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or years now, we have been hearing about soaring healthcare costs. An aging population putting more demands on healthcare, governments off-loading healthcare costs onto the private sector, and the development of designer and biologic drugs have all created fears about where it is all going.

Right now, in Canada, the number being bandied about as the cost of healthcare is about $183 billion. That is a 450 per cent increase since 1975 when the cost of healthcare in Canada was $39.7 billion.

Of the three biggest healthcare expenses, the amount spent on pharmaceuticals has increased the most. So there was a bit of good news recently from the Canadian Institute for Health Information (CIHI). Its ‘Drug Expenditure in Canada, 1985 to 2010’ report shows the growth in drug spending has slowed to its lowest rate in 14 years. Total drug expenditure reached $31.1 billion in 2010, an increase of $1.4 billion, or 4.8 per cent since 2009. In comparison, the average annual growth rate in drug spending was nearly twice as high between 2000 and 2005, at 8.9 per cent.

Generic Alternatives
There are reasons for this slow-down. A number of blockbuster brand name drugs have come off patent, allowing lower-priced, generic alternatives to enter the marketplace. The implementation of generic pricing policies by some provincial drug programs may also be contributing to the slowdown.

Yet, despite this good news, hanging over the heads of employee benefit plan sponsors and group insurance providers is the spectre of a new generation of drug spending. The implementation of generic policies by some provincial drug programs may also be contributing to the slowdown.

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Tackling Rising Drug Costs

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Yet, despite this good news, hanging over the heads of employee benefit plan sponsors and group insurance providers is the spectre of a new generation of drugs – such as biologics – and the increased use of high cost medications to treat cancer, autoimmune conditions, and other treatable rare diseases. In fact, today one employee can undermine the sustainability of an entire plan. In 2009, there were 1,500 claims in excess of $25,000 and, for the first time, an individual’s claim hit the $1 million mark.

No wonder we are hearing from so many quarters about the need to address drug costs.

Mark Ferdinand, vice-president of policy research and analysis at Rx&D, speaking at the Group Insurance Pharmaceutical Committee’s ‘Unravelling Drug Pricing’ session, said that current cost containment approaches do not deal with the underlying causes of year-over-year increases in drug costs. The problem is that most efforts have been made to control the supply side – limiting the cost of prescription drugs by negotiating prices and by requiring or encouraging the use of certain drugs through formularies.

Demand-side Measures
Meanwhile, demand-side measures – strategies such as prescribing guidelines, generic substitution policies, and fixed and tiered co-payments aimed at wholesalers, retailers, doctors, and patients – are being neglected. Unless the industry deals with demand, which has been rising for years, costs will keep going up, he said.

How badly is this being neglected? Consider the remarks of Saul Quint, a family physician and CEO INTERxVENT Canada. In a talk on physician prescribing behaviours at the same event, he said while physicians say that price influences them, their awareness of the cost of drugs is poor. One study found their median cost estimate was 243 per cent away from the true cost and only 31 per cent of their estimates were within 20 to 25 per cent of the true cost.

This is just one example. There is likely little, if anything, we can do to contain drug and healthcare costs. At best, we can put damage control measures in place. However, it will take an all-inclusive approach. The roles of all participants must be defined and each must buy in if we want get a handle on the situation.
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Heather Wolfe is assistant vice-president, Defined Benefit solutions for group retirement services, at Sun Life Financial. She is responsible for all aspects of the DB solutions business including its strategic direction, market segmentation, product innovation, and sales and marketing plan.

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**Middle Class Faces Retirement Income Decline**

Middle class Canadians are facing at least a 25 per cent drop in their disposable incomes when they retire, says a study by the Institute for Research on Public Policy. It says about half of middle income Canadians born between 1945 and 1970 face a sharper decline in their retirement incomes than experts previously predicted and reform proposals including expanding the Canada Pension Plan will do little to fix the problem. And it finds that under the various pension reform proposals, retirement incomes for people born from 1960 to 1965 would only improve between four to eight percentage points as these proposals would be phased in over 40 years and they would not qualify for most of the benefit. As a result, the report concludes “more much ambitious reforms than the ones being considered will be required to improve the adequacy of retirement incomes.” Middle income is defined as earning an average annual lifetime income of between $35,000 and $80,000.

**Risk Should Be Considered In Aggregate**

Multi-national companies should consider Defined Benefit balance sheet risks in aggregate, says Steven White, managing director, Buck Global Investment Advisors. In a session at Buck Consultants’ ‘De-risking: Are You In or Are You Out?’ seminar, he said many companies look at their DB plans one by one and come up with different solutions for each plan. Taking an aggregate approach when plans within a region are combined allows them to gain insight into the aggregate level of balance sheet risk. This, in turn, can lead to greater consistency of approaches to asset allocation across different regions and allows the global corporate to guide regional investment policies.

**Reform Offers ‘Excuse’ To Change Plans**

Pension reform could provide plan sponsors with an “excuse” to change their plans, says Malcolm Hamilton, of Mercer. Speaking at the ACPM Ontario council’s ‘Checking the Pulse of Pension Reform,’ he said sponsors should wait until the shape and timing of pension reform become clear. Then, they should use reform and the hype around it to improve the design delivery or communication of their retirement plans. He noted, however, that Canada now has one of the best retirement systems in the world with little or no problem for the already retired. And, he conceded that future generations may be less fortunate, in particular, if they behave foolishly. However, while the vulnerable group is private sector workers with above-average incomes, most reform is aimed at ensuring that seniors have better lives than working Canadians. For example, suggestions to boost the GIS would increase the post-retirement income of those who already receive more than 100 per cent of pre-retirement income. This would reduce the senior poverty rate to zero while the poverty rate for working age Canadians is 10 per cent. As well, a proposal to double tax-free savings account limits would improve the ability of high-income Canadians to save for retirement, but, in the long term, leads to a society where young people pay all of the taxes and old people collect all of the benefits.

**Cost Containment Doesn’t Deal With Cause**

A cost containment approach does not deal with the underlying causes of year over year increases in drug benefits costs, says Mark Ferdinand, vice-president of policy research and analysis at Rx&D. Speaking on pharmaceutical pricing at the Group Insurance Pharmaceutical Committee’s ‘Unravelling Drug Pricing’ session, he said unless the industry deals with demand, which has been rising for years, costs will keep going up. The problem is that most efforts have been made to control the supply side and while it is important, the demand side is being neglected when it comes to pharmaceuticals. Measures to control demand need to be directed at wholesalers, retailers, and doctors and include approaches such as requiring generic substitutions.

**Wholesale Changes Not Recommended**

Wholesale changes to the way pension obligations are met are not recommended, says William B. Solomon, a consulting actuary. He told the ‘De-risking Pensions & Benefits: There is nothing new beneath the sun’ session at the ‘2011 CPBI Saskatchewan Regional Conference’ that based on his nearly 50 years of experience in the insurance and pension industry, plans should not do anything drastic or significantly different from what they have been doing. He agrees that focusing on a plan’s asset mix is crucial and that better matching of assets and liabilities is desirable. Having said that, plans cannot lose sight of the fact that asset mix accounts for approximately 90 per cent of the return that a pension plan will earn and equities have enjoyed (and, in his opinion, will continue to enjoy) a higher rate of return than fixed income investments. “With a maturing liability structure, a more cautious asset mix is in order. However, in order to achieve an acceptable rate of return based on the current market conditions, a continued heavier commitment to equities is required,” he said. “If fixed income exposure is to be increased, some form of duration-matching product or long duration fund might be the way to go.”
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CAPSA Seeks Common DB Funding Approach

The Canadian Association of Pension Supervisory Authorities (CAPSA) draft ‘Pension Plan Funding Policy Guideline’ attempts to develop a common approach for Defined Benefit pension plan funding policies, recognizing the link between funding policy and fund governance, says a Towers Watson ‘Client Advisory.’ While funding policies are not currently required under any Canadian pension standards legislation, the draft guideline notes that it is good practice and good governance to develop and adopt a funding policy. It states that it is the plan sponsor’s responsibility to adopt the funding policy, if any, and suggests that the plan administrator should then ensure that it is consistent with the plan’s investment policy. In the course of activities related to the establishment of a funding policy, the guideline specifies that the plan sponsor is not held to a fiduciary standard of care, but may be subject to an implied duty of good faith, and that the plan sponsor has distinct roles as administrator and as employer. Towers Watson says while many employers may have an unwritten funding policy, few have committed their policies to paper, especially in the absence of legislative or regulatory requirements to do so. The guideline is open for comments until June 1.

Real Estate Sustainability Benchmark Created

Eleven of the world’s largest pension asset managers, including the Ontario Teachers Pension Plan, have joined forces to create the Global Real Estate Sustainability Benchmark. It will carry out an annual survey to scrutinize the sustainability of fund managers in the real estate industry. The goal is to simultaneously create shareholder value and reduce the sector’s substantial carbon footprint by creating more transparency in the environmental sustainability of real estate investment managers. The managers represent $1.4 trillion in assets under management.

Correction

In the April issue of Benefits and Pensions Monitor, the eMail address for Joe Di Massimo, senior vice-president, at Invesco was incorrect. It should read joe.dimassimo@invesco.com
True Hedge Fund Of Fund Diversification Through A ‘Convergent/Divergent’ Approach

By Robert P. Covino Jr.

A DIFFERENT VIEW OF DIVERSIFICATION

During most financial crises, there is typically an increase in asset class correlation and periods of investor irrationality. These periods appear to be occurring more frequently and are marked by significant volatility spikes and meaningful market retreats. In 2008, this was particularly damaging, as increased asset class correlation questioned long-held tenets about diversification.

Classical theory has held that an investor is diversified if invested in different asset classes, in different geographies and different market capitalizations.

With respect to this perspective on diversification, there is one approach that performed as expected in 2008 – the “convergent/divergent” fund of hedge funds approach. By combining strategies built for both rational (convergent) and irrational (divergent) markets, investors using this approach improved portfolio diversification, limited capital drawdown and improved the risk/return profiles of their portfolios.1

When reviewed closely, this approach also held up during many crises and market shocks over the last 20 years. In fact, past returns confirmed that divergent investment styles such as systematic managed futures, commodity trading advisors and global macro strategies provided diversification benefits when most traditional investment styles became more closely correlated and experienced large losses.2

CONVERGENT/DIVERGENT DEFINED

Most hedge fund strategies can be categorized as either ‘convergent’ or ‘divergent’ in nature. Convergent strategists believe that the intrinsic value of assets can be measured using fundamental data, such as a company’s future earnings, dividends and growth rates. Using fundamental data, a convergent manager can assess whether a security is over/undervalued, believing that the price will “converge” to its intrinsic value over time in a rational, efficient market. Most investment strategies fall into the convergent camp. As markets became irrational in 2008, it was not surprising that most convergent strategies performed poorly and, conversely, when volatility decreased in 2009, convergent strategies once again outperformed divergent strategies.3

The divergent strategist aims to profit when fundamental valuations are ignored by the market. Divergent strategies seek to identify serial price movements which reflect changing market themes and sentiment. Divergent strategies have been applied to most asset classes and often fall under the ‘global macro’ and/or ‘managed futures’ label. Divergent strategies tend to have positive convexity, or are ‘long volatility’, meaning they are geared to capture upside during volatile markets. Extreme events and market shocks generally create ideal conditions for divergent strategies.

By combining these two approaches, investors can help optimize risk/reward during challenging times. It is for this reason that we believe the convergent/divergent approach provides the only ‘true’ form of total investment diversification.

A POST 2008 PERSPECTIVE

Clearly, it is very difficult to predict volatility, future events, or to time markets precisely. This is precisely why we believe investors should always have exposure to convergent and divergent strategies in order to be fully diversified and, potentially, further mitigate left tail risk exposure.

As investors, consultants and academicians assess the lessons of the 2008 financial collapse, one observation that has consistently appeared is the strong absolute and relative performance of these divergent strategies such as global macro, commodity trading advisors and managed futures. They provided non correlated returns and meaningful alpha creation, while virtually all other strategies struggled in a market characterized by fear and inefficiency. As events become more fully digested, we believe that divergent strategies such as systematic managed futures, commodity trading advisors and global macro will increase in stature in a comprehensive, more fully diversified investment plan. 

1 Based on the returns of HFRX indices that track convergent/divergent styles for the period January 1 through December 31, 2008.
2 SSgA analysis January 2010, data from TASS, Bloomberg, Barclays, MSCI, FactSet, Standard & Poor’s.
3 HFRX index returns.

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Investing involves risk including the risk of loss of principal.
Supporting independence, promoting dignity, and ensuring respect for persons with disabilities and frail seniors is not just good business, it’s also the law in many regions of Canada.

According to the government, 14.3 per cent of Canadians report having a disability, with the percentage rising with age. Statistics Canada reports that people with disabilities are responsible for upwards of $25 billion in annual consumer spending power. They also influence the purchasing decisions of a further 12 to 15 million others – friends, family members, and co-workers.

**Spending Power**

With customer service excellence being one of the key drivers of corporate and retail success, making sure that frontline employees know how to interact with and meet the needs of all customers is vital. Let’s look at a few appropriate behaviours that experts suggest will help your workplace and corporate culture to be more welcoming.

Put the person first and say ‘persons with a disability,’ rather than ‘disabled persons’ or ‘the disabled.’ Figures of speech using ‘see,’ ‘hear,’ or ‘run’ are acceptable. Don’t be afraid to ask someone using a wheelchair if he or she would like to go for a walk. Also, many people who use assistive devices consider them liberating, not confining, so avoid saying ‘wheelchair bound’ or ‘confined to a wheelchair.’

When having a conversation with someone using a wheelchair for more than a few moments, sit down if possible so that you are eye-to-eye with them and the other person doesn’t have to look up at you and strain his or her neck. If you must stand, don’t lean on the wheelchair or hover over the person as it encroaches on their physical space.

**Have You Heard?**

Individuals who are hard-of-hearing can be anywhere from only slightly challenged to completely deaf. Those who cannot hear anything at all often communicate using sign language which relies heavily on facial expression and body language, making users look like they might be angry or emotional when in fact, they’re adding emphasis to their words.

Many deaf people, especially those who grew up in a deaf community, don’t consider themselves impaired at all. They just communicate using a different, if minoritized, language. When conversing with someone who has hearing loss, don’t shout, speak clearly and be sure to avoid whispering. The person may indicate a preference for one ear over the other and if that happens, stay on that side. Stop talking if you must turn away because the person may have difficulty hearing you if he can’t see your face.

**Now, See Here …**

Those who are visually challenged can have anything from vision loss to being completely blind. People who are legally blind often use a white cane. It is advised that you stand aside to let the person pass you to avoid collisions.

Guide dogs are also an option for some. They are highly trained and intelligent animals that guide their owners and help them to avoid danger. When the dog has a harness on or wears a jacket or sign advising strangers not to pet it, this means the dog is working and should not be distracted or interfered with in any way. In Canada, guide dogs are welcome anywhere that the general public is allowed.

Among the general population there is a range of disabilities, some visible but others invisible. The barrier lies in the physical and social environment, but the good news is it can be controlled by the service provider and experienced, knowledgeable staff. When your employees are properly trained and interacting on a regular basis with customers with disabilities, the added bonus will be that they’ll be more sensitive to their fellow staff members with a disability as well. Integrating people of all abilities leads to a greater understanding of various conditions and helps everyone feel more comfortable relating.

In the near future, as Canada’s population ages, people with disabilities will represent 20 to 25 per cent of the recreation, retail, workplace, housing, and entertainment markets. In order to stay competitive, human resource professionals should work with their marketing and sales teams to establish both training and customer service policies that facilitate access and recognize and remove obstacles.
IT’S MORE THAN A TEAM OF PEOPLE...

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Cooperating in building the future

Life, health, retirement
Pension funds across North America are facing record shortfalls. Research shows that 33 per cent of Canadian pension funds are struggling to meet liabilities; the Ontario Teachers’ Pension Plan funding shortfall, for example, ballooned to $17.1 billion in 2009, despite strong investment returns.

In the U.S., public pensions expect a shortfall of $2.5 billion that will force state and local governments to sell assets and make deep cuts to services. When anticipated future payments are taken into account, the amount reaches a staggering $1.9 trillion.

The solution for pension funds is simple: restructure asset allocation and include precious metals bullion.

Fiduciary Responsibility
Pension fund managers have a fiduciary responsibility to meet liabilities; they use asset allocation to achieve diversification in order to reduce risk, maximize performance, and thus responsibly manage their funds. To ignore the best-performing asset class year after year could conceivably expose managers and trustees to legal liabilities.

The traditional view is that three asset classes (stocks, bonds, and cash) are sufficient to achieve diversification. But Figure 1 shows that only precious metals offer negative correlation to stocks, bonds, and cash; a portfolio that consists of only positively correlated asset classes is not balanced or diversified.

Holding cash for portfolio protection does not work either. Figure 2 shows the dismal performance of five major currencies versus gold since 2001. For wealth preservation and portfolio protection, gold bullion should form the foundation of an investment portfolio.

Figure 3 shows various investment vehicles based on inherent risk. During periods of economic uncertainty, wealth preservation is critical and unnecessary risk should be avoided. The best investment strategy for long-term investors seeking low risk with secular growth potential is unencumbered physical bullion.

A prevailing myth says gold is risky and volatile. In fact, the opposite is true. Standard deviation, a commonly used measure of risk, calculates the total risk or variance associated with the expected return. Using this method to compare gold to every Dow Jones component over the last decade shows that gold is less volatile and has better performance. Other methods, the Sharpe Ratio and the Sortino Ratio, deliver similar results.

The Dow: Gold Ratio
The Dow: Gold Ratio measures trend changes in the gold price versus a basket of stocks as represented by the Dow. When the ratio is rising – as in the 1920s, the 1960s, and the 1990s – you should be overweight stocks. When the ratio is falling, as it did in the 1970s and is doing today, it is time to be overweight gold and precious metals in portfolios. Currently the ratio is less than 9:1 and falling.
meaning investors should rebalance into gold and precious metals, which will allow for reduced risk and maximized returns.

Although global pension assets are estimated to be $31.1 trillion, at present, pension funds allocate virtually no funds to gold.

According to an Ibbotson Associates study, conservative portfolios require a seven per cent allocation to gold, and aggressive portfolios require a 16 per cent to 17 per cent allocation, simply to achieve a balanced, diversified portfolio. This is known as strategic allocation.

From a tactical allocation standpoint, Wainwright Economics sees gold as a leading indicator of future inflation. In a high-inflation environment, which the ongoing global money printing practically guarantees, they recommend gold allocations of 17 per cent in a bond portfolio and 40 per cent in an equity portfolio, just to break even against inflation.

Beginning To Change

While pension funds are far below these recommended levels, the mindset is beginning to change. Last year, the University of Texas invested $500 million in gold due to fears of “unstable international financial markets and the possibility of high inflation.” This trend will accelerate as the global economic reality we live in becomes more widely understood.

Globally, financial assets are estimated at more than $200 trillion, while total aboveground gold bullion is a modest $3 trillion. About half of that is owned by central banks and half is privately held and not for sale at any price. When pension funds begin to move into gold, the price could skyrocket.

Savvy investors and pension fund managers alike can protect their portfolios and ensure that future liabilities are met by allocating to precious metals bullion now, while there is still enough supply available to meet pension fund needs and the price is reasonable.

Nick Barisheff is president and CEO of Bullion Management Group Inc. (info@bmgbullion.com)
Gary Ostoich is a leading figure in the Canadian hedge fund industry. He was instrumental in establishing the Canadian Chapter of the Alternative Investment Management Association (AIMA-Canada) and was elected its chairman in September 2009. He is also president of Spartan Fund Management, a Toronto-based multi-strategy hedge fund manager.

He sat down recently with Benefits and Pensions Monitor to discuss AIMA-Canada and the alternatives industry.

Benefits and Pensions Monitor: How long have you been involved with AIMA-Canada?
Gary Ostoich: I helped to create it in 2003 with Jim McGovern (managing director and CEO of Arrow Hedge Partners) and David Jarvis (chief risk and compliance officer, Spartan Fund Management).

I was at a law firm at that time. I can remember it was the summer of 2002 and we all came to the common conclusion that we should have an association in Canada to represent the hedge fund industry.

There were two associations globally – the Managed Funds Association in the United States and AIMA in the UK. We approached AIMA and, in 2003, we gathered together a number of Canadian hedge funds in Canada in a boardroom and everybody was unanimous in saying ‘yes, this is great.’

We started off with 10 members and now we are approaching 75 corporate members, but really the breadth of the organization is our 250 fairly active individual members.

BPM: Are investors finally coming to grips with the fact that hedge funds are strategies, not assets? Is this helping or hindering the cause?
Gary Ostoich: The word ‘hedge funds’ can be very misleading. I prefer to use the term ‘alternative strategies.’ Yes, investors are focusing in on the range of strategies that alternative managers are using. This is a good thing as it will then allow them to focus on potential benefits for their portfolios and what part of their portfolio alternative strategies should occupy.

BPM: Where does the Canadian alternative strategies market sit in 2011? Has it fully recovered from the financial crisis?
Gary Ostoich: I can confidently say that the Canadian hedge fund market has fully recovered from 2008 and is stronger as a result of the events of 2008. It’s interesting to note that the shape of the Canadian hedge fund market has changed as well. If you look back five years, long-bias managers dominated the Canadian hedge fund industry in terms of number and assets under management. Today, long-bias managers still exist, but you now see substantial growth in other strategies such as event-driven, multi-strategy, credit, volatility, and global macro, just to name a few.

The growth also reflects an increasing level of institutionalization among managers today versus managers five years ago. This has occurred throughout the entire industry.

All of these developments are good for investors and healthy for the continued growth of the industry.

BPM: We are hearing a lot about institutional investors moving more assets into hedge funds. Are we seeing this in Canada? If so, what is driving this?
Gary Ostoich: There has been tremendous global increase in the inflow by institutions into hedge funds. In Canada, a lot has changed in the last five years. Then, few, if any, Canadian hedge funds (including fund of funds) were receiving allocations from Canadian and non-Canadian institutional investors. Today, we hear of more and more Canadian and non-Canadian institutions investing in Canadian hedge funds.

A number of things have happened to account for this inflow. First of all, performance is a big driver. Canadian managers have performed very well compared to our peer groups in other jurisdictions. A KCS Fund Management and Simon Fraser University paper, ‘Risk and Return in the Canadian Hedge Fund Indus-
Benefits and Pensions Monitor – May 2011

Alternative
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With respect to Canada, the Canadian hedge fund industry has been regulated for decades within the same framework as other money managers within Canada and that regulation has served the industry well.

BPM: What are the challenges facing hedge funds and institutional hedge fund investors going forward?
Ostoich: This is a pretty broad question. There are a number of challenges, but let me touch on a few.

First is regulation. For the most part, we now have effective regulation in place globally to deal with the alternative investment industry. Unfortunately, regulation is, for the most part, not harmonized and managers need to contend with multiple levels of regulation. This is the reality. To the extent that we continue to see additional regulations being erected in certain jurisdictions to limit the access to investors by foreign managers, this is not helpful for the industry or for investors. The alternative industry still attracts a large proportion of entrepreneurial-minded business people that provide significant benefits to the global capital markets and we don’t want to discourage its growth.

An interesting spin-off from increased regulation within the financial services industry is that we continue to see a migration of talent from banks into the hedge fund industry.

It is no secret that the industry is becoming somewhat bifurcated. We have a small group of very large managers (more than $10 billion) and then we have the rest of the industry. We continue to see the majority of inflow of investor capital to a handful of very large managers. The challenge for a large portion (by number) of the industry is to continue to attract investor capital especially from large institutions that are looking to place relatively large investments. As we know, study after study has shown that some of the best returns come from small managers (less than $500 million) and most institutions understand this. In addition, we continue to see larger managers reaching capacity limits and forced into ‘hard closings.’ Given the foregoing, my belief is that the bifurcation will remain, but smaller managers will continue to attract capital although they will need to work harder to attract this capital.
ABERDEEN ASSET MANAGEMENT INC. Renee Arnold, Senior Manager, Institutional Business Development – Canada; 161 Bay St., 44th Floor, Toronto, ON M5J 2S1 Ph: 416-572-2020 Fax: 866-290-9322 eMail: renee.arnold@aberdeen-asset.com Web: www.aberdeen-asset.com


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Alternative Assets: Canadian Commercial Mortgage Investments Assets Under Management (as of Dec 31/10): $897.7M Ownership: Privately-owned Managed Since: 1992

ARROW HEDGE PARTNERS INC. Mark Purdy, Managing Director & CIO; 36 Toronto St., Ste. 750, Toronto, ON M5C 2C5 Ph: 416-323-4077 Fax: 416-323-3199 eMail: mpurdy@arrow-hedge.com Web: www.arrowhedge.com

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Alternative Assets: Real Estate Assets Under Management (as of Dec. 31/10): $16.2B Ownership: Bentall Kennedy took place in November 2010

BLACKROCK Eric Leveille, Managing Director; 161 Bay St., Ste. 2500, Toronto, ON M5J 2S1 Ph: 416-643-4040 Fax: 514-843-5198 eMail: eric.leveille@blackrock.com Web: www.blackrock.com

Alternative Assets: Hedge Funds, Funds of Hedge Funds, Private Equity Fund of Funds, Structured Products (including CDOs & Private Debt & Equity Funds), Real Estate Products, Long-only Absolute Return Funds Assets Under Management (as of Dec. 31/10): $3,586M (also manages $604M in Fund of Hedge Funds & over the fiscal year of 2010, Canadian pension funds have contributed approximately $658M in capital commitments to its Opportunistic (active) Funds. Ownership: Independent Managed Since: 1994 Relationships: Fund of Hedge Funds focuses on creating & structuring portfolios of Hedge Funds managed by unaffiliated firms

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Alternative Assets: Hedge Funds, Funds of Hedge Funds, Real Estate, Commodities, Currency, Private Equity, Distressed Securities, European Arbitrage Assets Under Management (as of Dec. 31/10): $8,220M Ownership: Pub

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**Dexia Asset Management** Christophe Vandeviele, Head of Dexia Asset Management;
FRANKLIN TEMPLETON INSTITUTIONAL* Duane Green, Senior Vice-president, Institutional Investment Services; 200 King St. W., Ste. 1400, Toronto, ON M5H 3T4 PH: 416-957-6185 Fax: 416-364-6643 eMail: dgreen2@franklintempleton.ca Web: www.franklintempletoninstitutional.ca

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HORIZONS EXCHANGE TRADED FUNDS Chris Sheridan, Vice-president, Institutional Sales; 26 Wellington St. E., Toronto, ON M5E 1Z2 PH: 416-601-2496 eMail: csheridan@horizonsetfs.com Web: www.horizonsetfs.com
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JCCCLARK LTD. Sean Wynn, Director of Marketing; 130 Adelaide W., Ste. 3400, Toronto, ON M5H 3P5 Ph: 416-361-4533 Fax: 416-361-0128 eMail: swynn@jcclark.com Web: www.jcclark.com Alternative Assets: North American Long Short Equity Hedge, Canadian Long Short Equity Hedge, Value Long Short, Specialty Situation Funds Ownership: 100% Insider-owned Managed Since: 2001 (Principal has managed Long Short Limited Partnerships since 1982)


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STONEBRIDGE FINANCIAL CORPORATION
Louis Bélanger, Assistant Vice-president, Structured & Project Financing; 20 Adelaide St. E., Ste. 1201, Toronto, ON M5C 2T6 PH: 416-
Alternative Assets:
- Infrastructure Debt, Private Debt, Private Securitization

Assets Under Management (as of Dec. 31/10):
$39.5M

Ownership: Equally owned by the Founding Partners
Managed Since: 1998

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TD Asset Management

Robin Lacey, Vice-chair; 161 Bay St., 34th Floor, Toronto, ON M5J 2T2
PH: 416-982-6585 Fax: 416-944-6158
eMail: robin.lacey@tdam.com
Web: www.tdaminstitutional.com

Alternative Assets:

Ownership: Wholly-owned subsidiary of the Toronto Dominion Bank
Managed Since: 2003

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UBS Global Asset Management

David Coyle, Executive Director; 161 Bay St., Ste. 4000, Toronto, ON M5J 2S1
PH: 416-681-5200 Fax: 416-681-5100
eMail: david.coyle@ubs.com
Web: www.ubs.com

Alternative Assets:
Infrastructure – Global Direct; Real Estate – Global Fund of Funds, US & European Direct & Global Listed; Hedge Funds – Single Manager, Multi-strategy & Single Strategy, Multi-manager Fund of Funds Assets Under Management (as of Dec. 31/10): $200M

Ownership: Wholly-owned subsidiary
Managed Since: 1997

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Vertex One Asset Management Inc.

David Wallin, Vice-president; 1920 - 1177 West Hastings St., Vancouver, BC V6E 2K3
PH: 604-681-5183 Fax: 604-681-5146
eMail: dave@vertexone.com
Web: www.vertexone.com

Alternative Assets:
Multi-strategy: Event Driven Focus – Merger Arbitrage, Capital Structure Arbitrage, Convertible Arbitrage, Distressed/High Yield, Option Strategies, Shorts, Longs, Private Placements, Special Situations
Assets Under Management (as of Dec. 31/10): $50M

Ownership: Private Corporation
Managed Since: 1998

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Susan M. Pozer, Vice-president; 280 Congress St., Boston, MA 02210
PH: 617-951-5000 Fax: 617-263-4100
eMail: mig@wellington.com or smpozer@wellington.com
Web: www.wellington.com

Alternative Assets:
Hedge Funds
Ownership: Private Partnership
Managed Since: 1994

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In November 2010, we stated that high inflation in emerging markets was an immediate concern given the domestic and global factors exerting upward pressure on prices. Now, six months later, we continue to hold this view. Furthermore, inflationary pressures continue to build due to current economic conditions:

- Economic growth in emerging countries remains strong, with signs that may be overheating.\(^1\)
- Confidence is growing in the sustainability of global economic recovery.
- Emerging market currency appreciation remains limited in 2011.
- Persistent rise in international commodity and oil prices continues to maintain pressure on headline inflation.
- Monetary policy in emerging and developed countries remains loose. In parallel, core prices continue to rise in certain countries (China, Brazil, Russia, Chile, Korea, and Poland) reflecting the influence of the commodity price spike on overall prices.

These cyclical factors will continue to exert upward pressure on inflation in emerging markets throughout 2011 and are likely to remain for the foreseeable future given that the fundamental drivers of emerging market inflation remain intact:

- higher global commodity prices
- controlled float FX regimes in the context of large capital inflows from developed markets
- inflation imported from China

Prices are under pressure given the mature stage of the real business cycle in many emerging countries, loose monetary policy, and ample global liquidity. In addition, the disinflationary effect of domestic currency appreciation is likely to moderate as currency appreciation has slowed since the beginning of the year.

Closing Output Gaps

Inflation continues to climb higher in emerging markets. As seen in Chart 1, inflation readings in key emerging countries have moved higher in 2011. Inflation rates in emerging markets accelerated to 5.9 per cent year-over-year (GDP weighted) in February from 5.4 per cent on average in 2010 (Chart 2). Commodities prices are a key factor behind this renewed inflationary pressure, though domestic-led inflation also plays an important role. Indeed, broad inflation is growing as output gaps in many emerging markets close given the strong recovery over the past two years.

Emerging growth will become more sustainable in the coming years. However, while growth will decelerate from elevated 2010 levels, the consensus still forecasts robust growth in 2011 and 2012 above historical averages – 7.7 per cent in Asia in 2011 (7.5 per cent in 2012), 4.2 per cent in Latin America (4.2 per cent in 2012), and 4.1 per cent in Eastern Europe (4.3 per cent in 2012). Therefore, output gaps in countries that are on average still negative will continue to close while those countries whose output gaps have already turned positive (particularly Latin American and Asia) will continue to grow in 2011 and 2012.

While it is difficult to measure the output gap, recent readings concerning retail sales (Brazil, Chile, Mexico, Korea, South Africa, China), credit growth (Brazil, Chile, Mexico, Korea, China), manufacturing capacity utilization (Korea, Brazil, Philippines, Turkey), unemployment rates (Brazil), and wages growth (Brazil, Poland, China) provide evidence of pressure on capacity utilization in emerging countries.

In other words, with emerging countries operating near or above full capacity and their growth expected to continue at a solid pace for the next few years, medium- to long-term price pressure will remain within manufacturers, retailers, and the labour market.

The core inflation rate, which excludes the direct effects of an increase in oil prices,
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and food prices, provides an indicator as to the second-round effects of an increase in commodity prices. There is a concern that higher core inflation will lead to an inflationary wage-price spiral via higher inflation expectations. Core inflation continues to increase in certain countries (Korea, China, Chile, Brazil, Russia) or has begun to rise (Poland), indicating that domestic prices have been contaminated by commodity price inflation.

As the risks of upward pressure on core inflation are directly linked to domestic macro-economic conditions (growth and monetary policy stance), at a regional level, we see higher risks in Asia and Latin American. In Eastern European countries, where the recovery has been subdued thus far, the risks of second round effects are lower. Indeed, core inflation rates in Turkey and South Africa are declining.

**Behind The Curve**

Most of central banks in emerging countries have begun to normalize monetary policy in order to maintain control of inflation. However, the speed and magnitude of policy rate hikes do not appear large enough relative to the evolving inflationary risks and economic growth. A number of central banks are already likely behind the curve, having paused or delayed monetary policy tightening, concerned about potential effects from the European debt crisis, a double dip recession in the U.S. and domestic currency appreciation. Monetary policy is more accommodative in key emerging countries now than before the crisis, even in countries whose central banks have recently tightened such as Brazil, Korea, and Poland. In certain cases (Turkey and Korea), real policy rates remain negative.

Monetary policies will remain accommodative despite expected rate hikes. Though analysts expect further rate hikes within the year, the hikes are not expected to average more than +125 bp (+75 bp in Brazil, +200 bp in Turkey, and +100 bp in Poland and South Africa). As a result, real interest rates in emerging markets will remain below historical standards and particularly low given their strong growth potential.

Beyond the cyclical factors leading to heightened concerns over the immediate risk of high inflation, we believe that the fundamental drivers of emerging market inflation also remain intact:

- **continual increase in commodity prices**
- **capital inflow into emerging markets**

**Chart 2**

**Inflation Rates**

The upward trend in food and energy prices since January 2009 has accelerated in recent months on the back of supply constraints, adverse weather conditions around the world, strong demand from emerging markets, improved economic outlook for the major developed countries, recent geopolitical risks, and the Japanese disaster. Other commodity prices (textile, raw materials, metals, and livestock) have also risen to historical high levels given the strong global demand from both emerging and developed countries.

A spike in food prices has a stronger impact on emerging market inflation when compared to developed countries. In emerging countries, food prices account for an average of 30 per cent of each country’s CPI basket whereas food accounts for around 13 per cent in industrialized countries.

The CRB Index and CRB Food prices have now exceeded the previous record levels observed during the 2007-2008 food crisis. In fact, CRB food prices have increased 21 per cent in 2011, surpassing the mid-2008 peak by 11 per cent, and oil prices (Brent) are not far from the June 2008 peak.

Despite certain countries introducing food subsidies or price controls, the rebound in global food prices has transitioned into higher domestic food price inflation across emerging markets since 2010.

CPI food prices increased on average by 7.2 per cent in China during 2010, 6.9 per cent in Russia, 6.5 per cent in South Korea, 10.6 per cent in Turkey, 6.1 per cent in Brazil, and 3.9 per cent in Mexico. However, with the exception of South Korea, food inflation pressure in most emerging countries remains below 2008 levels. However, given the lag (two to three months) before international food prices feed through to domestic prices, we cannot rule out a further increase in local food prices as global commodity prices continue to increase.

As food is typically the largest component in emerging market consumer price indices, higher food prices have pushed headline inflation rates higher. The recent spike in oil prices has also amplified concerns that consumer inflation is on the verge of spiking in emerging countries.

**Second Round Effects**

The risk that higher commodity prices will contaminate broader prices within the economy is likely to increase as long as the spike in commodity prices is sustained. Indeed, the longer higher food and oil prices persist, the greater the likelihood that they will spread through to second round effects.

We continue to maintain our structural view that supply and demand factors will continue to exert upward pressure on oil and commodity prices in the medium to long-term. The disruption to nuclear capacity in Japan, along with the unrest in the Middle East, reinforces our near-term view that structural forces are likely to cause price volatility and uncertainty.

We do not believe that food and oil prices will stay at their current level; suggesting that in terms of inflation, the worst may be yet to come. Capital inflows into emerging markets from emerging equity and fixed income funds have reversed since the
Inflation Expectations

The surge in energy and agricultural commodity prices, along with higher-than-expected inflation figures and concerns that commodity prices could rise further, are behind the recent increase in emerging market inflation expectations.

Compared to developed markets, the effect of food inflation is stronger in emerging markets. Food component of domestic inflation has globally risen more in emerging markets and its average weight in the CPI basket is higher.

Economists have revised higher their inflation expectations for emerging markets over the last four months. For 2011, inflation expectations for emerging countries increased to 5.9 per cent in March from 5.1 per cent on average in 2010. For 2012, inflation expectations have also risen, signifying that inflationary pressure is likely to intensify.

Short-term inflation forecasts in the major emerging market economies have not yet returned to their pre-crisis levels, with only few exceptions (India). However, the dispersion of emerging market inflation forecasts is generally greater than in developed economies, reflecting the uncertainty over the impact of rising food and commodity prices.

We believe that the uncertainty surrounding inflation has not dissipated and inflation releases may continue to surprise on the upside in the coming months. As inflation expectations depend on observed figures, we will not rule out an upward revision to consensus inflation forecasts.

Predicting inflation in emerging markets has become very difficult given the uncertainty around the domestic and international factors described above. Inflation-linked bonds are the only asset class offering a pure inflation hedge. They work like a conventional bond in that they pay interest at fixed intervals and return the principal at maturity, the main difference is that the principle and coupon are indexed to inflation. Therefore, as inflation increases, so does the coupon payment and principle.

Furthermore, emerging inflation-linked bonds offer attractive investment opportunities as emerging countries continue to exhibit strong growth while domestic consumption and foreign capital drive consumer prices higher.

Anne Vernicos is head of economy and markets, quantitative research and development, at HSBC Global Asset Management (www.assetmanagement.hsbc.com).

1. An overheated economy occurs when economic activity attains unsustainable high levels, exerting pressure on existing productive capacity. Production of goods and supply of services become unable to meet a growing aggregate demand leading to inflationary pressures.

2. Second round effects are the indirect effects of higher commodity prices on the rate of inflation. Indeed, second round effects occur when increases in commodity prices are passed through to consumer prices for non-energy and non-food goods or services and/or if workers respond to the increase in overall prices (i.e., the cost of living) by demanding larger pay rises which trigger new price increases, leading to an inflationary wage-price spiral. A persistent surge in commodity prices may also lead to an increase in inflation expectations, a factor that would put additional upward pressure on inflation.
In 2009, CEM Benchmarking Inc. (CEM) undertook a study of risk management practices across its client base of large global funds. We wanted to know the range of risk practices used and how successful funds have been in managing risks associated with the surplus and with active management (usually tracking error). Although we found that 78 per cent of the respondents measure counterparty risk and 64 per cent measure liquidity risk, this report does not focus on those issues.

There are big differences in the impact of surplus versus active management risk (tracking error), implying that it is important for funds to define which risks are important to them. These results should be interpreted cautiously due to small sample sizes. Preliminary indications are that funds with a high focus on surplus and active risks are managing their risk-adjusted returns more effectively than those with a low focus. These results do not permit us to argue that intensity of focus actually causes better results, but we see a positive relationship between those that focus on and measure these risks and their results.

Fifty-eight global funds with nearly US$2 trillion in assets participated in the study, with an average fund size of US$32 billion (See Chart 1). More public than corporate funds participated, as well as a handful of sovereign wealth and large Defined Contribution funds.

Difference In Magnitude
To understand the difference in magnitude between marked-to-market surplus and active management risks, we analyzed the CEM global database for clients with five years of history. We measured the following:

- Five-year surplus risk for 113 funds using the standard deviation of the surplus return, which is the annual total fund return less the annual liability proxy return. Sovereign wealth and DC funds were excluded from this analysis.
- Five-year total fund tracking error on 172 funds (active management risk using the annual standard deviation of

The quartile chart (See Chart 2) shows that, as a percentage of total assets, the median standard deviation of surplus return (16.8 per cent) is more than 10 times the standard deviation of value added (1.3 per cent). This demonstrates the large movements of markets and interest rates versus the smaller impact of value added. For this reason, we focused particularly on understanding surplus risk management practices.

More Risk Management
Funds with a higher proportion of internally managed assets do more risk management. These tend to be the larger funds, which are also more likely to believe in surplus management, have a group dedicated to risk, and do risk budgeting. The exception to this observation is large U.S. public funds which are less likely to do risk budgeting. The proportion of assets managed internally by the respondents grows from an average of six per cent for funds that are US$5 billion in size and smaller to 49 per cent for funds greater than US$50 billion in size.

Regulation varies by country as to whether and how risks should be measured. Dutch and Scandi-
all funds measure active management risk (tracking error). Of the 51 funds that measure active management risk, 88 per cent use volatility of value added and 43 per cent use value at risk (VaR).

Regulation is not the only driver of fund behaviour with respect to risk. Clearly, investment beliefs also play a role. The survey found 66 per cent of participants agree or strongly agree that pension liabilities change with market forces and that they should measure and manage this impact. Funds that disagreed with that belief were, for the most part, either U.S. public funds or funds with no liabilities. Beliefs appear to be aligned with the regulatory environment, possibly implying that managers’ beliefs adapt to the behaviour required by their environment.

High Focus

For both surplus and active management risk, the funds with a high focus generated better risk/return trade-offs.

We reviewed surplus risk results for 30 funds where CEM had five years of data to December 31, 2008. We separated them into two groups based on their own self-assessments. There were 13 with a high focus on surplus volatility and 17 with a low focus. At (0.3) per cent, median surplus returns were similar between the high- and low-focus groups. However, we found differences in the annual standard deviation of marked-to-market surplus returns—a 13.8 per cent median standard deviation for those with a high focus on surplus volatility compared to the 17.7 per cent generated by those with a low focus.

As well, the survey identified 47 funds for which we have a five-year return history of active management risk: 30 of these had a self-assessed high focus on active management and 17 had a low focus. The high-focus funds generated a median value added 61 bps higher than the 13 funds with a low focus. There was no statistically significant difference in the standard deviation of value added (tracking error) between the two groups.

Therefore, for both surplus and active management risks, the risk/return trade-off is superior for funds that focus on those issues. When interpreting these results, we caution that the standard deviations are based on annual observations, making them less statistically rigorous than monthly data. As well, the small number of funds with a five-year history makes it difficult to draw clear conclusions.

Documented board-approved risk levels are used by 67 per cent of respondents and half of these include a risk appetite statement integrated with their investment policy and/or specify procedures in case of a breach. For the funds with risk appetite statements, approximately half specify active management risk, whereas, despite its much larger impact, surplus risk is specified for only 30 per cent of funds.

For approximately half the respondents, the lowest level at which the board provides risk approval is the total fund. For 38 per cent, the board goes as low as specifying the risk for individual asset classes. For only five per cent does the board specify permissible risk levels for individual managers (internal or external).

The boards of 67 per cent of participants receive reports on active management risk and for 55 per cent on surplus risk. Within both groups, approximately two-thirds report quarterly and about 30 per cent report more frequently.

Which Risks To Take

Funds were asked whether they have a separate group that monitors risk and whether they use risk budgeting. Risk budgeting allows funds to determine which risks to take and how to allocate them across asset classes and managers. It establishes objectives for specific individuals and groups as well as the entire organization. In this way, returns and value added for different asset classes and managers can be compared to the risks taken to achieve them. Once a budget is allocated, monitoring informs fund leadership as to how much actual risk diverges from the budget.

We found that larger funds are more likely to have more risk monitoring activity. Almost all funds larger than US$25 billion and approximately half the funds between US$5 and US$25 billion have a separate risk group.

On average, global funds have approximately five full-time staff dedicated to managing risk. Of course, this varies by size, ranging from one person for funds under US$5 billion to 11 or more people for the very large funds. Relative to the global average, American funds have approximately half the staff dedicated to risk management per dollar invested, even taking their larger size into account. On average, global funds have 0.25 people dedicated to risk management for every US$1 billion under management. At 0.11 people per US$1 billion, American public funds have the smallest size staff dedicated to risk management. This compares to Canadian funds with an average of 0.37 people per US$1 billion. One likely reason for this is the difference in regulatory environments, described above. As well, it is possible that the difficult financial situations of many U.S. states cause the pension funds to receive less funding to sustain these risk groups.

Of the 88 per cent of funds that measure active management risk, 57 per cent use risk budgeting. Larger funds are more likely to use risk budgeting than smaller ones. The average size of those that do it is US$45 billion versus US$19 billion for those that do not. Of those that use risk budgeting, 62 per cent allocate the budget down to the portfolio manager level. Of those with active management risk budgets, 71 per cent measure the risk monthly or more often and 75 per cent of risk budgets incorporate forecasted active management risk.

Size also explains which funds tie compensation to performance. At US$44 billion, the average size of funds that tie compensation to performance is larger than the average US$10 billion size of funds that do not.

Finally, we asked how funds integrate the monitoring of these risks through their governance structures. We found that 85 per cent of the participants have a framework for managing risk, including annual asset/liability studies, investment policy statements that incorporate risk indirectly into asset allocation ranges, and credit risk limits. Funds without a framework were smaller, averaging US$13 billion in size.

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Recordkeepers play a critical role in the success of Defined Contribution plans. Many sponsors use price as the criterion to select a recordkeeper, but this is not enough. A mismatch between the needs of the plan sponsor/plan members and the services rendered by the recordkeeper often leads to disappointment for members and sponsors. This is sometimes followed by the replacement of the recordkeeper by the sponsors, despite the significant time, effort, and cost involved in making the change.

A proper assessment of the recordkeepers’ capabilities during the selection process can lead to longer lasting, mutually beneficial relationships between recordkeepers, plan sponsors, and members.

**Key Factors**

This article focuses on some key factors that should be considered during the recordkeeper selection process, in order to reduce the chance of disappointment by sponsors and plan members. Some of these factors include:

- Organizational strengths and weaknesses of the recordkeeper
- The recordkeeper’s target market
- The breadth and quality of communication material available through the recordkeeper
- Plan sponsor and member support services, how well the recordkeeper is staffed to support such services, and the capacity of the recordkeeper to absorb new clients
- Fees charged by the recordkeeper

Other factors not reviewed in this article include the availability of strong investment options, the administrative capabilities and the recordkeepers’ commitment to group retirement business, and their information technology infrastructure.

Pooled and mutual fund assets held by recordkeepers are segregated from general assets of the recordkeeper and generally not at risk if a recordkeeper fails. Only GIC assets are at risk if a recordkeeper fails. While most recordkeepers in Canada are considered ‘safe bets’ with very high credit ratings, it is important to periodically review credit ratings from public rating agencies. Subsequent credit downgrades over a short period of time could be indicators of further issues/concerns to come.

Organizational strengths can also be an indicator of the likelihood of a recordkeeper being taken over and the client turnover over the past few years.

When a recordkeeper is taken over by another recordkeeper, typically the acquirer tends to migrate the clients from the acquired company’s record-keeping platform onto their own platform. This can, at times, be cause for disruption for the clients of the acquired company. Sponsors should review the capabilities of the acquirer to determine whether they wish to continue their relationship with the new firm.

An assessment of client gains and losses over the past few years can provide valuable insight into service issues with the recordkeeper. It is, however, important to properly define ‘client gains’ and ‘client losses.’ Some companies may provide information based on the number of plans gained (which can include an existing client setting up a new plan) or plans lost (which can imply an existing client merging two plans). The key question should be the number of ‘new clients’ that came on board over the past few years (for example, three years) or ‘clients who left’ over the last three years. There is typically higher turnover in the ranks of smaller client segments. This is attributable to the higher tendency in these segments to change recordkeepers based on pricing only. As a result, higher weighting should be placed on losses and gains of clients with higher asset levels.

Sponsors’ preferences often vary – some may prefer customized service and on-site support while others may prefer a very ‘low-touch’ support model. Some recordkeepers are willing to assign a dedicated client relationship manager who would be willing to visit, on a regular basis, even clients with 10 to 15 employees. Other recordkeepers may assign the task of relationship management for smaller clients to a pool of individuals in a call centre.

Some recordkeepers are only willing to make education sessions available when there are a minimum number of members attend.
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ing a session. Other recordkeepers do not have minimums.

When selecting a recordkeeper, sponsors of DC plans with members in many provinces should assess the recordkeeper’s footprint in various provinces. Some recordkeepers may only have a well-developed servicing infrastructure in one or two provinces while others may offer a reasonable level of services in most or all provinces.

Ultimately, developing a good understanding of a recordkeeper’s target market would help to ensure that there is no mismatch between the services required by the sponsor and the services delivered by the recordkeeper.

**Communication Material**

Recordkeepers generally offer good-off-the-shelf materials such as booklets, statements, and educational content. However, it is important to consider the knowledge level and the needs of the employees and to tailor the communication material accordingly. For example, employees in certain industries may appreciate detailed communication material while, for most others, brief overviews tend to work best. Before selecting a recordkeeper, a plan sponsor should review the material offered by the recordkeepers and assess its quality.

When launching a new DC plan or introducing a new recordkeeper, employees receive all the required information from the recordkeeper to assist them to enrol in the plan and to select the appropriate investments. Many employees are not comfortable making these decisions, leading to high default rates in many plans. Most employees find the ‘binders’ or the booklets provided by the recordkeeper intimidating. As a result, while the sponsor thinks/hopes that employees will truly appreciate the true value of company sponsored ‘pension benefit,’ many employees are at risk of missing out on the value that the plan should be providing over the long term. Pension benefits are very valuable. It is important to highlight the significant benefits of a group pension plan such as:

- low investment management fees
- employer matching contributions
- oversight by the employer
- saving on a tax deferred basis

Plan sponsors spend a significant amount of resources in designing a DC plan, finding the best recordkeeper to manage the plan, and selecting a list of investment options after performing the appropriate due diligence. The communication material offered by the recordkeeper should highlight the benefits of the pension plan—in other words, push its value.

Communication materials work better if they are engaging and relevant. Sponsors should determine which recordkeeper offers communication material that would better engage the employees.

**Support Services**

Before selecting a recordkeeper, a sponsor needs to determine the type of reporting required and then assess each recordkeeper based on quality of the reporting in specific areas.

In order to meet their fiduciary obligations, plan sponsors should be able to review the plan statistics on a regular basis. A review of the plan statistics may highlight the need to provide information sessions on specific topics to plan members. The same review may lead to determining whether certain fund options are under or over utilized and lead to remedial action by plan sponsors. Sponsors also need to determine on a periodic basis whether contributions to employee accounts are allocated on an appropriate basis by the recordkeeper.

With respect to employee support material, sponsors should assess the user friendliness and usefulness of each website, retirement projection software, the risk profiler questionnaire, and member statements. With respect to the website, sponsors should determine the ease of obtaining information and accessing the retirement projection software.

The risk profiler questionnaire should be reviewed to gauge the robustness of the question set and resulting outcomes.

The employee statement should contain all the relevant information. It should contain information about fees, rates of return, benchmark rates of return, and dollar value of assets in the plan as well as information on expected versus targeted retirement income.

Lastly, retirement planning tools should be assessed in the context of ease of use, links to current information, options to include sources of income such as government plans and spousal accounts, and the assumptions used for the projections.

The capacity to absorb new clients can be assessed by reviewing the number of clients gained by the recordkeeper and how the staffing level and the information technology platform have changed in order to accommodate the addition of new clients.

The number of current clients served by the proposed client relationship manager is also a factor to consider.

**Fees**

The competitiveness of the fees cannot be assessed by simply comparing the investment management fees quoted by different recordkeepers. Plan sponsors have to assess total fees. The first thing to address is how recordkeeper fees are structured.

Often, a portion of asset-based fees are diverted to the recordkeeper. Furthermore, the recordkeeper may also charge a portion of the recordkeeping fees as a flat per member fee which is typically payable by the plan sponsor. Flat per member fees reduce the investment management fees which are typically paid by plan members. The higher the flat per member fee that the plan sponsor is willing to pay, the lower the investment management fees paid by plan members. As a result, sponsors have to ensure the fee quotes provided by all the recordkeepers are using the same flat per member fees assumption.

Fees also vary by client size. Generally, smaller clients have higher IMFs than larger clients. Other fees that should be considered include:

- fund operating expenses which are included in the pricing offered by some providers and quoted separately by others
- fees when the sponsor decides to replace an existing fund option
- fees charged to plan members who are leaving the plan
- the additional explicit trustee fees charged by some recordkeepers while others include the trustee fees in the investment management fees

Should a sponsor decide to offer GICs, then the GIC rates across the providers may also vary. Sponsors, however, cannot purely rely on the ‘enhancement’ rate offered by the recordkeepers. The enhancements are typically added to the base GIC rates offered by the recordkeepers. However, the base GIC rates can vary from one recordkeeper to the next. The range of variations can be as high as 0.50 per cent to 0.75 per cent. Therefore, better base rates and enhancements should be considered when comparing recordkeepers.

In conclusion, only a careful assessment of the overall fees charged by each recordkeeper can truly assist the plan sponsor to determine which recordkeeper is offering the most competitive pricing.

Fees are only one of the several factors that should be considered during the selection process. For the most part, the success of the DC plan is highly dependent on the proper assessment of recordkeepers’ capabilities during the selection process. Clients who are in the process of selecting a recordkeeper would greatly benefit by listing the key selection criteria that are important to them and then selecting a provider that best meets their needs.

Vartkes Rubenyan is a principal with Mercer’s investment consulting business.

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The highly anticipated resolution of the Dawson versus Tolko Industries Ltd. pension conversion case occurred on March 16, 2011, with a surprise ending. After a trial of several weeks duration and the passage of some months without a judgment rendered, the parties settled prior to judgment and applied to have the case dismissed. It would seem that one of the parties “blinked.”

The settlement terms have not been made public and thus it can only be speculated as to which party initiated it. It seems likely, however, that the plaintiffs must have received some consideration to achieve the settlement. Even if the defendants agreed to cover the plaintiffs’ legal costs, this would have been a considerable sum given the time frame and complexity of the proceedings. This alone should give pause to employers and advisors that have been involved in or may be considering a Defined Benefit to Defined Contribution conversion for a pension plan.

**Dawson Case**

The basics of the Dawson case are pretty straightforward. The employer, Riverside Forest Products (which was subsequently acquired by Tolko), implemented DC provisions under its pension plan in addition to existing DB provisions as of January 1, 1998, and allowed existing employees the choice of converting their DB pension to DC or remain under the DB provisions. Information and disclosures were provided to employees through seminars and written materials to assist them in making their choice.

Although straightforward, the Riverside scenario is fraught with risks and uncertainties in relation to the conversion group. I highlight some of these with the following series of questions:

- Were the plan sponsor’s objectives for the conversion accurately disclosed to members?
- Were individual financial disclosures concerning conversion adequate?
- Were economic and actuarial conversion assumptions appropriate relative to a range of possible future outcomes for individuals?
- Did illustrations reflect the possibility of termination of employment, death, or early retirement prior to normal retirement?
- Was there a ‘winners and losers’ analysis for individual members and was there any disclosure to potential losers?
- What is the appropriate date for a winners/losers determination?
- Was there disclosure of the DB pension normal cost to each individual member?

These questions (and there are potentially many others) are useful in measuring the potential for lawsuits in any DB to DC pension conversion. If a plan administrator (which is the fiduciary role of the plan sponsor) is uncomfortable with any of the answers to these questions, they would be wise to re-evaluate their conversion and perhaps take mitigating steps, whether the conversion is under consideration or has already occurred.

I believe the most effective tool in a pension conversion exercise to mitigate risks and uncertainties is a ‘winners and losers’ analysis at the time of the pension conversion. In my view, failure of a fiduciary to conduct and utilize such an analysis in a manner that reflects the best interests of plan members could constitute negligence. To illustrate the importance of this, I offer an actual example:

**Assumptions**

- Employer ‘normal cost’ neutral (employer DC contribution rate equal to current service DB funding cost)
- No change in actuarial/economic assumptions underlying DB normal cost
- Employee cost neutral – no change in level of required contributions
- 100 per cent DB to DC conversion by employees for past and future service
- Final average salary DB pensions and comparable DC account balances projected to normal retirement date
Results of Winners/Losers Analysis

- Value of DC benefit roughly equivalent to value of DB benefit for 60 per cent of plan members
- 20 per cent of members are clear winners from conversion
- 20 per cent of members are clear losers from conversion

Although distribution of winners and losers will vary according to a number of factors, the very nature of DB funding (lower cost for retirement benefits for younger workers, higher costs for older workers) is such that there will be some potential winners and losers in every conversion process. In respect of a 100 per cent conversion of a final average DB pension formula to DC, younger members will be winners and the losers will be older shorter service members. Older service members tend towards the neutral result as interest on accumulated funding of their individual benefits means lower future levels of contributions are required to achieve a comparable pension.

The only effective way to deal with fiduciary risks associated with conversion losers is to accept higher cost levels in respect of future contribution requirements (at least for the short to medium term). One option is to introduce the element of choice (convert to DC or remain DB) with full, complete, and accurate disclosure such that few losers, if any, are likely to convert.

Anti-discrimination Rules

However, offering a choice between DB and DC carries additional risks. Anti-discrimination rules will likely require that choice be made available to all of the cohorts in the winners/losers analysis and many in the neutral cohort will opt for the security of DB, while others will prefer DC for the potential gains in pension values if investment returns are favourable. Employees will inevitably make their own ‘CSW’ (could of, should of, would of) winners/losers analysis, potentially every time investment losses are suffered in their DC accounts. Any weaknesses in disclosure, economic/actuarial assumptions may be revealed with the clarity of 20/20 hindsight, and the continuing existence of the DB option will stand as an enticing carrot to argue that they should be allowed to convert back to DB on a retroactive basis. Dawson stands as an excellent example of this.

CSW analysis can be eliminated if no choice is provided. Under this approach, the DB formula applies for past service benefits only and DC benefits accrue for future service of all plan members. This is not, technically a conversion, as no DB benefits are actually converted to DC. One potential flaw in this approach is that some employees might claim that conversion to DC for future service is a change to their terms of employment. However, this can usually be managed on a case-by-case basis if it should become necessary and is dealt with at the time of the conversion, rather than potentially years later.

There are other ways to manage CSW risk and also offer choice. For the client in the winners/losers illustration above, employees were offered the choice to convert their DB benefits for past service to DC accounts (all future service was required to be DC). The client set a goal to achieve 100 per cent conversion with the understanding that a significant increase in current service costs would be required over the next five years. Fortunately, the plan had a large surplus which would be utilized to absorb the additional cost, the funding basis was already very reasonably conservative to the economic conditions at the time of conversion, and it was permissible to freeze accrued DB entitlements based on service and earnings for the period ending on the date of the conversion. The latter element allowed us to compare projections with the frozen accrued DB against a conversion value calculated with the funding valuation salary scale, thus significantly stacking the deck towards a conversion election for the winners and neutral cohorts. In addition, termination benefit illustrations were provided showing results at five-year increments in the future until retirement and further reflected pessimistic, conservative (relative to then current financial markets and equivalent to actuarial funding basis of the original plan), and reasonable relative to general consumer expectations for returns from a balanced portfolio for the financial markets at the time.

For the loser’s cohort of older short service employees, the differential between the values of the frozen accrued DB pension and the conversion amounts was not a sufficient incentive to ensure the conversion choice. Furthermore, it was the client’s objective as a fiduciary that there should be no losers in the conversion process. To address this, lump sum ‘make whole’ amounts were calculated for the difference between projections for pensions purchased from DC accounts at normal retirement age to be equivalent to what the original plan would have provided, relative to what the DC accounts on the revised plan were projected to provide. These amounts were amortized over a five-year period and deposited as contributions to RRSP accounts opened for the affected member (the losers cohort), if they elected to convert their accrued pension to DC accounts. RRSP accounts were utilized due to the non-discrimination rules applicable to the pension plan.

Single CSW Claim

This conversion took place on January 1, 1998, (the same date as the Riverside conversion in the Dawson case), and the 100 per cent conversion objective was achieved. In the 13 years since, of the 120 employees involved in the conversion only a single CSW claim has arisen. This claim came at the retirement of the affected employee in mid-2003, after the bear markets of 2001 and 2002 which were further compounded by the employee’s DC investment choice to be highly weighted in equity funds. The plan sponsor provided a modest additional retiring allowance to the employee that resulted in a total retirement benefit equivalent in value to the outcome that would have occurred if he had not elected to convert his frozen accrued DB pension.

Another simpler way to eliminate CSW risk is to simply terminate the plan and (perhaps) replace it with a group RRSP. Fiduciary obligations can be effectively met this way and a winners/losers analysis becomes unnecessary, as all employees become losers from a pension perspective.
Does Your Benefit Plan Address The Obesity Epidemic?

- Failure to treat obesity as the root cause of many illnesses
- A lack of knowledge about proven treatments for obesity
- Perception that effective treatments are already available through the workplace or already covered by government
- Perception that obesity is simply a ‘lifestyle’ condition
- Failure to recognize the true costs of obesity
- Obesity is the root cause of a number of serious, chronic, and costly illnesses such as:
  - Type 2 Diabetes
  - Sleep Apnea
  - Hypertension
  - Cancer
  - Asthma
  - Coronary Artery Disease
  - Gallbladder Disease
  - Depression

Effectively treating obesity will result in a resolution or significant improvement of these illnesses, which can lead to significant cost savings for plan sponsors through reduced medication costs, reduced absenteeism and improved presence, decreased short- and long-term disability claims, and increased productivity as well as fewer workplace injuries.

The cost of effectively treating obesity can literally pay for itself.

A lack of knowledge about proven obesity treatments may be another reason obesity treatments have limited coverage in benefit plans. You may not be aware of the various treatments for obesity, specifically treatments for severe or morbid obesity.

Scientific studies have evaluated the effectiveness of diets, exercise, weight-loss drugs, and medically assisted weight-loss procedures.

To start, diet and exercise are generally not effective for achieving long-term weight loss in individuals who need to lose a lot of weight. Participants initially lose about two to five kilograms with diet and exercise, but the weight is typically regained over time. More than a third of patients in these studies don’t stick to their diet plan and drop out before one year. Diet and exercise typically have a 95 per cent failure rate.

The only weight loss medication available in Canada – Xenical – is approved by Health Canada for use by individuals who are overweight with one or more co-morbid illnesses or obese (BMI of more than 30). Clinical trials demonstrate that significantly more patients in the Xenical group achieved a more than five per cent weight loss than in the placebo group. However, this is typically not enough weight loss for someone who is severely obese to achieve a sustained reduction in co-morbidities.

Previous Attempts

Medically assisted weight loss procedures are reserved for those individuals who are morbidly obese (BMI of more than 40) or severely obese (BMI of more than 35) with one or more co-morbid conditions (such as type 2 diabetes), who have failed previous attempts at losing weight.

The two most common procedures in Canada are laparoscopic adjustable gastric banding (LAGB) and gastric bypass. Both procedures result in substantial sustained weight loss and improvement or complete resolution of co-morbidities in most patients, as shown in Figure 1.

Both procedures have been available in Canada for a number of years and are recommended as effective treatment to achieve long-term weight loss by the Canadian Clinical Practice Guidelines on the Management and Prevention of Obesity in Adults.

Another issue is the perception that effective treatments are already available through the workplace or already covered by the government. By offering diet and exercise programs in the workplace, you may believe that you will see significant improvement in employee health and wellness, but, unfortunately, this is often not the case based on the amount of weight loss required and due to high failure rates.

While diet, exercise, and oral obesity medications do have their place in therapy for overweight individuals, they simply don’t work well enough to be considered effective treatments for the severely or morbidly obese.
Those treatments that are most effective for morbidly or severely obese individuals are currently difficult to access. For example, although gastric bypass procedures are covered by all provincial plans, in reality, access is extremely limited, with five- to seven-year wait times on average and some provinces do not have any hospitals that offer the procedure.

In contrast, laparoscopic adjustable gastric banding is only covered in three provinces (Alberta, Quebec, and New Brunswick). In the remaining provinces, individuals pay the full cost of the procedure out-of-pocket, including the cost of the medical device.

Although the adjustable gastric band is a Class 3 Health Canada approved medical device, it is not included in most benefit plans – even though other Class 3 Health Canada approved medical devices are covered and even though providing coverage makes good sense from both an economic and therapeutic perspective.

‘Lifestyle’ Condition
The perception of obesity as a ‘lifestyle’ condition implies that people choose to become obese and, in that perception, there is an element of blame and judgment. Studies, have found that:

- 54 per cent of obese individuals reported experiencing weight stigma from their co-workers

- 43 per cent reported experiencing weight stigma from their employers

- 27 per cent of obese women and 12 per cent of obese men reported weight-based employment discrimination

If your plans pay for oral medications for obesity, offer a Weight-Watchers at-work program, fitness subsidies, and the like, but don’t cover the recommended treatment for severe or morbidly obese individuals, are your plans discriminating against severe or morbidly obese plan members by restricting/excluding recommended medical benefits from them? In other words, do your plans support ‘overweight’ plan members, but discriminate against ‘severe or morbidly obese’ employees?

Discrimination against individuals because of their weight has taken on a new legal understanding in Canada over the past decade, according to Hugh O’Reilly, a lawyer who heads the pensions and benefits practice group of Cavalluzzo Hayes Shilton McIntyre & Cornish in Toronto. The Supreme Court of Canada has noted that a disability doesn’t need to be unchangeable to qualify for the protection of human rights law. That is, human characteristics or conditions that can be changed, such as obesity, qualify as disabilities in the same way as characteristics that cannot be changed, such as gender. This understanding makes it unconstitutional to discriminate against individuals because of their obesity.

Finally, plan sponsors may not recognize the true costs of obesity or relate those to the co-morbid conditions that result. These costs include coverage for the medical treatment of obesity-induced illnesses such as insulin, insulin pumps, and injection supplies for diabetes; medications for hypertension and cardiovascular disease; C-PAP machines for sleep apnea; and medications for asthma.

These obesity-induced illnesses can lead to major health crises including heart attack, stroke, and limb amputation. Obesity also negatively impacts worker productivity and is directly linked to more workplace injuries, all of which provide significant risk to the insurer and cost burden to the plan sponsor.

Research indicates that obese employees take 13 times more days off work and incur short- and long-term disability claims that are on average more than $7,000 more than those of healthy-weight employees.

**Medication Savings**
The effective treatment of obesity can lead to cost savings. Medication savings alone following medically assisted weight-loss procedures can reach $2,000 to $3,000 annually per individual. These are savings that, if applied to the cost of covering a gastric banding medical device, would pay for itself in a short period of time. Further cost savings can be realized with decreases in absenteeism and reduced disability claims.

There are many possible reasons that...
current benefit plans lack adequate coverage for obesity treatments. Although it is important to examine these reasons, it is even more critical that you take action and update your plans so that they are equitable to obese individuals.

Employers can implement numerous initiatives to encourage a healthy, active workforce, including:

- Talking with health plan providers about the availability of employee educational materials and provide wellness tips and facts on:
  - Nutrition
  - Importance of a healthy diet
  - Exercise programs
  - The health risks of being overweight or obese

- Offer employee assistance programs for private counseling or access to community-based weight management program

- Develop obesity prevention strategies, particularly in the child and adolescent dependent group

- Encourage employees to participate in a voluntary, self-reported health risk assessment (HRA) to increase awareness of healthy and non-healthy behaviours, rewarding positive outcome

- Follow the ‘right therapy for the right individual’ approach to ensure employees receive coverage for the recommended medical treatment according to the severity of their condition

- Be inclusive, provide coverage for medically-appropriate care

- Say ‘yes’ to an employee’s or dependent’s request for medically assisted weight loss options for severely or morbidly obese individuals and benefit from improved health outcomes and reduced health plan costs

It simply makes sense to target the root cause of serious illnesses, and – as previously shown – the cost savings are there.

As a plan sponsor, take the time to update your plans to reflect the medical realities facing plan members today.

Arya M Sharma, MD, FRCP(C), is professor of medicine, research chair for obesity research and management, at the University of Alberta and medical director for the Edmonton Weight Wise Program (www.drsharma.ca)

1. Nutrition: Findings from Canadian Community Health Survey – Adult Obesity in Canada; Measured Height and Weight. Ottawa, ON: Statistics Canada; 2004
Companies that still offer health coverage to future retirees are reducing the value of these benefits and making them available to only longer service employees.

According to the 2009 Towers Watson Comparison study, 43 per cent of the participating organizations have post-retirement health coverage and 27 per cent maintain retiree dental programs. In more than one-third of these companies, only employees who are age 55 with 10 years of employment are eligible for health and benefits at retirement.

“Even where companies want to keep retiree benefits they may need to change the way they are structured,” says Tim Clarke, Aon Hewitt’s health and benefits innovation leader. “They are looking at stricter eligibility, but, at the same time, if they are providing benefits to fewer people, they can actually be more generous with the benefits they provide.”

Entire Spectrum

Clarke says that when he sits down with an employer to discuss how they can restructure a retiree benefits program, there is an entire spectrum of eight or nine gradations from providing no coverage at all to just providing access to benefits. “That is where the company doesn’t pay for post-retirement coverage, but they allow the employees to buy into the company-sponsored program – sometimes to a level as rich as the plan for active employees.”

Six years ago, Procter & Gamble Canada introduced a new program that gives retirees more flexibility than the former more traditional, one size-fits-all approach.

Regular full-time employees who retire at age 55 with 15 years of service or part-time employees with 15 years of full-time equivalent service are eligible for the health and dental program with premiums fully paid for by the company.

The retiree plan is not the same as the full flexible benefits plan offered to active members, but Jane Lewis, Canadian HR manager, says the plan design allows the company to maintain a comprehensive level of coverage while still better managing costs.

Reflecting on her own experience when her mother was diagnosed with cancer at a routine medical appointment, Lewis says, “The whole paradigm changes. If you need to learn about home care, who do you call? The healthcare co-ordinator is a valuable benefit because it helps retirees navigate and access some of these important services.”

For the most part, changes to post-retirement benefit plans only impact future retirees because of the Dayco case where the Supreme Court of Canada ruled that benefit entitlement is determined at the date of retirement.

However, Elizabeth Brown, a partner at Hicks Morley, says there are recent cases where courts have found benefits could be modified after retirement. There are also instances where employers have passed changes to active plans on to retirees on the basis that what they got when they walked out the door was the right to the active package.

Other companies have tried to buy out retirees. Greg Durant, Towers Watson group benefits actuary, says these were typically situations where the company was pulling out of Canada and all they had left was the retiree obligation. Therefore, they offered a financial incentive in exchange for changing the promise.

More Restrictive

Where an employer does not offer post-retirement health and dental benefits, the available options for health and dental coverage can be expensive and much more restrictive.

Most insurance companies have established retiree plans for former members of their group programs. The advantage of rolling over into one of these policies is that at retirement former employees can generally obtain coverage without passing a medical examination.

After age 65, government programs in most provinces cover drug benefits, although some of these programs (with the exception of Ontario and Quebec) have an income-based test. Individual coverage may also be available from a variety of insurance providers and professional associations or other affinity groups.

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Employee health is a business issue. A number of things currently impacting health and productivity in the workplace will only intensify in the future, so organizations should have a plan to address the issues. Understanding these trends, knowing how they will affect workforce management, and learning new ways of communicating to employees to ensure the engagement of employee health will have a lot to do with some organizations being on the positive side of the ledger and others not.

The most obvious trend is our aging workforce, which shows in our demographics. In the year 2020, which isn’t far off, the youngest Boomers will be 56 years old, Generation X (those born between 1965 and 1979) will be 41 to 55 years old, and Generation Y – whom we have always considered young fry – will be up to 40 years old. Right now in the workplace, we could have a 32-year-old managing and supporting a 61-year-old which presents all kinds of issues. These issues require empathy and compassion in order to support an employee, but it may be hard for a 32-year-old to be able to provide that support without adequate coaching.

Will reach retirement age in the year 2015 – a mere four years from now – and this total will represent 22.1 per cent of the workforce. That is a staggering amount. Put another way, today we have five working Canadians for every senior over the age of 65, but in less than two decades that ratio will go from 5:1 to 3:1.

What does this mean? It will have huge ramifications for the workforce because an aging workforce is one with chronic health conditions, reduced immune response, and large numbers of people suffering from depression, exhaustion, insomnia, and anxiety. Employers take note, the time for a good hard look at your coming labour pool is here.

Another trend is that of fewer people entering the workforce. The last year in which Canada had a positive replacement fertility rate was 1971 and since the 1960s our fertility rate has been trending downwards. The impact of this could well be talent shortages. Ruth Wright, associate director, leadership and human resources research, Conference Board of Canada, says “The recession gave employers only a brief reprieve from looming workforce shortages and an ongoing competition for talent. A growing economy and an aging workforce mean that it is just a matter of time before pressure in labour markets begins to build again.”

The aging workplace aside, probably the most dynamic trend right now is the ever-increasing diversity of working people. The Conference Board, in 2010, said about two-thirds of net growth in our total population was from net migration (immigration minus emigration). But it also forecasted that in 2030 all of the country’s population growth will come from net migration, reaching some 350,000 people annually. Thus, employers are going to have to pay far greater attention to not only generational issues, but also cultural issues. By 2020, it is expected that visible minorities will be on the verge of becoming the majority in urban workplaces. Employers must address the rising importance of training that emphasizes the value of collaboration and respect for differences. This will be how to enhance individual and organizational effectiveness.

Social Media

How people communicate with each other is also changing. The reliance on social media to keep updated on world events, business issues, and networking has intensified. Naturally, technology and social media are at work in the office, too. There is increasing reliance on technology to access information on a just-in-time basis.

What is the impact of this? Employees’ skills with written communications, and ability to manage information from multiple media, are impacting how

Looking For Balance

There will be many people contemplating retirement and many others looking for a balance between the needs of family and work. According to Statistics Canada, approximately 3.6 million Canadians
people interact with each other.

Employee health – both physical health and mental health – is affected by all these trends. Consider these figures. According to the Heart & Stroke Foundation report ‘A Perfect Storm of Heart Disease On Our Horizon,’ between 1994 and 2005, the rates of high blood pressure among Canadians skyrocketed by 77 per cent. What’s more, diabetes was up 45 per cent and obesity 18 per cent. These affect not only older people, but younger ones as well. According to the same report, among those 35 to 49 years of age during that same time frame, the prevalence of high blood pressure increased by 127 per cent, diabetes by 64 per cent, and obesity by 20 per cent.

The impact of all this in the workplace will be profound. We’ll be looking at loss of energy, disinterest in the job, and a diminished ability to focus on tasks, along with feelings of discouragement, and even hopelessness. And that translates into loss of productivity and higher rates of absenteeism, not to mention a lack of understanding about which benefit or services can be accessed by employees for support and an ever-increasing reliance on prescription drugs in order to treat mental nervous issues. This is not a good recipe for a productive workplace or for an employer who is facing significantly higher costs for benefits and insurance in the form of drugs and in the form of short-term and long-term disability.

Our workplace is already experiencing rising incidence of stress, diabetes, dementia, and cardiovascular problems and it points to much greater benefits costs for employers. Drugs will be a big part of this cost. We can expect anywhere from 25 to 40 per cent of a typical employer’s total benefits cost will be for drug spending. On top of that, we have mature workers who may want to be compensated for age-related changes which could involve such costly items as ergonomic workstations.

The burgeoning issue of mental health in the workplace will have huge repercussions for employers. A Community Care Access Centre (CCHC) study from 2002 said that more than 450,000 Canadians – almost half a million people – who were aged 25 to 64 and employed, had at least one episode of depression in the previous year. It affected more women than men and those with a chronic health condition were more likely to experience depression. Workers with major depression had been unable to carry out work for 32 days in the previous 12-month period and that’s a lot of down time.

Workforce health impacts an organization through missed deadlines, reduced quality of work, reduced concentration, increased absenteeism and lateness, and more relationship issues and conflict with co-workers.

However, what many employers fail to realize is that much of this cost is driven by chronic conditions which are preventable. According to Health Canada (IMS Health Canada 2010), the top 10 dispensed therapeutic classes for the year 2009 were, in order, cardiovasculars, psychotherapeutics, gastrointestinal/genitourinary, cholesterol agents, hormones, analgesics, anti-infectives systemic, diabetes therapy, neurological disorders, and diuretics. The total number of prescriptions was 483,000, which was 5.5 per cent higher than the year before.

Reliance On Drugs

Treating mental health involves a combination of therapy and drugs, but there is an increasing reliance on drugs to resolve issues. In the workplace, people are off work for longer periods because they don’t know that support is available. However, Employee Assistance Programs (EAPs) can provide support and treatment to those who are off work.

No one is saying that all these problems can be prevented by an employer who
values an engaged and healthy workforce, but an employer can definitely mitigate the effects of current trends which impact the workplace by moving to a proactive approach that engages employees in managing their health. Such an approach would enhance the effectiveness of both the individual and the organization.

As with many things, communication is key and a strategic health model which integrates programs is the way to go. The methodology involves assessing, designing, and managing. Such a program would encompass seven steps:

- Define your organization’s health and productivity (H&P) objectives
- Assess your current H&P programs
- Define gaps to reach your H&P objectives
- Create an H&P business and implementation plan
- Create an H&P measurement plan
- Implement an H&P solution
- Manage and govern the H&P solution.

Returning to the subject of mental health, which can be harder to identify and treat than a physical problem, the first question to ask is how we can discuss such issues. The answer is to educate your ‘people leaders.’ In other words, have ambassadors in the workforce who can educate case managers. This will involve communication, risk identification, demonstrating a willingness to change, developing targeted programming, and measuring outcomes so you can see how you’re doing.

Here are some concrete examples of what can be achieved:

- A financial institution integrated its programs for managing EAP, short-term disability (STD), workers compensation (WC), and long-term disability (LTD). The result was significant — a 47 per cent decrease in average duration.
- A transportation company introduced attendant support on the first day on its case files, which led to a 34 per cent decrease in the average duration of employee absence, as well as a 41 per cent drop in the total number of absence days.
- A retail drug company that integrated EAP with STD management realized a 30 per cent reduction in STD incidence and a 28 per cent reduction in STD duration.
- An oil-and-gas company that integrated EAP, STD, and WC management achieved a 38 per cent decrease in average duration and a 69 per cent drop in new LTD claims.

In all these examples, the result was a much improved workplace focused on outcomes. So, employers can get a handle on trends that will have profound impact on the workforce. But to do that they need an integrated approach that does the following:

- Defines desired outcomes and objectives
- Includes multiple programs aligned to those outcomes
- Is operationally linked and not just existing side-by-side
- Focusing on prevention, early intervention/treatment, and recovery/return to work
- Assists employees in navigating support programs/services that relate to behavioural change
- Empowers employees to manage their own health
- Delivers outcomes that demonstrate employee health and productivity through key metrics

The benefits are greater access to programs, enhanced employee satisfaction, and reduced incidence and duration of absence, not to mention direct cost savings to the employer. And that sounds like something that can’t be turned down.

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CONFERENCES

Designed to appeal to institutional investors and financial advisors who are interested in disciplined, risk-controlled investing and strategies in Canada, the ‘10th Annual Canada Cup of Investment Management’ highlights issues that are unique to the Canadian marketplace, while also exposing the region to the latest investment trends and strategies taking place in the U.S. and beyond. Speakers include Kenneth R. French, director, head of investment policy and director of investment strategy, Dimensional Fund Advisors; and Deborah Fuhr, managing director, global head of ETF research and implementation strategy, at Blackrock. It takes place June 7 and 8 in Toronto, ON. Visit: http://www.imn.org/Conference/Canada-Cup-Investment-Management/Agenda.html

Global exchange consolidation and an exploration of Canada’s regulatory framework in comparison to the U.S. and Europe will be among the topics covered at the ‘FPL Canadian Trading Conference 2011.’ The conference agenda is divided according to interests into business and technical streams. As well, the event features networking opportunities and a trade show. It takes place June 9 in Toronto, ON. Visit: www.fixprotocol.org/canadianconference2011

Tom Rand, a venture capitalist, entrepreneur, and author of ‘Kicking the Fossil Fuel Habit: 10 clean technologies to save our world’ will be speaking at the ‘Canadian Responsible Investment Conference 2011.’ It takes place June 20 to 22 in Victoria, BC. Visit: http://www.socialinvestment.ca/

Highlighting the best strategies and technologies adopted by end-users to address market changes and keep spending to a minimum will be among the sessions at the ‘Toronto Financial Information Summit.’ Other sessions will look at trends impacting data and technology spend and assessing the cost implications of regulatory reforms. It takes place July 7 in Toronto, ON. Visit: www.financialinformationsummit.com/toronto

The ‘Certificate in Canadian Benefit Plans,’ formerly known as the ‘Concepts and Practices of Canadian Benefits,’ is now part of the International Foundation of Employee Benefit Plan’s Certificate Series program. The program is designed to provide a solid foundation in employee benefit and human resource practices in Canada. It takes August 15 to 17 in Niagara Falls, ON. Visit: www.ifebp.org

‘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: http://www.acpm-acarr.com/national.aspx

For a complete listing of upcoming events, visit www.bpmmagazine.com/benefits_events.html
Judging by weight alone, the 600+ page ‘Financial Crisis Inquiry Report’ from the National Commission on the Causes of the Financial and Economic Crisis in the United States should tell us everything we need to know about these past few horrible years.

And it does, in its own way. But before we forget about this report, as we typically do with big government reports, or pass legislation covering proprietary trading and non-credit, non-exchange traded derivatives (which had nothing to do with the crisis), there are a few points here that we should note.

**List Of Factors**

The main report’s list of factors is by now mostly well-known and includes:

* Failures in regulation and supervision from government
* Failures of corporate governance and risk management at financial firms
* Too much borrowing on risky, poorly understood investments by consumers
* A poorly prepared, changing, and panicky government response when the crash came
* A widespread breakdown in accountability and ethical behaviour in the corporate world
* Poor mortgage lending and securitization standards
* Credit default swaps that expanded the meltdown
* Credit rating agencies asleep at the switch

The problem with the above checklist is that such a listing makes it seem as if all of these issues were equal in their impact, and that, perhaps, if we don’t have these exact same factors in the future we can avoid the next crash.

This weakness is pointed out in one of the two dissenting statements from the commission. One notes that “Not everything that went wrong during the financial crisis caused the crisis, and while some causes were essential, others had only minor impact. Not every regulatory change related to housing or the financial system prior to the crisis was a cause.” The other dissenting statement notes that “The majority’s report covers in detail many elements of the economy before the financial crisis that the authors did not like, but generally failed to show how practices that had gone on for many years suddenly caused a world-wide financial crisis.”

So what could have precipitated the crash? Well, as one dissenting statement notes, a credit bubble appeared in many places around the world, as did a housing bubble. So strictly U.S. based factors of mortgage securitization and aggressive mortgage lending – or even investment in U.S. housing – could not have been primary factors. Neither could lax regulation as many other countries had tighter financial controls than did the U.S. and yet they suffered a similar fate.

Instead, they suggest that along with a worldwide credit and housing bubble (which has happened before and will happen again) came massively flawed moves by financial institutions. Firms that had seemingly removed large elements of risk, ended up with enormous concentrations of housing risk. They amplified this risk by holding too little capital relative to their balance sheet risks. These firms believed that their investments were both solid and liquid. When this turned out not to be the case, the failure and near-failure of some worldwide financial institutions evaporated confidence and trust in financial institutions and was compounded by the inability of governments to stop the bleeding. Financial systems froze. Panic and fear of contagion, which had occurred at other times throughout history, took hold and, it can be argued, are still being felt today.

**Label Villains**

This sounds plausible to me, though not to everyone on the commission – many of whom wanted to find and label villains to match up with the many victims. However, the one point that every member agreed on was that the crisis was avoidable because it was man-made. When other commentators have spoken of ‘Black Swan events’ or ‘Once in a lifetime occurrence,’ they make this seem as if the crisis was some freak accident of nature (like an earthquake in Japan) or something that happened via computer malfunctions/risk model failure/high frequency trading that in some way was outside of human control. This wasn’t the case. We caused the crash and if we don’t spend at least some time trying to understand why this one happened, we shouldn’t be surprised when we cause the next one sometime in the future.
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