LIMITED
Francis Chartier, Head of Institutional Investment Sales; Ste. 300 - 2011 McGill College, Montreal, QC H3A 1G1 Ph: 514-286-4559 eMail: francis.chartier@hsbc.com Web: www.assetmanagement.hsbc.com

INTEGRA CAPITAL LIMITED
Charles Swanepoel, Co-chair Investment Officer; 2020 Winston Park Dr., Ste. 300, Oakville, ON L6H 6X7 Ph: 905-829-1131 Fax: 905-829-2726 eMail: contactus@integra.com Web: www.integra.com

INVECO
Joe Di Massimo, Senior Vice-president; 120 Bloor St. E., Toronto, ON M4W 1B7 Ph: 416-324-7442 eMail: joe.dimassimo@invesco.com Web: www.invesco.ca

J.P. MORGAN ASSET MANAGEMENT (CANADA) INC.
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Benefits and Pensions Monitor – August 2011
Why are we beating the pension reform horse to death? There are some easy answers.

As a result of some preparatory work for some recent speaking engagements and an opportunity to participate in one of the finance department’s pension reform roundtables last year, I found myself looking back at the overall issue to determine if there was something I was missing in the whole debate around pension reform.

Many issues and supposed truths have circulated and I highlight some of them below. This is by no means an exhaustive list:

◆ Defined Benefit plans are inherently superior to Defined Contribution plans
◆ Organized labour will resist all attempts to move away from DB plans (see above)
◆ The Canada Pension Plan should be doubled or in some way enhanced
◆ A new voluntary add on to CPP or some other supplemental plan should be created
◆ DC plans, group or otherwise, have extremely high fees when compared to DB pension plans, particularly as they relate to investment costs
◆ Big quasi-public plans are willing to manage the employer to participate and an inducement to get younger Canadians over a certain salary level to participate and participate at a level that will produce reasonable retirement incomes.

The interesting thing to note in all this is the means are almost at our fingertips even now.

The venerable Group RRSP provides a solution that will solve or at least assist in solving some of the key concern areas with some minor tweaks in tax treatment of employer contributions to maximize its effectiveness.

Eliminating nuisance payroll taxes on any employer contributions would remove the last real disadvantage of the structured group RRSP. Some of these can already be mitigated by insisting on no in service withdrawals and we advocate such a feature in all plan designs.

**What’s In It For The Employer?**

For the employer, there are a number of benefits from this approach. They include:

◆ Total flexibility in contribution design and the ability to forego contributions without consulting a regulator (a key inhibitor for many sponsors looking for cost controls and an emergency bailout option)

◆ Use of a leveraged formula to ensure sufficiency of outcome (employer matches at 50 per cent to some reasonable total target such as 12 per cent)

◆ Ability to target key employees, particularly much valued older knowledge workers, to retain their services

◆ Ease of plan design and administration with limited fiduciary responsibility

◆ No regulatory filings or fees

◆ Low cost investment vehicles on a group priced basis

◆ Options for employee advice services which are shown to improve outcomes

**Pensions Reform, What’s In It For Me?**

other smaller plans’ pension money, all for the greater public good

◆ Government and some insurers want to bring us the Pooled Registered Pension Plan

◆ Multi-employer target benefit plans are now paragons of virtue, cost efficiency, and good governance

Underlying all of this are the assertions that Canadians making more than $45,000 a year up and to $150,000 a year are not saving enough for retirement; Canadians in the 45 and under demographic – and perhaps even older – are carrying too much debt, in addition to not saving for retirement; and the current alternatives for solving this problem do not exist.

Poppycock!!!

**Political Agendas**

To sift through the various political agendas and also to look at people’s savings habits, one can fall back on a fairly basic principle – what’s in it for me?

This question, if asked often enough (or if turned around to read ‘what’s in it for them’), will explain much of what has gone on so far.

The real truth here is that for many Canadians saving for retirement, postponing consumption is simply not an option. Faced with the choice between immediate gratification, or even day-to-day living, and saving for a rainy day, most will say ‘let it rain later if it must and I will deal with it then.’

The key to the pension reform debate lies in figuring out how to get more Canadians saving and more employers participating in that savings process.

The current PRPP proposals seem to be heading in the right direction, but don’t address some basic concerns – most prominently, the requirement for the employer to participate and an inducement to get younger Canadians over a certain salary level to participate and participate at a level that will produce reasonable retirement incomes.

The interesting thing to note in all this is the means are almost at our fingertips even now.

The venerable Group RRSP provides a solution that will solve or at least assist in solving some of the key concern areas with some minor tweaks in tax treatment of employer contributions to maximize its effectiveness.

Eliminating nuisance payroll taxes on any employer contributions would remove the last real disadvantage of the structured group RRSP. Some of these can already be mitigated by insisting on no in service withdrawals and we advocate such a feature in all plan designs.

**What’s In It For The Employer?**

For the employer, there are a number of benefits from this approach. They include:

◆ Total flexibility in contribution design and the ability to forego contributions without consulting a regulator (a key inhibitor for many sponsors looking for cost controls and an emergency bailout option)

**For The Employee?**

This approach also offers a number of benefits to employees including:

◆ Immediate ownership of employer’s contribution which is important to today’s younger workers who will likely shift through many jobs and do not want to be locked in

◆ Ability to access home buyer and lifelong learning plans using the employer’s portion as well as providing an ability to invest in real assets and for their future (which is a real selling feature for younger employees who are typically reluctant to join a plan if they can’t see any real additional value for them)

◆ Access to lower cost group subsidized payout products

◆ Choice of investment strategy – which members want even if they don’t always handle it well or feel intimidated – with design structure which can be changed to suit the real investment knowledge level of the group by offering solid default
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options such as target date funds or a
group-wide balanced fund
Will this solve all the issues? No, but
this type of change can be instituted quickly
and without consultation amongst the prov-
inces, with the exception of any healthcare
and WSIB payroll tax that may exist.
What other concerns need to be
addressed?
The plans should be set up in tandem
with a Tax Free Savings Account which can
facilitate contributions for lower income
plan members and also allow higher income
earners to supplement their contributions.
Employers should receive some sort of
reward when they contribute to a program
they offer. This could operate in much the
same way as the credits given for hiring
new workers.

Financial Literacy
We also need to encourage and promote
the new initiatives on financial literacy,
particularly in our primary and secondary
schools.
Establishing a universal RRSP program
similar to that proposed in the PRPP would
allow the self-employed and members of
very small companies access to reduced
group investment costs and payout products
even if their employer does not contribute.
As well, an increase in the maximum
contribution levels for all DC registered
vehicles and removal of the one-year lag
time for the RRSP limit is necessary as is
some sort of lifetime overall target for tax
assisted accumulations to provide additional
contribution room should market conditions
warrant and catch up funding be required.
If we are really interested in looking
after those who do not have workplace
retirement savings, while still not entering
into a ‘Nanny State’ or forcing members
into a collective solution which may or may
not be beneficial to them, then the struc-
tured group RRSP best answers the ‘what’s
in it for me?’ question for employees out
there who are most at risk.

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pension consultant at Steven-
son and Hunt (neil.craig@
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What Are PRPPs?

For employees, a PRPP is like a Defined
Contribution-Registered Pension Plan (or
group RRSP) plan. It is a savings vehicle,
limited by RRSP limits and regulations, that
allows workers to save for retirement, but it
does not guarantee retirement security.
Essentially, anyone with income and
room under their RRSP limits will be eligible
to contribute to a PRPP, but mainly workers
with no Defined Benefit workplace pen-
sions. Workplaces with DC plans might see
PRPPs as an alternative option, and employ-
ners offering DB plans might use some of
the characteristics of PRPPs, such as poten-
tial lower cost and fiduciary role, as selling
points to get rid of their existing DB plans.
Employers will have to offer a PRPP to all
employees not currently covered by a registered
pension plan. Other individuals, such as the self-
employed, will also have the option to join in,
but they will have to take the responsibilities
otherwise assumed by employers to set a PRPP.
Employers, not employees, will decide
contribution levels. It will not be mandatory
for employers to contribute or match contri-
butions to PRPPs. However, if an employer
chooses to participate – that is, make direct
contributions like employer contributions to
an RPP – both employer and employee con-
tributions would be made in the same man-
ner as contributions to a DC RPP.
More specifically, PAs would be reported
in respect of the contributions, and contribu-
tions would be limited to the maximum PA
for DC RPPs (18 per cent of earnings up to a
specified dollar limit, $22,970 for 2011).

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STARCH RESEARCH

Benefits and Pensions Monitor is pleased to announce that the
respected STARCH RESEARCH firm conducted face-to-face
interviews with BPM readers the research firm selected from
our national circulation. The researched issue was October
2010. Interviews were recently completed and the report
published in February 2011. We would like to express our
thanks to those readers for their time.

Here are just a few of the results to consider:

❑ 81% of our readers keep their copies for future reference.
❑ Readers pick up the magazine for reading an average
  of 2.4 times, providing multiple ad exposures.
❑ MONITOR has a total average readership of 6.7 readers
  per copy. Just imagine the total potential audience!
❑ Only 57% of our readers regularly read our closest
  competitor.

It is our view that all magazine readership research should be
dated and sourced by an independent and qualified research
firm to be valid.

For more information, please contact
John McLaine at 416-494-1066.
I
n a time not so long ago, shareholders would passively defer to the judgment of management of a corporation. If the shareholder was unhappy with the share performance of a company or a significant shareholder disagreed with the management of said company, they would simply divest of their holdings.

However, that was then and this is now. Today, we are seeing unprecedented levels of shareholder activism. In particular, over the last three years we have seen a rise in shareholder activism that overlaps with the international stock market crash of 2007. In 2003, there were only six proxy fights; in 2006, there were 13 proxy fights. In 2009, there were 43 proxy fights with a slight decline in 2010. However, 2011 gives the appearance that it will continue to trend upward as shareholders remain somewhat disgruntled.

What is interesting to note is that in the past, it was typically a large shareholder that was either upset with the direction or the share performance of the company. Now, we are witnessing environmental groups using their investments and clout to press for improved performance and pushing social governance to ‘shake up’ the board. Pension funds are pressuring corporations to improve their corporate governance structure. Hedge funds that disagree with management’s strategic plan are launching proxy battles if they believe they are not being taken seriously by management and are left with no other alternative. More recently, we are seeing far more contested and requisitioned meetings launched to scuttle proposed mergers and acquisitions transactions.

A variety of factors have caused the steady surge of shareholder activism in the market, including, but not limited to, changes in the standards and expectations of corporate governance, SEC rulings (including NYSE Rule 452), corporate and security legislation (National Instrument 54-101), the availability of information and advisors (proxy solicitors) for activists, and a growing sense of confidence in launching proxy contests, coupled with depressed stock prices.

More Commonplace

This new era of shareholder activism, once relatively rare in the Canadian marketplace, is becoming much more commonplace. It begs the question, what has changed and why?

As noted above, one could blame the recent explosions of shareholder activism on the recent implosion of the international stock markets, but that would not be entirely accurate. Today’s shareholders are more savvy and educated. They usually look for instant gratification. This group of investors is no longer like its predecessors. When things are going badly, they expect change to follow immediately. It is when this does not transpire that the activist shareholder becomes impatient and sees it as the time to take action.

Usually the activist shareholder’s ultimate objective is increasing shareholder value and wealth. They believe this can be accomplished in a variety of ways such as:

- a sale of the company or the assets of the company
- a change in the share capitalization
- a change in strategy
- a change in the composition of the board

Recent changes in Canadian corporate legislation have made it far more convenient, providing the activist shareholder with a forum to have their voice heard. Canadian corporate legislation allows any shareholder (individually or jointly and in concert) holding more than five per cent of a company to requisition a meeting. If the company does not schedule a meeting (or acknowledge receipt of the requisition and set out plans to address the requisition) within 21 days of receiving a valid requisition, the shareholder can then call the meeting. Also...
under National Instrument 54-101, shareholders are allowed to communicate with other “like-minded” shareholders as long as they do not speak with more than 15 shareholders to accumulate support in terms of the number of shares to vote for their own nominees. To explain this in greater detail, if a shareholder communicates with more than 15 shareholders, 54-101 states that they must issue a circular and send it to all shareholders. If they do not surpass that ceiling of 15, a shareholder could attend an annual meeting, surprise the board, and effectively take over a company if the activist shareholder has greater support for their nominees than the incumbent board.

Activist Shareholder

To be clear, not all activist shareholder investors immediately wish to engage in proxy contests. Depending on the motivations and objectives of the activist shareholder (individual or institutional), additional tactics include:

◆ lobbying, negotiating, or threatening the management of the company
◆ requesting board representation based on the significance of the activist shareholder financial stake in the company
◆ meeting requisitions
◆ waiting for the annual general meeting and doing a stealth attack
◆ proposing a change at the annual general meeting

Typically the institutional activist shareholder does not want to take control of the company but wishes to force corporate governance improvements. Institutional shareholders like to see poor corporate governance curtailed and for companies to be up to speed and adhering to good corporate governance practices. Institutional Shareholder Services and Glass Lewis & Co., LLC are third-party proxy advisory firms that communicate daily with their subscribers (usually the large institutions) about proper governance standards. They have pushed to increase the independence of the boards, separate the chair and CEO positions, reign in excessive executive compensation, and adopt majority voting standards with a director resignation policy for board members. It is when these conversations fail, at the institutional level, with management of a company that the institutional activist may embark on the proxy fight path.

Variable Component

Shareholder activism is here to stay and the manner in which it is invoked is the variable component. The most important endeavour for a company to undertake in order to potentially avoid these pitfalls is to recognize and understand its investors and their differing motives. The company’s board and management team should have access to an up-to-date shareholder composition of the company’s shareholder base, which includes the retail versus institutional makeup, trading activities, and profiles of all institutional holders and the proxy advisors they defer to. Shareholder communication and outreach programs that engage shareholders and keep them informed of the company’s business strategy improve shareholder understanding of management decisions and the value of holding the company’s stock. Regular communication with the company’s largest shareholders will provide key insight into their expectations and shed light on any potential issues that may need to be addressed. In turn, this communication will allow the company to take stock of who its ‘friends’ are, should an activist campaign be launched.

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*Starbucks Research - February 2011
Employers and tax professionals optimistically greeted the introduction late last year of a new type of employee benefit trust – the Employee Life and Health Trust. Historically, Health and Welfare Trusts (HWTs) have been the only trust vehicle organizations have been able to use to finance employee health benefits in a tax efficient manner. These benefits include those from a group sickness or accident insurance plan, a group life insurance policy, or a private health services plan. The administrative rules related to ‘Interpretation Bulletin IT-85R2,’ which governs HWTs, however, led to a steady stream of technical interpretations and court cases in which the Canada Revenue Agency (CRA) had to defend and sometimes amend its administrative positions. In order to clarify the application of these positions, the CRA released draft IT-85R3 in 2005 and invited comments. Greeted with consternation by the tax community, the revised interpretation bulletin was never released.

**Strong Impetus**

Another strong impetus for change arose in 2008 when the retiree health and dental programs of GM and Chrysler were to be wound up during restructuring. Facilitating a settlement with the Canadian Auto Workers Union led to the need for a new type of employee benefit trust that would allow settlement funds to provide benefits over a longer period. This also presented an opportunity for the government to address some of the problems related to the administration rules surrounding HWTs.

In February 2010, the Department of Finance announced amendments to the Income Tax Act (ITA) which created a new type of taxable trust – an Employee Life and Health Trust (ELHT). Jim Flaherty, the minister of finance, introduced the amendments as a way of ensuring that “a fair and neutral tax regime applies to employee life and health trusts.” Ten months later, new section 144.1 of the ITA received Royal Assent. These rules now apply to trusts established after 2009.

While the general operating concepts of the two types of trusts are similar, the new ELHT codifies certain aspects of the Canada Revenue Agency’s existing administrative positions regarding HWTs. They also provide greater certainty regarding the tax deductibility of employer contributions and taxation of the trust, itself. As well, there are a number of provisions that deter abuses of these trust vehicles.

**Carefully Review**

For sponsors of employee benefit trusts, it is important to carefully review the tax and financial implications of the two types of trusts. The government stated in the technical notes to the legislation that currently it has no intention of making any changes to the tax rules applicable to HWTs. While it appears there are no obstacles preventing employers from setting up new HWTs, employers considering establishing a new employee benefit trust or changing an existing HWT should be aware of the tax differences between the two types of trusts and their potential impact.

The CRA has taken the view that contributions made by an employer to an HWT are deductible only to the extent they are utilized to provide benefits paid that same year. However, since an HWT provides a plan of insurance for employee benefits, it is arguable whether contributions to the trust should be deductible when the legal liability to pay them is incurred. This would result in the tax deduction being tied to the funding of the trust and not the payment of benefits by the trust.

The new legislation, however, does not allow for this treatment, except in the case of certain multi-employer plans. Instead, employer contributions and deductions to an ELHT are treated in much the same way as the current position of the CRA on employer contributions to HWTs. An employer may deduct contributions made to an ELHT in a year to the extent the contributions are used to pay for:

- designated employee benefits
- insurance premiums in respect of designated...
employee benefits

- group term life insurance premiums

The timing of employer deductions must be matched to the benefit payments made by the ELHT. This rule is intended to prevent an employer from claiming an immediate deduction for prefunding an ELHT.

Prefunding, however, is allowed. Contributions that are not deductible in the year they are made may be deducted in a later year, to the extent the undeducted amount enables the trust to make the necessary benefit payments in that future year.

The total amount deducted by an employer cannot exceed the total amount it contributes. Therefore, should the ELHT pay higher than anticipated benefits as a result of investment performance on a contribution, the employer can only deduct what was actually contributed and not the higher benefit payment.

The new legislation also references the use of actuarial valuations. A new subsection, 144.1(5), of the ITA allows employers to rely on actuarial reports that determine the contribution amount reasonably required for the ELHT to provide designated benefits in a particular year. This allows employers to "rebut a presumption" (in the absence of evidence to the contrary) that the amount contributed was for the purpose of enabling the ELHT to provide these benefits.

Ultimately, these rules will increase compliance costs because trust administrators will have to determine amounts spent on providing designated employee benefits and report this information to employers for their deductibility calculations.

Administrative Nightmare

The timing of employer contributions could be an administrative nightmare for certain multi-employer plans because required contributions are generally a fixed dollar amount per hour worked and employees may work for more than one employer during a year. The legislation, therefore, contains a special rule for certain multi-employer ELHTs. If the trust meets the criteria, the employer contributions to the multi-employer plan are fully deductible in the year of contribution. The criteria includes:

- No more than of 95 per cent of employee beneficiaries will be employed by a single employer or a related group of employers
- At least 15 employers contribute to the trust, or at least 10 per cent of the employee beneficiaries work for more than one participating employer
- Employer contributions are made pursuant to a collective bargaining agreement and in accordance to a negotiated formula that does not provide for variation in the contributions determined by reference to the financial experience of the trust
- Employer contributions are determined by number of hours worked or some other measure specific to each employee

The ELHT rules address the issue of funding contributions with promissory notes. Generally, interest payable by an employer on such notes would not be deductible because the interest is not payable on "borrowed money." As well, treating notes as an investment asset of the trust would cause interest payable to be treated as trust income. This would cause the trust to be liable for income tax on the interest income before it had received any payments on the notes.

New rules in subsection 144.1(6) of the ITA provide relief from these results. Interest or principal payments on the notes are deemed contributions to the trust. Thus, while the promissory notes themselves are not considered contributions and are not deductible, interest or principal payments on the notes are deductible to the same extent as other employer contributions to the ELHT.

‘Key Employees’

Whereas an HWT may be used to provide benefits only to employee-shareholders or high-income employees of an organization, this is not allowed for an ELHT. The new legislation defines ‘key employees’ and sets out numerous requirements in order to prevent an ELHT from being established primarily for their benefit or that of their family members.

A key employee is defined as:

- a shareholder who owns more than 10 per cent of issued shares
- an employee who in any two of the previous five years earned more than five times the maximum pensionable earnings for the year (maximum of $241,500 for 2011)

The health benefits that key employees may receive through an ELHT cannot be any more advantageous than those paid to a ‘reference class’ of employees who must represent at least 25 per cent of the trust beneficiaries. At least 75 per cent of the beneficiaries of this reference class must be non-key employees. Thus the rules governing ELHTs ensure that key employees do not receive more favourable benefits than other employees.

Restrict Ability

This provision may restrict the ability of small organizations to establish ELHTs since they may not have enough non-key employees. Instead, they may have to provide employee health and insurance benefits through HWTs or other vehicles such as private health services plans or insurance policies.

While HWT beneficiaries were never clearly defined, beneficiaries of an ELHT are specifically described in the legislation. They include current and former employees, related dependents of these employees, and another ELHT. Including the latter as a beneficiary means that should a group of employees wish to leave an existing ELHT to join a different one or start a new one, the funds held in the ELHT for their benefit may be transferred.

These are only highlights of the tax differences between HWTs and ELHTs; there are numerous others. Still, while ELHTs are certainly better defined than HWTs, gray areas remain. Until the Canada Revenue Agency sheds more light on some of the remaining ambiguities related to both HWTs and ELHTs, employers and trustees should seek additional clarity.

Addenda

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

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Rebecca Hughes, CA, (rhughes@bdo.ca) is a tax associate and Alistair Whitehead, CA, (awhitehead@bdo.ca) is a senior manager of BDO Canada LLP.
Today, we have a rapidly aging population and more working Baby Boomers taking time away from their jobs to care for senior parents. People are more likely now to turn down promotions because of such commitments or won’t take that job transfer to another city because they can’t leave their mother or father. It’s no surprise that the home care industry, especially for seniors, is growing dramatically.

There are significant cost savings in using trained, professional caregivers to assist seniors in their homes or in care facilities. An Ontario study – ‘Valuing Home and Community Care’ – said that the healthcare system in Ontario could save $150 million per year with more investment in home care and community care.

As Long As Possible
Let’s not forget that seniors want to live at home as long as possible, but as they age, they may need help with safety issues, companionship to avoid loneliness, and help in coping with chronic diseases such as arthritis.

Clearly, the onus is not only on society, but on employers to come to the plate for seniors’ home care. It makes economic sense.

According to a Health Canada report ‘National Profile of Family Caregivers in Canada, 2002,’ 25 per cent of caregivers said their employment situation had been affected by caregiving responsibilities. While countless working people in their 30s and 40s are caring for young children, once they get into their 50s, those caregiving tasks expand to their parents and that is the trend now.

There are many advantages to using an organization that provides professional home care services for seniors:

- Liability rests with the organization, not with the family caregiver or employer of the family caregiver. What’s more, a reputable home care provider is fully covered, which means their professional caregivers are screened, bonded, and insured.
- Professional caregivers are trained to look after seniors, many of whom have unique health and disability issues such as Alzheimer’s.
- An organization that specializes in senior homecare has backup when the need arises and can recommend other services in the community for older adults such as foot care, meal prep services, and adult day programs.

Not Fully Focused
In the HR community, the term ‘presenteeism’ refers to employees who are not fully focused on their job; they may have to leave work to take their parents to doctor appointments which can result in lost productivity. Statistics Canada says 65 per cent of women and 47 per cent of men working full-time provide at least four hours of caregiving a week to a senior parent. Executives and professionals with eldercare responsibilities may suffer from depression, exhaustion, insomnia, and anxiety, not to mention reduced immune response. The catch-all for this is stress which can lead to short-term and long-term disability and that is a situation no employer wants. So what can an employer do? Here are some suggestions:

- Bring this issue out of the closet and let employees know you recognize that ‘seniorhood’ is something you will address.

The Case For Home Care

- Reach out into your community and put together a list of resources to help families understand their options and navigate the healthcare system.
- Advise families how they can pay for home care.
- Research local home care providers so you can advise employees when they find themselves in a crisis.

Jeanie Burke (jburke@homeinstead.com) is co-chair of the Nova Scotia Home Care Association and runs Home Instead Senior Care in Halifax, NS. Bruce Mahony (bmahony@seniorservice.ca) is a member of the Ontario Home Care Association and runs Home Instead Senior Care in Toronto, ON.
The future for employment-based health insurance in North America and the lessons learned for pension fund investing in the last decade will be among the topics covered at the International Foundation of Employee Benefit Plans’ 44th Annual Canadian Employee Benefits Conference. Featured speakers include Douglas Porter, an economist at BMO Capital Markets who will provide an economic and financial outlook for Canada, and Malcolm P. Hamilton, partner at Mercer Ltd. who will discuss the fate and security of pension plans in Canada. It takes place September 11 to 14 in Vancouver, BC. Visit: www.ifebp.org/canannual

‘Advanced Investments Management’ is again being offered at the Wharton School by the International Foundation of Employee Benefit Plans. Sessions will look at advanced bond management, risk-and-return analysis of equity and real estate investments, and private equity and venture capital. It takes place September 12 to 15 in Philadelphia, PA. A refresher workshop in core investment concepts is being offered in advance of the program on September 11. Visit: www.ifebp.org/education/certificateprograms/wharton/advancedinvestments/

‘Prendre le contrôle en zone de turbulence’ is the theme of the ‘CPBI Quebec Regional Conference, 2011.’ It takes place September 12 to 14 in Gatineau, QC. Visit: www.cpbiqu.ca/

‘Global Problems … A Local Perspective’ and ‘Emerging Opportunities and Challenges of DB Plans – Beyond the Financials for the 2011’ will be among the plenary sessions at the Association of Canadian Pension Management National Conference. This year’s conference theme is ‘It Begins Here – From Reform to Action.’ Sessions will assist delegates in formulating their organizations’ action plan in response to the multitude of recent industry reforms and developments. It takes place September 13 to 16 in St. John’s, NL. Visit: www.acpm-acarr.com/national.aspx

Bill Adams, of the Boston Company, will discuss the importance of foreign content to the investment portfolio in today’s global investment market at the ‘2011 CPBI Atlantic Regional Conference.’ His talk will look at the items to take into consideration – from risk to regional conflicts to currency – when investing in emerging markets. Theme of this year’s event is ‘Recipe for Renewal.’ It takes place September 14 to 16 in Charlottetown, PE. Visit: www.cpbiqu.ca/ Barry Allan, founder and chief executive officer at Marret Asset Management Inc., and Geoff Marshall, vice-president, portfolio management, at CI Investments Canada, are among the featured speakers at the ‘High Yield Bond Conference.’ It takes place September 20 and 21 in Toronto, ON. Visit: www.euromoneyseminars.com/chyb

Social media will share the stage with traditional communications at this year’s ‘Annual Conference of the Insurance & Financial Communicators Association (IFCA).’ It takes place October 2 to 5 in Nashville, TN. Visit: www.ifcaonline.com
Behavioural economics is no longer on the fringes of the financial world as it was a decade or so ago. The long list of cognitive and behavioural biases that humans show in their financial decision-making is now widely known, but, unfortunately, this knowledge has lead to some erroneous conclusions: that we know almost all that there is to know about decision-making and that these behavioural biases affect all people in the same way. A series of papers coming out of a symposium at Laval University, and just published in the ‘Journal of Applied Econometrics,’ show that people’s expectations concerning the stock market vary tremendously and are subject to a range of biases and issues which are yet to be fully understood.

Stock Market Crash

In a paper from Peter Hudomiet, Gabor Kezdi, and Robert Willis, the influence of the recent (2008-2009) stock market crash on people’s expectations, and the changes on their expectations of the stock market, is examined. This is a worthwhile exercise as one school of behavioural thought notes that people use recent events (the ‘recency effect’) in order to forecast the future (in which case the crash should have a negative effect on everyone’s expectations).

On the other hand, other behavioural work notes that those people who believe in mean reversion of markets would expect the exact opposite in the future. Results from highly detailed surveys show that the amount of disagreement about the future of stock market returns increased substantially after the market crash. Generally there was increased optimism after the crash, but also increased uncertainty. Those who owned stocks were generally more positive and less uncertain (though results varied widely) than non-stockholders.

A paper from Michael Hurd, Maarten Van Rooij, and Joachim Winter on the stock market expectations of Dutch households examined the previous bullish period of 2004-2006. It also showed wide variations between people on how they perceived the future, yet showed evidence of the recency effect, as those who believed that the future would be positive for the stock market jumped from 41.6 per cent in 2004 (which was preceded by several down years from the 2000 highs) to 50.1 per cent in 2006, after the Amsterdam stock market increased by about 75 per cent. Yet beliefs did not translate into actions as the number of investors in the sample actually holding stocks did not increase between 2004 and 2006.

Finally, it is impossible for people to exhibit biases in how they use information if they don’t have or understand that information in the first place. This is most noticeable when it comes to people’s understanding of their social insurance benefits. Adeline Delavande and Susann Rohwedder examined the uncertainty that U.S individuals felt about their future Social Security benefits and found, perhaps not surprisingly to those of us in the pension world, widespread misunderstanding and uncertainty over everything from qualifications for benefits to the amounts they would eventually receive. While some of this inattention may come from rational reasons (a very wealthy person may care little about the amount of benefits they would eventually receive as it would form only a very small fraction of their total retirement resources), it was difficult for the authors to pinpoint the reasons for the rest of this lack of knowledge.

Levels Of Uncertainty

About the only important factor that could be isolated was age, with younger people, who were farther away from retirement, having less certainty and knowledge of their benefits. However, even people five years away from retirement still recorded high levels of uncertainty about the Social Security system and how it worked. This unfamiliarity may be correlated with lack of knowledge of finances generally, as those individuals who were more uncertain about their benefits also tended to hold a smaller portion of their wealth in stocks. However, overall it remains difficult to account for people’s lack of understanding of a key component of their retirement income and how this affects their overall financial planning.

These papers show that while we might be partial slaves to emotions and biases, we are still heterogeneous individuals and that there is a wide range of mental models that people use to understand what is happening around them, and convert this into their own beliefs and eventually their actions.
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