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Ontario’s position on Target Benefit plans is puzzling.

Ian Edelist, a principal at Eckler Ltd., told the ACPM Ontario region session “Target Benefit Plans: Has Their Time Come?” that the province seems to be having a hard time coming to grips with ways to allow the use of these plans in non-union environments.

Now we could have understood this completely if this was 1990 and Bob Rae had just led the New Democratic Party to form the government of the province.

**Tunnel Vision**

But, we digress, other than tunnel vision or a lack of imagination, there is no reason that Target Benefit plans should not be available for the private sector in non-union environments in Ontario.

The legislative changes needed for Target Benefit plans in Ontario and Quebec are quite simple, says Benoit Brière, director of pensions and benefits at Resolute Forest Products. At the same ACPM Ontario region session, he said changes are needed to current pension legislation on funding, plan design, and administration and governance. In the area of funding, the employer’s financial liability limit would need to be changed as well. Sponsors of these plans would need to be made exempt from any liability for shortfalls at a plan wind-up. The current solvency rules would need to be replaced by a projected adequacy rate. In terms of administration and governance, rules need to be made which would allow the establishment of Target Benefit Plans for future service without having to terminate an existing Defined Benefit plan.

If the lack of a union to negotiate for members is a barrier to allowing the private sector to move to these plans in Ontario, surely there are other vehicles to do so. We allow employers to provide Defined Benefit plans in non-union environments in Ontario. Why is it so difficult to imagine the same for Target Benefit plans? Indeed, in the absence of a board to mainly decide when benefits and/or contributions should be increased or decreased, it might be even wise, and advisable for Target Benefit plans in union environments, to set out a schedule. When the projected adequacy rate is at this level, benefits will be lowered or contributions increased. If there is a sense that members should have a say, then let them vote. In Ontario, we already require that when it comes to surplus distribution (remember surplus?). Why can’t the same be done for changes in the Target Benefit plan benefits and contributions formula?

**Silly Thing**

The really silly thing about all of this is that, as we understand it, a non-union, private sector employer in Ontario could start a new pension plan with all the features of a Target Benefit plan.

Failing that, any employer can offer their members a one-option Defined Contribution plan which acts, in many ways, in a similar fashion to a Target Benefit plan.

The real issue here is fairness. The government must make all retirement savings tools available to all employers in the province. If Target Benefit plans are an option in unionized settings, they should be available for non-union workplaces as well.
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Belton Boiselle
Roger Belton and Kasey Boiselle are joining forces to create Belton Boiselle Benefits & Pensions. The two have more than 30 years working with Western Canada employers to maximize the value of their group employee benefit and retirement plans. Belton was president and Boiselle was a group and individual benefits specialist of Belton Financial based in Winnipeg, MB.

Eckler
Josephine Marks is with the financial services practice at Eckler. One of the country’s leading actuarial and asset management professionals, she has more than 30 years of financial sector experience. Colin Ripsman is a senior consultant in the investment practice. Prior to joining the firm, he was a vice-president and institutional portfolio manager at a global investment management firm.

Strata
M. Catherine Miller is a consultant at STRATA Benefits Consulting Inc. Previously, she was vice-president of a Winnipeg, MB-based human resource consulting firm where she led the compensation and benefits practice.

Stikeman Elliott
Lyle Teichman is senior counsel in the pension and benefits group at Stikeman Elliott. Prior to joining the firm, he was a senior lawyer and consultant with Towers Watson.

OPTrust
William Hatanaka is CEO of the OPSEU Pension Trust. He has more than 30 years of financial services experience, most recently as group head, wealth management, TD Bank Financial Group.

Segal Rogerscasey Canada
Ruo Tan is president of Segal Rogerscasey Canada. He joined the firm in 2010 as senior vice-president and since then he has focused on expanding investment research, relationship management, and client services. Kathleen Pabla is vice-president and director of research. Most recently, she was director of investment research and analysis in investment management services for Manulife Financial. Nino Boezio is vice-president, portfolio strategist and consultant. Most recently, he worked in the managed products area for TD Bank Group.

Hicks Morley
Andrea Yau is an associate in Hicks Morley’s pensions and benefits group where she assists public and private sector clients on legal and regulatory issues regarding all aspects of pension plans and other employee benefit plans.

Mackenzie
Susan Small is senior vice-president, global consultant relations, at Mackenzie Institutional. She will oversee its consultant relations efforts worldwide.

Jarislowsky Fraser
Pierre Lapointe, a 27-year veteran of Jarislowsky Fraser Limited, has been named chairman of the executive committee. Previously executive vice-president, he has been a director and member of the executive committee since 1995. The executive committee is empowered with the overall management of the firm.

Industrial Alliance
Clément Gignac is senior vice-president and chief economist at Industrial Alliance Insurance and Financial Services Inc. A seasoned financial strategist and communicator with 30 years of experience in both the private and public sectors, he spent the majority of his career at the National Bank.

Spartan
Dejan Knezevic is vice-president, national sales, at Spartan Fund Management Inc. He has more than eight years of experience in the financial services industry, including a senior sales position with a well-known Canadian hedge fund.

People Corporation
Paul Asmundson is vice-president, corporate development, at People Corporation. Most recently, he was a senior member of the investment banking department at TD Securities, where he focused on mergers and acquisitions and financing activities.
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Simulator Users Do Better

Three years after launching its retirement simulator, ‘On Target Retirement,’ Desjardins Financial Security has found in some cases participants contributed 50 per cent more for their retirement than non-users. It also found that on average, participants using the simulator are enticed to start saving early and contributions were higher. The tool takes an abstract concept and visually demonstrates the impact of saving. Employees can see how their monthly contributions will add up over time. They can also try different scenarios such as changing their retirement age or seeing how much they can potentially save by increasing their contributions. The tool integrates the data into their statement which means they are continually reminded of their progress and encouraged to stay on track.

Homewood App Offers Range Of Services

Homewood Human Solutions has released an app that makes accessing a complete range of health and wellness services as easy as touching a screen. Its key features include a collection of streaming videos and podcasts on subjects such as relaxation and reducing tension, visualization, caregiving, and work-life balance.

Consistent Governance Desired

Employers with business operations in different countries want to know how to create Defined Contribution pension plan governance and plan design that is consistent across borders, says Matthew Smith, head of retirement sales and strategy at BMO Global Asset Management. He told the BMO Group Retirement Services session ‘When Global Meets Local’ that this is just one of the emerging trends he is now seeing. He is also seeing a new emphasis on fee disclosure, in part, in the U.S., because of new rules requiring providers to let sponsors see the fees they are paying and for sponsors to show their members the fees. One challenge, however, is the development of advisors and consultants who are telling sponsors they are paying too much and trying to squeeze everything they can out of the process.

PBI Signs Principles

PBI Actuarial Consultants Ltd. (PBI) has become a signatory of the Principles for Responsible Investment (PRI). Following the acquisition of ACBA, an organization that adhered to Principles for Responsible Investment (PRI), PBI decided to become a signatory. The PRI were devised by the investment community in a process that was co-ordinated by the United Nations Environment Programme Finance Initiative and the UN Global Compact. They reflect the view that environmental, social, and corporate governance issues can affect the performance of investment portfolios and, therefore, must be given appropriate consideration by investors and investment consultants.

Shareholders Hold Managers Accountable

More shareholders are holding company managers accountable for their actions which is driving an increase in shareholder actions. Paul Renaud, president and chief executive officer, OMERS Private Equity, told the CVCA – Canada’s Venture Capital & Private Equity Association Professional Development Series session ‘Under Fire: The Rise of Shareholder Activism in Canada’ that the number of shareholder actions has gone from six in 2003 to 170 this year and counting. Prior to this year, the busiest year was 2009, right after the financial crisis, when 43 actions were launched. These actions are due to investors being unhappy with manager strategies which they blame for falling share prices or dissatisfaction with management decisions. That Canadian activism on the rise, he said, is not surprising considering the number of corporate scandals, shareholder impatience to get returns, increased disclosure, and a more friendly regime towards shareholder activism in this country. Plus, the small market in Canada means institutional investors have large holdings in companies so activists are finding allies in large pension funds. His advice to management is to know who your shareholders are and to understand their concerns, take them seriously, and address them promptly.

Employers Get Benefit Cost Reprieve

Canadian organizations got a modest reprieve from the increase in employee benefits costs in the past two years, but the relief will be short-lived, making cost containment an ongoing priority for employers, says the Conference Board of Canada’s ‘Benefits Benchmarking 2012’ report. Employee benefits represent a significant investment for employers. The average annual cost of providing benefits is $7,061 per full-time employee. Annual costs per employee are higher in the public sector at $7,498 than in the private sector at $6,922. For a typical employer, this translates into spending of just over 10 per cent of gross annual payroll. Cost containment is gaining traction as a top short-term priority for employers. In fact, in terms of employers ranking of the objectives of their benefits strategy, cost containment falls only after ensuring compliance with regulatory requirements and maintaining their competitive position in the market in order to attract talent.
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Emerging Markets Offer Opportunities

Emerging markets continue to offer opportunities, says Stephen Way, senior vice-president and portfolio manager at AGF Investments Inc. Speaking at its ‘Beyond BRIC’ discussion, he said their domestic consumption remains intact and they are becoming increasingly competitive and are expanding outside of their borders. However, investors need to be aware of some of the long-term risks in these markets. With developed market currencies devaluing because of quantitative easing, international currency wars could start which concerns emerging markets. Increasing government intervention and reform in China, Brazil, and India is creating uncertainty. And they also face resource scarcity, both in terms of skilled labour and commodities. Finally, to increase productivity, improvements need to be made in their infrastructure, business processes, and machinery. However, emerging markets margins have actually come down, making him quite optimistic about those companies in these markets that understand what it takes to make profit.

Equities Ready To Be Rediscovered

It’s only a matter of time before the investment professionals who allocate institutional money re-evaluate their historically low equity exposure and hurdle rates and rediscover equities to some extent, says a report for AllianceBernstein. ‘Buy and Hold is Dead ... Long Live Buy and Hold’ asks if long-term equity investing is dead. Fifty years ago, it says, the average holding period for stocks was more than eight years. Today it is less than eight months. Institutions face a contractual hurdle rate that their investments must clear in order to meet spending needs. In the current ultralow-rate environment, institutions that have pulled back from equities may find it difficult to meet these obligations without turning back to the stock market. The attractive valuation of the U.S. equity market merits their attention as S&P 500 companies are earning more than ever before, paying record dividends, and growing those dividends faster than earnings. On top of this, American blue chip companies are in extremely strong shape financially, with historically high levels of cash and borrowing rates that are near all-time lows.

LDI Used By More Than Half

More than half (57 per cent) of corporate pension sponsors continue to use liability-driven investing (LDI), says SEI’s ‘Annual Global Liability Driven Investing Poll.’ Among those organizations using LDI, more than half (52 per cent) invest greater than 40 per cent of their portfolios in an LDI strategy. It also found as LDI continues to be an important risk management strategy, implementation has evolved to provide a more sophisticated match of the plan’s duration of assets to liabilities. The most important criteria for implementing a successful LDI strategy are having a framework that incorporates funded status, benefit stream, and duration of exposures; strategies that incorporate an organization’s risk tolerance and key corporate sensitivities; and liability matching that is more sophisticated and highly customized.

Economy May Enjoy Boost

Economic growth tends to be sluggish for about a decade after a major financial crisis, says Eric Lascelles, chief economist at RBC Global Asset Management. In his ‘The End of Deleveraging?’ economic commentary, he says there are myriad reasons for this, but a central contributor is that deleveraging frequently proves necessary to reverse earlier excesses. “It is thus very encouraging that U.S. private-sector balance sheets may finally be reaching equilibrium. The economy should enjoy a boost as these sectors get back into gear, even if the forward momentum is less than many expect,” he says. While some leverage is economically useful, the U.S. clearly took this notion too far in the 2000s and subsequent deleveraging has been a drag on growth over the past four years. Importantly, the private sector has now completed deleveraging, presenting the opportunity for slightly better – or at least better quality – economic growth. However, government deleveraging tends to lag the rest and is only now commencing. Given the brute force of public deleveraging, it may be that one form of economic weakness will just be replaced by another. However, there are reasons to be cautiously optimistic. “First, it matters that future economic growth – no matter how slow – will be driven to a greater extent by the private sector. This means that consumer spending, business investment, and hiring may strengthen. Second, U.S. public-sector austerity has actually been underway for a few years, whereas some elements of private-sector deleveraging are just now ending. In other words, the economy was temporarily doubly burdened. With the economy back to a single drag, perhaps faster economic growth will be in store, he says.

China Works On Middle Class

The new government of China will likely continue to pursue more market friendly reforms, says Timothy Schuler, senior vice-president, investment strategist and portfolio manager, at the Permal Group. In the opening keynote at the ‘Legg Mason Canada RETHINK 2012’ event, he said, however, the financial crises of 2008 and 2011 have taught it a lesson. Up until these events, it was depending on the world for its economic growth. However, it now realizes that its economic growth must be driven by internal consumptions so it is now trying to develop its own middle class. He suggests that in five to 10 years that middle class will be developing and there will be robust growth in China.

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Evolving Benefits In The ‘Gen Y’ World

By Karen E. Treml

With Baby Boomers approaching retirement, Generation Y, born between 1977 and 1989, is their workplace successor. They have grown up with an entirely different way of thinking.

Their world is filled with personalizations and customizations that have become their norm and Kim Siddall, principal, AQ Group Solutions, says younger employees drive a different kind of workplace – which includes more freedom of hours.

The New Wellness

For Generation Y, health changed from being about ailments to being about wellness. This has impacted benefit packages. Younger employees want flexibility and benefits they can navigate for their needs, says Jake Clark, president and lead consultant at BenefitsDirect Corp.

“Younger workers want sabbaticals for travel or for professional and personal development, with financial support, from their employer. They incorporate healthy lifestyle choices into their lives that they want their employers to support through facilities or financial support. And their expectations drive increased flexibility in benefits,” says Siddell.

Alan Coles, of Coles Group Inc., says there is an increase in ‘feel good’ benefits such as massages and chiropractors. This is making paramedical coverage much more a ‘dollars-in-dollars-out’ benefit – the maximum limit for an item or service is virtually always below its full costs and, when used, is typically used to its maximum. Thus it becomes a ‘trading of dollars’ with the carriers. “The benefit would be better dealt with through a health spending account (HSA) or other arrangement where one can remove the insurance component and have it on a transactional basis,” he says.

Actuarial Solutions Inc., has moved towards healthcare spending account (HSA) + insurance benefits, says Joe Nunes, president. “Younger workers are less forgiving of the idea that the benefit plan is of value when they are older. They want value now. HSA+ programs allow flexibility while providing cost control.”

Similarly, Clark says, in SMEs particularly, there’s a large uptake and integration of HSAs that manage funding while giving self-service plan flexibility.

These flexible spending options are growing in prevalence and sponsors have to make benefit plans meet the needs of all four generations in the workforce, giving care to design options around what this generation values.

Along with driving greater flexibility, Generation Y has changed how benefits are communicated, information is accessed, and the portals for claims submission. As a generation matrixed with smartphones and personal devices, insurers are responding with plan member facing technology allowing access to information and claims submissions via devices.

Whether it’s flexibility or changing accessibility, one thing is certain – Generation Y looks at benefits when considering employment. “A competitive plan is expected,” says Clark. “An effective, well-designed approach unlocks employee engagement and excellence, signifies well-designed human resources strategies and infrastructure, and cascades value to employees.”

Benefits Make A Difference

Siddel agrees. “Younger employees know what competitors offer. If they like what they see elsewhere, there will be retention issues. This generation is not staying for 30 years and a gold watch!”

With their confidence, ambition, technological prowess, and unique ethics, Generation Y focuses on balancing work and personal life, with wellness a strong consideration. Their expectations drive organizations to increase benefit flexibility to attract, retain, and engage them. Freedoms and choices underlie Generation Y decisions and being able to adapt benefits to their needs is an enormous benefit to employers.

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In other cases, it’s possible that your employee isn’t caring for their child or an aging adult but for a sibling, cousin, or friend. A sister injured in a car accident or a friend struggling with cancer may also need assistance. With a seemingly endless number of scenarios that can cause the need for a caregiver, it’s a situation no employer can ignore or avoid.

Tangible Support
Although many caregivers rely on their spouse, neighbours, siblings, or friends for help, getting tangible support from employers can be highly beneficial. However, caregivers often try to mask their troubles at work so it may be hard for management to tell who needs help.

If an employee starts coming in late, looks tired, is suddenly gaining or losing weight, becomes irritated or angered quickly, looks constantly worried or sad, or complains of frequent headaches or pains, he or she may be suffering from ‘caregiver burnout.’ Approaching the situation with understanding and compassion is the best way to help.

Often caregivers feel guilty about not being able to do their fair share at work or feel badly that they can’t spend more time with a loved one. Some may need to shift their hours. Others may need to reduce their commitment by moving to part-time hours, while others may need the flexibility of working from home or taking extra days off, especially if they are long-distance caregivers.

One size does not fit all
Each caregiving role will vary. A solution that may work for one employee, won’t be suitable for another. As caregiving tasks differ, so does the length of time spent caregiving. Open lines of communication between employees and management in an environment that fosters empathy and compassion and finding programs and services that meet their needs is key to being truly supportive.
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The Way Forward
2012 – A Year Of Challenges

This year, 2012, will be remembered as a year of challenges. Throughout the year, there was the ongoing saga of Greece and the Eurozone which dampened stock markets. The historic run of negligible interest rates caused Defined Benefit pension plans to struggle to get even close to full funding.

Pooled Registered Pension Plans (PRPPs) continued to be a focus of discussion, even though the provinces seemed to be taking forever to act on them. The one province that did take quick action, Quebec, saw an election kill the proposal before it saw life.

On the benefits side, healthcare benefit cost increases did, in fact, moderate, but it may be the calm before the storm as practitioners, group insurers, and sponsors wrestle with the looming spectre of expensive biologics which may save more lives, but at what monetary cost.

After a one-year hiatus to mark the 20th Anniversary of Benefits and Pensions Monitor, our annual ‘Review and Forecast’ is back, but with a slight twist. In addition to the excellent commentary from industry experts, we’ve also entered the C-suite and asked leaders in the industry to provide their unique perspectives. We call this ‘A View for the Top.’

And this ‘Review and Forecast’ starts off with an interview with Canada’s Minister of State (Finance), Ted Menzies, who has been championing the cause of PRPPs since his appointment to the post in January 2011.

We’ve also been able to enlist David Feather, president and CEO of Russell Investments Canada, who shares some thoughts on risk management; Kim G. Redding, CEO and CIO at Brookfield Investment Management Inc., who examines infrastructure; Karen Burke, director, regulatory affairs, drug safety, and quality assurance at Amgen Canada Inc., who offers a look at the newest entry into the drug field; and Joan Johannson, president of BMO Group Retirement Services, writing about retirement planning.

As always, we hope you enjoy.

A Conversation With Ted Menzies

Since December 2010, the government of Canada has been working with the provinces and territories on a new type of broad-based privately administered pension arrangement – Pooled Registered Pension Plans (PRPPs). They see this as an effective and appropriate way to help bridge existing gaps in the retirement system by providing an accessible, large-scale and low-cost Defined Contribution pension option to employers, employees, and the self-employed.

Ted Menzies, federal Minister of State (Finance), has been championing PRPPs since they were announced. He discusses the status of PRPPs in an interview with Benefits and Pensions Monitor.

Benefits and Pensions Monitor: What do you see as some of the significant developments that have happened in terms of PRPPs recently?

Ted Menzies: When we started, the federal Pension Standard Act hadn’t been updated and a lot of things had changed. That prompted us to look at pensions overall and, in our analysis, we found some serious gaps in workers’ coverage – the 60 per cent of Canadians in the workforce now who don’t have a workplace pension plan – and that was very troubling. Together with the provinces, we looked for some potential ways to improve that.
When we brought all the analysis to the finance ministers’ meeting in December 2010, there were two options – the CPP enhancement and the framework for Pooled Registered Pension Plans (PRPPs). We looked at the Canada Pension Plan and there wasn’t the necessary and mandatory consensus that we needed amongst our partners – the provinces and territories – to make any changes to CPP. However, there was unanimous support to work on a framework for PRPPs. That was the genesis of it and, as you know, our legislation received royal ascent in June.

I’ve been communicating with our provincial finance ministers and most of them are in the process of moving forward with legislation, at different trajectories if you will. Some of them have legislation close to ready; some are going to bring it forward in the spring. Quebec, as you know, had it in their recent budget as the Voluntary Registered Savings Plan (VRSP). They are going to look at how they would roll it out and whether they can use the legislation that was drafted by the previous government. So we will see how that rolls out, but the intent is similar.

I really don’t care what they call it. The platform we put forward had very broad legislation so people can either adopt the legislation or adapt it, but we encourage them to utilize the basic principles because harmonization is so important to make it fair and equal across all the provinces.

**BPM:** So it sounds like there’s a lot more taking place on PRPPs in the background than what most people, even those in the industry, are aware of?

**Menzies:** Part of it is because of cabinet confidentiality. This is legislation and as much as everyone would like to know what the legislation is going to be, it’s all kept in confidence, even, of course, at the provincial level. There has been a lot of work done. I’m very encouraged by the co-ordination with the officials. When I speak to the officials, what we are hearing from the different provincial levels is encouraging. But it takes time to move this forward and we’ve had a couple of elections recently which has slowed the process.

**BPM:** One of the criticisms of PRPPs is that they’re not going to be mandatory for employers in any province, other than in Quebec, based on its former VRSP proposal. What was the thinking at the federal level behind not making it mandatory?

**Menzies:** First, we do not have the jurisdiction to do so. However, as I said before, we made our legislation broad enough to accommodate the provinces. It is provincial matter, so it’s the right of the provinces to decide whether or not it’s going to be mandatory. It looks like it’s going to be in Quebec. I don’t want to speak for them, but in their first iteration it looked like they wanted it to be mandatory for any employer with more than five employees and that’s fine, that’s their decision.

Some of the other provinces are analyzing it right now.

**BPM:** PRPPs address the issue of pension coverage. However, the other big issue seems to be the decline of Defined Benefit pension plans in Canada. Is there anything the federal government is doing to show leadership across the country on this?

**Menzies:** Well, we’ve protected DB pension plans. However, when I say ‘the plans’ I mean we’re protecting the plan members – that’s what we wanted to be sure we did.

We don’t think it’s our role to dictate that retirement savings should be one form of a pension or another going forward. But what the OECD said in one of its most recent commentaries is that there is a gap in private sector savings and filling it will help the overall long-term health of retirement income. So whatever form it takes, we’re looking at the 60 per cent of Canadians that don’t have an employer sponsored pension plan.

In the pension outlook the OECD recently released, it talks about the need for a private sector option, and that’s all this is. That’s all we’ve ever said that it is. There are lots of other pension models out there that may very well be of interest, but PRPPs are an option that wasn’t there for many of these Canadians and it’s in their workplace. That’s what we’re looking at; that’s what we think is important. We’re not suggesting that anything else be taken off the table; we just think we need another option.

**BPM:** You’ve talked about the importance of harmonization when it comes to making PRPPs effective, yet there’s indications that the provinces will be creating their own versions. Is that something where the federal pension regulator and the provinces need to sit down and try to make the rules more consistent?

**Menzies:** We hope that by this being accepted by all of the provinces that we will see some harmonization. And if there was one other thing that was unanimous amongst the finance ministers, it was the recognition that harmonization in necessary. If you move from Nova Scotia to British Columbia, for example, you will be able to take this pension with you and it will be treated the same way in all provinces. That is very important for people because we have labour mobility and we have people mobility like never before. So we need that and I get the sense the provinces recognize it and are working towards that. Certainly our officials have indicated that to me.

As we’ve said all along, the PRPP is not a silver bullet. It’s another option that people can use and it will encourage them to think about their retirement savings, analyze whether they have enough to retire on or whether they have enough to retire in the fashion they’d hoped. So that’s our goal, to make sure we can provide another option for Canadians.
RISK MANAGEMENT

Sponsors Respond To Trying Times

The past decade has been tough on Canada’s pension plans. They’ve been hurt by the dual impact of the equity market’s sharp drops during the tech wreck in 2001/02 and the recession in 2008/09, as well as the concurrent decline in interest rates over that period. Although Canada has had a relatively healthy economy, we have not been immune to the issues happening across the globe. Most pension plans have seen their well-funded status evaporate, without immediate prospects for improvement. At the same time, many organizations have faced increased internal constraints on the resources available to manage their plan.

These factors have institutional investors seeking new ways to manage overall risk, improve risk-adjusted returns, and ensure their assets are aligned with their liabilities – while applying a more effective implementation framework. In terms of overall strategy, many are choosing to reduce their equity allocations, alter their fixed income exposure, adopt liability-driven investing strategies, and look further to alternative investments and non-domestic securities to improve their plan’s long-term economic viability.

Fulsome View

For many of these investors, the goals are to protect their pension plans, participant benefits, and corporate balance sheets. We recognize that regulation and policy changes, market volatility, and a prolonged low-interest rate environment have raised the stakes for most institutional investors. These issues have also raised the need for risk analysis that can look at the asset/liability relationship from multiple perspectives to provide a fulsome view of how risk can best be managed.

As most investors have discovered since 2008/09, correlations among traditional asset classes increase substantially during times of extreme market stress. Institutional investors who diversified across a wide range of asset classes found that, when they most needed those asset classes to be different from one another, they turned out to be more alike than expected. With the exception of Treasuries and Government of Canada bonds, all major traditional asset classes declined significantly in value during the equity bear market that started in October 2007.

Institutional investors determining their asset allocation strategy are trying to answer three key questions:
- how to properly diversify their portfolios to reduce correlations
- how much risk to take while enhancing returns
- how to hedge their risk exposures relative to their liabilities.

These issues haven’t changed from five years ago, but what has changed is the nature of the returns available in the market and the financial conditions facing many plans. What has also changed is the increased need to find the most effective implementation strategy.

Many of the country’s largest institutional investors are finding they can partly answer those questions by increasing their allocation to infrastructure and real estate. These alternative assets offer risk, return, and diversification characteristics distinct from those of traditional asset classes. They can also feature steady cash flows and may offer income linked directly to inflation. As such, alternative assets can play a key role in a diversified institutional portfolio. That said, implementation issues can be difficult, in particular, finding good managers. In alternative investments the difference between 1st and 4th quartile performance can be 15 to 20 times greater than in traditional investments!

However, the even larger challenge for both large and small institutional investors is how to bring all of these elements together in a more effective implementation framework. The reality of a low yield and low return world is the struggle to meet a determined discount rate or funded targets while managing risk along the way. As a consequence, this is an environment where small incremental additions in return, and minimizing slippage from unintended risk exposures, can have a significant impact as to whether key objectives will be achieved.

Traditional Separation

Many plans are now acknowledging the need to step beyond the traditional separation between advice, asset management, and risk management within their governance model, and embrace a more integrated approach. This integration gives institutional plans the ability to focus on the larger decisions that have the greatest impact on plan results, more effectively manage their risk exposures, and ensure ongoing and more consistent alignment with their liability requirements. Interestingly, this is one of the advantages of the very largest plans in Canada that have large internal teams. But this same benefit is available to plans of all sizes through the introduction of a holistic and integrated strategic management approach in their governance model.
Shiller Barclays CAPE™ Index Family
Value Oriented Indices Based on the CAPE™ Ratio

Robert Shiller and Barclays have launched the Shiller Barclays CAPE Index Family after a year-long collaboration. The index methodology identifies undervalued sectors based on a modified Cyclically Adjusted Price-Earnings (CAPE) ratio, and uses momentum to eliminate potential value traps. The Shiller Barclays CAPE Index Family is suitable for long-term investors seeking a value-oriented strategy and offers improved risk-adjusted returns.

Traditional valuation measures, such as the Price-Earnings (PE) ratio, have a problematic aspect in that they typically rely on earnings information from only the past year. One-year earnings tend to provide noisy signals, which are influenced by the business cycle. The CAPE ratio addresses this concern by using an inflation-adjusted average of longer-term earnings. The CAPE ratio was formally devised by Campbell and Shiller in 1988, and has been widely used as a valuation tool for the overall stock market. The intuition behind the CAPE ratio is that lower ratios generally indicate higher future market returns and higher ratios indicate weaker future returns. There is a strongly negative correlation (-55%) between the CAPE ratio and subsequent long-term returns of the S&P 500® Index, indicating that the CAPE ratio provides useful information about the subsequent long-term performance of the stock market. To determine if the same relationships exist at the sector level, Barclays recreated 40 years of sector-level return and earnings information and conducted rigorous analysis. This proved that the relationships identified at the overall market level also held true across each of the 10 GICS sectors. By building on these initial findings and the predictive power of CAPE for long-term sector returns, the Shiller Barclays CAPE Index Family systematically selects the favorable, or undervalued sectors based on the CAPE ratio.

While sector CAPE ratios can provide useful information about future sector returns, absolute CAPE ratios are not necessarily comparable across different sectors. For example, the Utilities sector typically trades at a relatively low CAPE ratio, while the Information Technology sector typically trades at a relatively higher CAPE ratio. If a strategy simply focused on lower CAPE ratios, the strategy would choose Utilities repeatedly. Therefore, to make the CAPE ratio more comparable across sectors, we introduce the Relative CAPE Indicator. To compute this indicator, we divide a sector’s CAPE ratio at a given point in time by the 20-year historical average of this sector’s CAPE ratio.

Each month, the Shiller Barclays CAPE Index Family selects the five sectors with the lowest values on the Relative CAPE Indicator, i.e., the sectors that are the most undervalued according to the indicator. Only four of these five sectors, however, end up in the final portfolio for a given month, as the sector with the worst 12-month momentum among the five selected sectors is eliminated. This momentum filter, which seeks to identify the sector with the worst market sentiment in recent history, is designed to help avoid the so-called “value trap” constituents in a value portfolio that are undervalued due to legitimate fundamental reasons.

The Shiller Barclays CAPE Index Family initially consists of three indices that allow investors to access the CAPE value premium in different ways depending on their investment goals. Each index uses the four undervalued sectors at the heart of the methodology. The Sector Index takes an equally weighted long position in each of four favored sectors. The Sector Market Hedged Index overweights the four favored sectors and underweights the remaining six sectors. The Sector Tilted Index takes a long position in the four favored sectors and a short position on the market benchmark according to the weighted beta of the four favored sectors.

Performance of CAPE-Based Indices (Sept 2002 – Sept 2012)

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<tr>
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<td>8.66%</td>
<td>7.18%</td>
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<tr>
<td>Volatility</td>
<td>20.19%</td>
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<td>19.89%</td>
<td>21.24%</td>
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<td>0.44</td>
<td>0.34</td>
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<tr>
<td>Maximum drawdown</td>
<td>(43.41%)</td>
<td>(9.47%)</td>
<td>(47.62%)</td>
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To view Barclays full research report on the Shiller Barclays CAPE™ Index Family and important disclosures, go to www.barclayscommunications.com/shiller.pdf

Source: Barclays

The Shiller Barclays CAPE™ US Sector Portfolio Index was launched in September 2012. The information prior to launch dates included at the left is hypothetical historical. You should not rely on historical or hypothetical historical information. Such historical and hypothetical historical information is not indicative of future performance.

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The Evolution Of Emerging Markets Debt

It was in the midst of the 'tequila crisis' or Mexican peso crisis in 1994 that emerging markets debt (EMD) was first defined as a distinct asset class by J.P. Morgan. Fortunately, the nature of EMD as an investment space has changed considerably from these origins. Traditional hard currency sovereign bonds issued by emerging markets since 2010 have become mainly investment grade and are considered an important component of mainstream global fixed income portfolios.

EMD has even diversified within itself, with a lengthening of duration, introduction of emerging market local currency bond markets, and, more recently, the tapping of the global bond market by companies established in emerging economies.

In terms of its size, the tradable EMD asset class amounts to roughly US$3 trillion outstanding; approximately half of that is in local currency sovereign bonds, with the rest split between hard-currency sovereign bonds (one-third) and hard-currency corporate bonds (two-thirds). At a time when much of the developed world is engaging in monetary and fiscal policies that are leading to accelerating indebtedness and other outcomes, emerging markets are benefiting from positive technical factors and their relatively stronger public finances.

Russia’s Default

Russia’s 1998 default on its domestic debt pushed the average spread of U.S.-dollar-denominated emerging markets sovereign bonds to above 1,100 basis points over U.S. treasuries. Since that challenging period, the EMD asset class has shown strong resilience even during some of the more notable downturns in recent years (such as October 2008, September 2011, and May 2012). The potential sources of alpha from EMD securities have varied over time, regions, and industries, but have often included one or more of the following:

- high income
- spread compression
- U.S. dollar or emerging markets interest rate duration
- foreign currency gains

Traditionally, most EMD issuances and assets are managed in U.S. dollar terms, although some are in Euro- and Yen-based currencies, along with some hedged share classes. For Canadian dollar-based investors, EMD seems to be generally passively managed in Canadian-dollar hedged terms. Other non-U.S. currency-based investors face a similar situation.

However, a passive foreign exchange hedge via currency forwards is not always an optimal solution, particularly if nominal rates fall back below those of the United States (which happened in 2005 to 2007). To the extent that emerging market currencies can add alpha, constantly hedging to the Canadian dollar might strip out possible incremental return opportunities. As the Canadian dollar has increasingly attracted foreign capital flows, as a deemed risk-managed commodity currency, certain emerging market currencies are more likely than others to appreciate even further against the Canadian dollar while still benefiting from a strong loonie. The South African rand and Chinese renminbi are good examples of currencies that might behave in this manner.

Analysis of volatility levels and one-, three-, five-, and 10-year returns of EMD and other asset classes (from U.S. treasuries to emerging markets stocks) leads to some interesting observations about the impact of passive Canadian-dollar hedges. Over a 10-year period, the Canadian-dollar hedge added significant positive returns to the various asset classes. Over the three- and five-year periods, we saw the same development, except in emerging market stocks.

Hedging Examined

Yet analysis of the one-year time period reveals that hedging resulted in significantly lower returns and increased volatility across the asset classes, including EMD. The hedge, via currency forwards that were long on the Canadian dollar and short on the U.S. dollar, proved costly as the loonie depreciated against the greenback. In this one-year scenario, unhedged U.S. dollar-denominated emerging markets sovereign bonds did almost as well as U.S. treasuries, given their long interest rate duration in U.S. dollars (approximately 11 years Macaulay duration and seven years modified duration). Unhedged emerging markets local currency sovereign bonds fared less well and these weak positive returns became losses when the currency hedge was applied.

While EMD remains an asset class that offers significant opportunity, currency hedging can have both a positive and negative impact on realized returns. This is an important consideration for plan sponsors and consultants when including EMD in a given portfolio. A dynamic currency hedging program, rather than a passive one, can minimize the negative impact of currency movements and potentially benefit from them as well.

The effective use of currency hedging may, in fact, be as important in determining returns as the strategic positioning of an EMD portfolio among different segments of this diverse asset class.
At T. Rowe Price, we believe it’s critical to research investment opportunities from the ground up. Our dedication to hands-on, fundamental research is just one way we seek to avoid unnecessary risks and find true long-term opportunities for our clients.

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Overcoming The Challenge Of Real Estate Investing

Persistent volatility in equity markets over the last several years combined with excessively low interest rates is forcing pension plans to find non-traditional sources of return stability and income yield. For Canada’s largest pension funds, this has resulted in a significant shift into so-called alternative assets, particularly direct real estate. For example, we estimate that Canada’s 10 largest pension funds had about 12 per cent of their assets (equating to nearly $90 billion) allocated to real property at the end of 2011, up dramatically from about five per cent a decade earlier.

And, due to the demonstrated stability of direct real estate’s return, its attractive yield, and its diversification benefits, many of these larger funds have expressed a desire to continue increasing their real estate targets, reaching a probable level of about 15 per cent over the next few years.

Allocation Goals

Large pension plans have structural advantages when it comes to achieving their real estate allocation goals. For example, funds such as Ontario Teachers (Cadillac Fairview), OMERS (Oxford), and the Caisse de dépôt et placement du Québec (Ivanhoé Cambridge) took advantage of the dislocation in Canadian property markets in the 1990s to directly acquire a diversified portfolio of core real estate assets through the purchase of real estate operating companies. Such ‘in house’ property investment expertise allows ready access to deal flow, cheap financing, capability in development, and generally lower investment costs. As such, large pension funds have the ability and discretion to strategically grow their existing high quality real estate portfolios.

Large funds without an operating platform, such as the Canada Pension Plan Investment Board (CPPIB), still have the scale and capability to grow a high quality real estate portfolio, but this is done mainly through joint ventures both domestically and abroad. Given its substantial size, CPPIB is able to allocate significant capital to strong partners who have deep local expertise in the markets they choose to invest in.

The economic forces pushing Canada’s large pension funds into greater real estate allocations are having the same impact on mid-sized and smaller pension plans. Many of these funds are also struggling to reach their required returns and have expressed the same need to shift out of public equities and into more stable and higher yielding investments such as direct property. However, unlike their larger counterparts, mid-sized and smaller pension funds in Canada have comparatively less experience and exposure investing in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate. However, unlike their larger counterparts, mid-sized and smaller pension plans in Canada have comparatively less experience and exposure investing in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate. For example, we estimate that those funds with assets of less than $250 million had only about one per cent of their portfolio in direct real estate.

So the challenge for mid-sized and smaller funds is how to grow their exposure to this asset class. Given a relatively crowded Canadian property market universe where the average institutional quality deal can be upwards of $20 million, smaller funds simply do not have the scale or structural ability that their larger peers have to build a diversified high quality portfolio of properties directly. This means that mid-sized and smaller plans may be forced to adopt a comparatively more constrained and, at times, expensive, real estate investment strategy. For example, they would have to compromise diversification and stability in order to invest in just a few return-enhancing properties. Or, they would also have to settle for investing in lower quality properties because they would not be able to compete with larger pension funds and other well capitalized investors such as REITs for more expensive, institutional quality properties. They would also have to bear greater illiquidity risk because of the necessary long-term commitment to those select few properties. Implicit in this arrangement is the close, long-term relationship with a manager and the due diligence and potentially higher management fees that would go with it.

Pooled Funds

For these mid-sized and smaller funds, there is an efficient way for to overcome such real estate investment challenges. They can allocate their capital away from directly held properties to commingled or pooled funds. Pooled funds gather capital from a group of like-minded investors for more expensive, institutional quality properties. It also allows for greater diversification (both in property type and geography) and, most importantly, it allows investors to benefit from professional asset management at lower costs per dollar of investment compared to a direct approach.

Pooled funds can be either closed-end or open-end. Closed-end funds have a fixed term,
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Central region
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Eastern region
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aiming to raise investment capital, acquire properties, hold them for a specific period, and then sell those assets for a gain. Although closed-end funds can be tailored in many ways and offer investors considerable opportunity to achieve outsized returns, the major concern is that it can be difficult to sell an investment in this type of vehicle before the fund is set to liquidate. Valuation can also be sometimes challenging and some closed-end funds may also restrict their investors’ ability to sell their ownership right.

Open-end funds, on the other hand, do not have a fixed term. This allows investors to buy into these funds and sell out at their own discretion, reducing some of the liquidity risks associated with real estate investing. Scale, quality of properties, diversification, liquidity, and superior asset management are all reasons why open-end funds have been especially popular over the past few years with investors interested in attaining exposure to core real estate in Canada. This group includes not only medium and small pension plans, but also foundations, endowments, and other institutional investors both from Canada and abroad.

With the growing need for diversification and stability, we expect pension funds of all sizes to continue increasing their exposure to non-traditional assets like real estate. Fortunately, there are a range of investment products and platforms in Canada that funds of any size can use to efficiently realize their higher allocation goals in this particular asset class.

### PENSION INVESTMENT

What Is ‘Trending’?

The horse has left the barn. We have just passed the four-year anniversary of the fall of Lehman Bros., which, some would say, sparked the greatest financial crisis in modern history. We all know what this crisis has spawned:

- Volatility in public securities markets
- Sustained, historically low interest rates
- Economic uncertainty on a global scale

Retelling this story is akin to rubbing salt in an old wound.

The three prominent trends in our conversations with pension plan sponsors as they respond to these developments (what the twitter-verse refers to as ‘trending’) reflect some of the innovative and bold steps that some have taken in response to the challenges associated with this ‘new normal’ world.

**Trend 1**

It is no great revelation that pension plans have now recognized the utility of investing in products or strategies that generate returns that more closely reflect their liability profile, preferably with an optimal decline in risk. Unfortunately, the likelihood of the government of Canada issuing 30-year real return bonds with a five per cent coupon anytime soon is wishful thinking. Accordingly, many pension plans have already made the decision to seek out alternative solutions to achieve their investment objectives. We characterize their search efforts as focused on outcome-oriented investment products or strategies.

Rather than investments that tie performance to a benchmark, pension plans are shifting focus to outcome-oriented strategies that aim to achieve a pre-determined rate of return in order to better match their liabilities. Outcome-oriented strategies deliver a return that is significantly less volatile and has significantly less risk relative to traditional benchmark-oriented strategies. The specific investments that comprise outcome-oriented strategies are total return or inflation-linked strategies, but also include real estate, infrastructure, and private equity. The longer duration and relatively more consistent returns and lower risk profile benefits of these kinds of strategies are known by plan sponsors who are integrating them into their portfolios in greater numbers.

**Trend 2**

As plan sponsors move from developing their understanding of outcome-oriented strategies to actually implementing them, some have stopped along their ‘de-risking’ journey to consider an innovative investment strategy known as ‘risk parity.’

A risk parity strategy focuses less on the nature of the absolute outcome (see Trend 1) and more on the risk that is associated with each major element of a balanced portfolio. At the heart of this strategy lies a portfolio comprised of equity, fixed income, and commodity assets, with exposure mostly in the form of listed future contracts.

The portfolio’s objective is to continually balance the amount invested in each asset class so the amount of risk relating to each is maintained at a prescribed level. This prescribed level is considered a key benefit because the portfolio seeks to achieve an equity-like return profile, but with significantly less risk. While this objective is often touted by hedge fund of funds, the difference in these risk parity strategies lies in the greater transparency and liquidity that comes from the use of listed futures operating in a highly regulated, daily settlement market.

Accordingly, the net benefit of achieving returns normally associated with a balanced equity market portfolio, but with historically less measurable risk, is attracting interest and assets from many plan sponsors.

**Trend 3**

One unique characteristic of the Canadian pension landscape has been the historical tendency of pension plans to invest in the domestic economy. While laudable in theory and nationalistic...
Infrastructure: A Unique Listed Market Opportunity

The current investment landscape is presenting a myriad of challenges to navigate and opportunities to consider. Following a multi-year decline in interest rates and recent global financial upheaval, the ability to invest for yield has diminished and the outlook for growth has been subdued. As this low rate, low growth environment is expected to continue for the foreseeable future, investors are beginning to consider strategic allocations to specialized asset classes, including high dividend equities.

Among such equities, global infrastructure securities are attracting attention throughout the world as they provide a unique listed market opportunity to invest in an important and rapidly expanding asset class. Indeed, with a current market capitalization of approximately $1 trillion, the global infrastructure securities market is poised for meaningful growth as private sector investment in infrastructure has become an economic necessity. Through a combination of IPO activity, fund-raising by existing companies, and organic growth, we believe the global infrastructure securities market has the potential to reach $3 to $5 trillion in size over the next 10 years.

Kim G. Redding
is CEO and CIO at Brookfield Investment Management Inc.

Liquid And Well-diversified
Global infrastructure securities represent a liquid and well-diversified investment universe of companies that own and operate long-lived assets and provide essential services such as electricity transmission lines, oil and gas pipelines, airports, and toll roads. Typically characterized by relatively high current yields, predictable cash flows, and compelling risk-adjusted performance, we believe these securities offer an attractive combination of income, stability, and growth.

The accelerating need for infrastructure spending in general – and the expansion of the global infrastructure securities market in particular – is being driven by several significant, large-scale trends. Global population growth is creating demand for infrastructure at a time when existing assets are in need of refurbishment or replacement. Moreover, population and economic growth in emerging markets is creating the need for new infrastructure development.

A recent analysis conducted by the Organization for Economic Cooperation and Development (OECD) projected the level of investment needed to fund global infrastructure refurbishment and development to be 3.5 per cent of world GDP through the year 2030, or approximately $70 trillion. As economic distress has depleted government resources to fund these expenditures, we estimate a $25 trillion gap in government infrastructure spending over the next 25 years. While this gap creates pressure on already strained national budgets, it also creates a significant opportunity for private investment on a global scale.

The foundation for this opportunity has been built over the last several decades, dating back to the privatization of the UK water sector under the leadership of Prime Minister Margaret Thatcher. The success of the initiative over many years has been due largely to the reliability and transparency of the UK water regulatory framework, which has effectively balanced the interests of the general public and investors seek...
Benefits and Pensions Monitor
| December 2012

ing fair returns. As a result, UK water companies have provided stable income streams, meaningful dividend yields, and protection against inflation, creating an attractive investment opportunity for private capital.

More recently, the infrastructure investment market has witnessed the evolution of Public-Private Partnership (PPP) businesses. Within these vehicles, the government retains a significant amount of project risk – such as traffic volumes on a toll road – while private capital is utilized to develop, finance, and operate the assets. This model represents a growing portion of the infrastructure asset class as it offers low-risk investment and attractive dividend yields. Recent IPOs and equity raises within the PPP market, including the listing of infrastructure portfolios held by Bilfinger Berger and John Laing, have resulted in significant growth in the size and stature of this market. We expect this growth to continue as the PPP model gains further acceptance around the world.

Looking Ahead
As we look forward, we anticipate privatization activity to accelerate as governments monetize existing state-owned assets and seek private capital to fund new development opportunities. Additionally, we expect diversified companies and construction conglomerates to continue recent trends towards simplification by spinning out their pure-play infrastructure assets into separate entities. The listed market is poised to participate meaningfully in these opportunities for investment. Existing listed companies are likely to play a crucial role in the monetization of government assets and will serve as natural buyers for portfolios of assets held by diversified owners. Furthermore, we expect IPO activity to escalate as current assets are bundled and floated, development projects are completed, and monetized and private equity funds seek to exit, often through the public market.

With an estimated $25 trillion to be spent in the next 25 years globally, we believe the infrastructure asset class represents an unprecedented investment opportunity. As investors look to participate, the global infrastructure securities market has the potential to offer a unique combination of liquidity, stability, and growth through attractive dividend yields, predictable income streams, protection against inflation, and a rapidly expanding investible universe. We firmly believe these compelling investment attributes, combined with the critical need for spending around the world, will create significant growth potential for the global infrastructure securities market in the next decade and beyond.

The biotechnology world continues to experience tremendous growth as innovative biologic drugs (those derived from living organisms or cells such as yeasts and bacteria) offer options to patients suffering from cancers, rheumatoid arthritis, diabetes, and other serious diseases. Biologics have revolutionized treatment and greatly improved the quality of patients’ lives.

The Canadian biologic drug landscape is set to change with the entry of subsequent entry biologics (SEBs), often referred to as biosimilars. Health Canada defines biosimilars as biologic medicines that enter the market subsequent to a version previously authorized in Canada and with demonstrated similarity to a reference biologic drug. It is important to note that biosimilars are similar, but not identical, to the original biologic. As such, they should not be considered interchangeable.

Changes To The Biologic Landscape: The Entry Of Biosimilars

The Same, But Not The Same

Karen Burke (Ph.D) is director, regulatory affairs, drug safety, and quality assurance at Amgen Canada Inc.

Chemical Structure
There are several reasons for this. Biologics have bigger and more complex molecular structures than small chemically-synthesized drugs. For biologics, it is not only the chemical structure of the protein that determines how it works, but also the way this structure is folded. The manufacturing process for biologics is so complex that it is virtually impossible for a biosimilar manufacturer to generate an identical medicine to the originator biologic.

Let’s use a common analogy to...
Our numbers tell a great story

Since its inception in 1983, the Prime Canadian Property fund’s gross asset value has increased from $33.4 million to over $2 billion. For over 30 years, we’ve provided a stable income return and capital appreciation from diversified portfolio investments in core properties like Bentall V, Vancouver’s premier office address. And we’re going to keep doing it.

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Malcolm Leitch,
Chief Operating Officer, Investment Management at MLeitch@Bentallkennedy.com or phone 604.646.2812


**Investment Policy Changes Sustain Pensions**

A decade of falling bond yields and volatile equity returns has led to volatility in funded ratios (market value of plan assets over plan liabilities) along with sharp increases in contributions for pension plans using traditional investment policies which depend on strong and stable equity returns to achieve the funding objectives.

As Chart 1 illustrates, pension plans with a 60/40 mix have had very volatile funded ratios and many now have large deficits to deal with.

Explain 'similar but not identical.' One well-known biologic process is the fermentation of grapes to produce wine. We are all aware that the taste of the wine often depends on where it originates. For example, the Pinot Noir vines in Canada are as well known for their quality as the Pinot Noir vines in France.

The same can be said for biologic and biosimilar drugs. They are similar, yet not identical. However, unlike wines, even small differences between a biologic and its originator biologic medicine can make a difference to patients. Substituting one biologic for another can cause unexpected outcomes. In rare cases, unwanted immune reactions can affect how well the drug works in the patient. Another very rare, but potential, patient risk is that the body may begin to identify both the biologic drug and similar proteins made by the body itself as foreign substances. This can result in the body’s own proteins being attacked by the immune system, which can have a devastating impact on the patient.

While plan managers have become used to considering plan coverage for generic drugs exclusively once their brand-name synthetic (small molecule) drugs go off-patent, this general practice should not extend to biosimilars. Biosimilars should not be considered interchangeable with their originator biologies because, as outlined above, even small differences between products may have the potential to cause unexpected outcomes if a patient is switched from drug to drug.

To date, only one biosimilar drug has been approved in Canada. As such, it is difficult to speculate how biosimilar companies will price their products in Canada. Having said that, the production of a biosimilar is much more complicated than a small molecule generic. Higher development costs suggest that it is unlikely similar cost savings as those seen with small molecule generics will be found.

**Patient Outcomes**

The impact of substitution on patient outcomes must be considered and biosimilars prescribed only by physicians who consider the biosimilar to be appropriate for their patient. It is also important that pharmacists not make substitution decisions without the consent of the prescribing physician. Regulatory policies around the world, including Canada, consistently highlight the need to involve the physician in the decision-making process.

Biosimilars will change the treatment landscape in Canada and they present both new opportunities and new challenges. As a pioneer in the field of biologic medicines, Amgen Canada believes that biosimilars can play a role in providing options for patients. Biosimilars will be found.

Trading landscape in Canada and they present both new opportunities and new challenges. As a pioneer in the field of biologic medicines, Amgen Canada believes that biosimilars can play a role in providing options for patients, provided these medicines are safe, effective, and of high quality. The decision to treat a patient with a biosimilar should be made by the physician. The primary driver for decision-making in choosing the right biologic medicine is the patient. Science and patient safety should lead decisions.
Asset/liability modeling studies introduced in the 1980s are now the industry standard. The main issue comes from models that often understate the chances and severity of adverse results and cluster equity/fixed income asset mixes at 60/40. As a consequence of using long-term assumptions and time horizons where high equity returns (with high short-term volatility) would make the plan whole, fiduciaries take misplaced comfort in average ‘we’ll be okay’ outcomes.

Managing to a benchmark of investment indices creates a false sense of progress and so does comparing fund results to universes of unrelated pension funds. A first quartile total fund return does not necessarily mean that the funded ratio hasn’t fallen and that pensions can be paid. Fiduciaries should focus on plan liabilities, not asset-based benchmarks, when managing the fund.

Reliance on the investment managers to improve their results isn’t keeping plans fully funded. While it is important to monitor managers, changing investment managers based on individual performance against benchmarks while keeping the asset mix policy the same, hasn’t proven to be a successful strategy. Aligning investment policy and asset mix to liabilities...
better manages plan risk and has far more impact than manager decisions.

Stress testing and other techniques complementing the standard asset/liability modeling are better approaches to identify the ability of a plan and sponsor to withstand severe events. Indeed, plans need to consider the impact of such severe events as a further drop in bond yields or a repeat of the 2008 stock market correction. It does not matter if an undesirable event only has a one per cent chance of occurring, if the sponsor cannot finance the incurred shortfall in the event that it takes place (tail events happen more frequently than a distribution shows), the policy should be changed to reduce the risk and effect.

Investment solutions for financing Defined Benefit pensions have evolved significantly since I joined the industry 35 years ago. Pension funds are larger, more mature with outflows often exceeding inflows, and the receipt of pensions more imminent for many members. The need to better match assets and liabilities as a cornerstone of investment policy has become more evident to some industry advisors, including myself. The typical 60 per cent equity, 40 per cent universe bond asset mix works well in generally rising stock markets for sponsors with high tolerances to risk, but for many plans, and in this environment, it is the wrong strategy. However, there are other methods including:

- Investment solutions now include a wider range of matching fixed income products, such as commercial mortgages, infrastructure debt, and custom liability matching solutions.
- Equity alternative assets such as infrastructure and real estate are increasingly popular, but these investments are illiquid and supply is limited.
- A desire to limit equity volatility has led to a greater focus on high dividend strategies and low volatility equity strategies.
- Some plans have successfully focused on the ultimate goal of securing pensions. They better matched plan assets and liabilities and managed for downside risk. These plans can serve as great examples. Their alternate approaches often include much lower equity weightings, higher fixed income and alternatives weightings, and more control of interest rate risk through extended bond duration to match liability duration.

Worst Effects

Plans which adopted this risk management approach through the 1990s have avoided the worst effects of funded ratio volatility and contribution increases that came with the tech crash of the early 2000s, the financial crisis of 2008, and the ongoing European debt problems. Plans that adopted the approach more recently have benefited from better growth and stability in their funded ratios than they would have otherwise experienced.

Do not wait for better times to reduce risks. Start taking action now. You owe it to your pensioners!

ANNUAL REVIEW AND FORECAST 2012

Promoting A Wellness For All Approach

A s today’s workplace expands beyond the traditional head office, companies are looking for cost effective and equitable solutions to deliver the wellness message to a decentralized workplace. Whether your employees work from their car, truck, home office, or small branch office, there are numerous ways to encourage healthy lifestyle choices both at work and at home. Here are a few examples of successful strategies to provide wellness without borders.

Consider engaging the services of a wellness consultant to co-ordinate your wellness program and ensure that employees are supported regardless of work location. A key role of the consultant will be to provide one-on-one coaching service. Whether your employees are interested in how to lose weight, how to train for their favourite sport, where to purchase home fitness equipment, or managing work life balance, the wellness consultant will be ready with information and support.

WELLNESS

Sue Pridham is president of Tri Fit Inc.

Virtual Wellness Committees

Bring together representatives from across your organization to assist in the communication, promotion, and delivery of specific wellness activities. They will also help to provide input and solicit feedback from co-workers on the programs and services offered.

Wellness Reps

Train employee volunteer wellness reps for each branch or region to support the wellness program. Wellness reps will act as ambassadors for the program through promotion, education, and leadership. They can post monthly resource materials, communicate new program offerings, and co-ordinate healthy team building activities such as walking challenges.

Stretch Break Leaders

Employee volunteer stretch break leaders are professionally trained to conduct daily stretch breaks to reduce the incidence of MSI and combat the health hazards of prolonged sitting.

Wellness Zones

Consider setting up ‘Wellness Zones’ to support health and well-being. These are flexible spaces dedicated to providing information, resources, and equipment to create awareness of positive health practices. Employees can drop in throughout their work day to monitor their blood pressure, weigh in, stretch, or de-stress with a relaxation CD. They can also promote wellness programs that are going on each month. They can be designed, packaged, and distributed to specific branches at minimal cost.

Wellness Portals

A wellness portal can act as a virtual

BPM
We know how important benefit and pension plans are to you, and with ongoing industry changes, working with the right benefits plan partner is more important than ever. We’re celebrating our 40th anniversary as one of Canada’s foremost Third Party Administrators. With this exciting milestone, we’re taking this time not only to reflect on the past, but also use our experience to drive a vision for the future.

Thank you to all our valued clients for being with us on this journey. We promise to continue delivering outstanding service and industry leading expertise.

We Care,
You Benefit.
ManionWilkins.com
RETIREMENT PLANNING

‘Enchantment Of The Investor’

As I live in the Greater Toronto Area, ON, when travelling I am often asked whether the housing market in Toronto has been overheated. Is foreign investment driving up the cost of condominiums? Are resale values going to continue to climb?

In fact, there appear to be a number of ‘hot’ real estate markets in Canada from St. John’s, NL, to Victoria, BC. These questions could well apply in any of these markets. What is also compelling is the question ‘how does this impact a retirement plan?’

Key Component

In fact, according to a recent BMO Retirement Institute survey,1 41 per cent of Canadians consider the equity in their home to be a key component of their retirement investment strategy. This is not surprising as 47 per cent of Canadians view their residence as their most significant asset accounting for more than half of their net worth.2 This reflects conventional wisdom that the home is not just a lifestyle choice, but also an asset that will appreciate over time, allowing the retiree to downsize to lower cost accommodations, and free up capital to improve their lifestyle in retirement.

Joan Johannson
is president of BMO Group Retirement Services.

This is where the overheated market comes into play. Will the coming years sustain the ‘hot’ real estate markets allowing for downsizing to increase retirement capital? Can the retiring baby boomer, for example, sell the spacious, four bedroom suburban property at a high price and purchase a nice little bungalow at a reduced price? The boomer generation super-charged the development of suburbs full of large family homes, but is now poised to reconsider this lifestyle as their children move on. Of course, when children simply move back home, then down-sizing is delayed. But consider the global study that indicates the aging demographic bulge will eventually downsize and this could drive housing prices down by one per cent per year over the next 40 years.3 This nest egg could disappear. Having said this, Canada is also a diverse marketplace constantly being refreshed with immigration and the new populations moving to Canada may help to diffuse an over-supply.

Then there is the question of the next step. After all, one has to live somewhere and this is an important lifestyle choice. In fact, according to the 2012 BMO survey, 32 per cent of Canadians believe that living comfortably in retirement is the most important financial achievement of their lifetime. Of course, the definition of ‘living comfortably’ varies with each individual. The question is ‘will the comfortable alternative be affordable?’

For example, what if the boomers increase demand for smaller bungalows to acquire accessible one-floor accommodation? What if younger generations also start valuing a single floor design? This is exactly the combination that I have witnessed in the GTA. Savvy developers who invest in such properties may, with a little granite here and hardwood flooring there, drive the price of that little bungalow to approach or even top what is asked for the larger family home. Suddenly, the gains from changing accommodations may no longer be so achievable.

However, the market has other alternatives and we have all seen the boom in condominium development. Condominiums are attractive due to their lack of physical maintenance requirements, the fact that a snowbird may leave home...
without it being readily apparent, and that they are better sized for an aging couple or a single occupant. Again, this is a real estate option that can be of interest across generations. In this case, though, the Canadian boomer may also be in competition with foreign investors looking for a stable market. This too can over-heat real estate prices, especially in urban centres.

Of course, condominiums come with attendant maintenance fees, replacing the cost of home maintenance, but with far less control over how these monies are spent or how high they might go over time. This lack of control can be a challenge on a fixed income with little extra cash for increases.

Cash To Spare

However, there are also those with cash to spare in retirement who are looking at splitting their time between accommodations. The downturn in the U.S. real estate market has been an encouragement for cross-border investment by would-be snowbirds. This is an area requiring extensive study to determine if taxes, healthcare coverage, and other costs still make this viable as a long-term commitment.

As well, the marketplace has also generated a proliferation of fractional and timeshare holiday opportunities in recent years. Even the principal residence can feel like a country club in many new retirement/active lifestyle communities. Features may include golf courses, health clubs, pools, and even docks for boats – all for the boomer to enjoy. Of course, there is an attendant and ongoing cost, reflected in maintenance and/or club fees which can quickly drive up the cost of living in such an environment.

In scuba diving, there is a term called ‘enchantment of the deep.’ This refers to a type of euphoria that a diver can experience which can dangerously override common sense. I suggest that there can also be ‘enchantment of the investor,’ lulling the pre-retirement individual into a wonderful lifestyle vision that could lead to hasty decisions. After all, when is a timeshare more attractive than the day you gaze upon the turquoise waters of the pool or rolling greens of the fairway? It is important to consider the many costs embedded in these solutions.

Decisions to sell or stay are often emotional ones, loaded with values outside of economic calculations. However, there is a level of financial literacy required at retirement than at any earlier stage in life. In fact, acquiring a healthy view of one’s true financial picture is critical when approaching retirement and decisions related to selling a residence and selecting a new abode. The options are far more numerous and complex than in our parents’ day. Most service providers for group plans currently offer very good retirement calculators and a number of assumptions and inputs may be made and alternatives run to test end results. This is an important step in defining where one stands and the impact of certain decisions. However, as the inputs become more numerous and decisions more complex, it is often a good decision to acquire a full financial plan specific to one’s own situation. Working with a financial planner and investment advisor, the prospective retiree can acquire more comfort in their options and decisions.
True Value

Certainly, of great importance in an evaluation of one’s financial net worth is the true value of the primary residence when considered part of a retirement plan. In addition, and of equal import, are the costs and considerations specific to alternative retirement living arrangements. For true peace of mind, these assumptions could be checked to current market conditions and alternative assumptions fed into financial planning models to develop best, worst, and most reasonable case scenarios that are re-visited on a regular basis.

In today’s economy, real estate in Canada could reasonably be considered part of the foundation of a strong plan. However, with a worst case to best case financial plan in hand, one can address many of the key drivers to a future lifestyle to create a degree of reasonability around expectations and create a blueprint for retirement which can be adjusted, as needed, over time.

Are our real estate markets overheated? Perhaps, perhaps not.

Will current values be supported in the future? Again, perhaps or perhaps not.

Should a prudent person look at alternative scenarios and a range of lifestyles as part of a well-researched financial plan? Now that’s one question which I think we can agree has only one true answer – yes.

BPM

1. BMO R1 Q4 2012, Harris Decima survey, “Retirement and Homeownership”
2. BMO Retirement Institute Report (Canadian Edition), ‘Home sweet home or retirement nest egg,’ October 2012
3. ‘Aging and Asset Prices,’ Elod Takats, Bank for International Settlements, August 2010

RETIREMENT SAVINGS

Pooled Registered Pension Plans Help Bridge Retirement Savings Gap

What’s the one thing that Canadians agree on when it comes to our retirement savings system? Employers, employees, government officials, and industry experts all agree that a significant number of Canadians are not saving enough for retirement. Many individuals will face a gap between the lifestyle they expect to live and what their savings will support.

There has been much debate and discussion on the merits of various initiatives and proposals intended to improve Canada’s retirement savings system. Our country has a three-pillar system for retirement saving:

- Universal government programs
  - including Old Age Security (OAS), the Guaranteed Income Supplement (GIS), and the Canada/Quebec Pension Plan (CPP/QPP)
- Personal savings
- Tax-advantaged workplace savings plans

Unfortunately, for many Canadians, one of these pillars is missing. Estimates are that more than 500,000 employers in Canada do not currently offer a workplace retirement savings plan. This means that approximately 7.6 million Canadian workers do not have access to a plan.

Will current values be supported in the future? Perhaps, perhaps not.

Should a prudent person look at alternative scenarios and a range of lifestyles as part of a well-researched financial plan? Now that’s one question which I think we can agree has only one true answer – yes.

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Access Plummet

The overwhelming majority of the companies that do not provide employees with access to a plan are in the private sector and have less than 500 workers. In fact, if you work for a company in Canada with 500 or more employees, there’s an 80 per cent chance you have access to a registered pension plan (RPP). On the other hand, if you work for an employer with less than 100 employees, your chances of having access to a RPP plummet to less than 10 per cent.

It is highly unlikely that these smaller businesses, not-for-profits, and the self-employed will ever take advantage of a Target Benefit, Defined Contribution, or Defined Benefit pension plan. Pooled Registered Pension Plans (PRPPs) are being introduced to give these companies the ability to provide a simple, low-cost, easy-to-administer pension plan to their employees. PRPPs can provide the third pillar to millions of Canadians.

Because PRPPs are designed with the ability to opt out of participation, employees retain the choice to decline joining or adjust their contribution levels. In contrast, DB or DC plans are typically compulsory for employees with little, if any, flexibility of opting out. This lack of flexibility may pose a bigger concern for low income earners.

There has been some suggestion that PRPPs may be inappropriate for low-income earners as increased savings will result in a claw-back of income tested benefits when employees retire. While this premise may very well be true, it would also be applicable to any tax-deferred savings program – including RRSPs, DB, and DC pension plans. So the question is, “why is this criticism being attached to PRPPs?” In fact, it’s an excellent question and should be investigated further. However, it’s more a reflection of the launch of Tax Free Savings Accounts (TFSSAs) as an alternative mechanism for low-income earners to save for retirement than it is about PRPPs.

When it comes to saving, modest-income employees – if given the choice – will often opt out since other priorities such as paying for food, shelter, and clothing trump saving for tomorrow. These employees are likely to be very sensitive

Sue Reibel is senior vice-president and general manager, group retirement solutions, at Manulife Financial.

3. ‘Aging and Asset Prices,’ Elod Takats, Bank for International Settlements, August 2010
The Winds Of Regulatory Change Are Blowing

In the words of Winston Churchill, “there is nothing wrong with change, if it is in the right direction.” This certainly rings true when you consider the international regulatory environment since the 2008 financial crisis. Regulatory change for the financial services industry more than ever before is being driven internationally by the G20 and standard setting bodies such as the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS) through the development of new international regulatory frameworks.

At the behest of G20 leaders, the FSB and the IAIS have been busily crafting new international regulatory frameworks to manage risks posed by so-called ‘global-systemically important insurers’ (G-SIIS) and below that, a broader group of companies being labeled ‘internationally active insurance groups’ (IAIGs). The rationale behind the creation of these new frameworks is that the breadth, size, and activities of these companies pose a risk to the financial system both within and across jurisdictions, should they collapse. Put slightly differently, jurisdictions with a G-SII or IAIG presence are relying on each other to properly supervise and regulate these companies to avoid another Lehman Brothers-type event. They, therefore, all have an interest in ensuring that supervisory gaps are closed, that better co-operation and co-ordination exists between each jurisdiction’s supervisor, and that, in the event that one of these companies should fail, its resolution will not be disorderly and policyholders will be protected.

Devil In Detail

Our industry does not quibble with these objectives. In fact, we have come out in support of them. Yet, in pursuing these objectives, the devil is always in the detail. There are three details, in particular, which we are asking international standard setters to keep in mind.

The first is that the insurance business model is unique to the financial services space. Insurers direct premiums into secure investments that appropriately match the expected amount of benefits paid and the duration of the policies. Banks, by comparison, hold assets that are sensitive to short-term changes in the economy – such as business and consumer lending – which can lead to weakened balance sheets and liquidity squeezes. Such differences in the business model help to explain, for example, why the rationale for imposing higher capital requirements on banks does not automatically translate over to insurers. For insurance, additional capital should only be considered where other measures are not sufficiently able to mitigate a particular risk.

Secondly, traditional insurance is not a source of risk and these businesses are already well regulated in most jurisdictions. In the oft-cited case of AIG, the epicentre of the firm’s crisis was its financial products division whose bank-like activities were not being properly regulated by either insurance or banking supervisors. Supervisors should, therefore, focus on the activities of an insurer that are non-insurance related.

Last, but certainly not least, while a strong regulatory regime is a source of strength for our industry – and here the Canadian example immediately springs to mind – we need to be mindful of the consequences of too much regulation, or regulation that is overly prescriptive or conservative. We need to ensure that policyholders are protected. However, we must not lose sight of the fact that the insurance industry must be allowed only to realize they have not adequately prepared. Employees are reminded to save without being compelled to save.

Panacea

Are PRPPs a panacea that will address all of Canada’s retirement savings issues and concerns? They are not. There remain many other issues – including low levels of financial literacy, rampant consumerism, and high debt levels. PRPPs are, however, a significant improvement that will provide millions of Canadians working for smaller businesses and not-for-profits with access to the third pillar of the retirement savings system.

Academic debate in search of the ideal should not delay the introduction of real solutions that will provide real benefits.

1. Statistics Canada and Manulife Analysis
2. Industry Canada 2011 Key Small Business Statistics and Manulife Analysis
3. Statistics Canada, CANSIM database, tables 2810042 and 2800010
to compete. Insurers play an invaluable role in delivering products and services that individuals need now more than ever before. Insurers are also among the largest investors in the economy, with investments in safe and long-term assets. Regulatory excess runs the risk of having consumers and businesses pay more for their financial products or, worse still, legitimate products and services could be pulled from the marketplace as they no longer make economic sense. Attention also needs to be paid to ensuring that companies are able to compete on a level playing field across jurisdictions and between the large multi-national insurers and their smaller rivals who avoid being designated a GSII or IAIG.

**Important Step**

As the international regulatory environment in which we operate is changing, so should we as an industry. Over the last few years, insurance associations from around the world have been collaborating more closely in terms of our communications with the key international standard setting bodies. These efforts recently culminated in the creation of a Global Federation of Insurance Associations at a meeting of insurance association heads, held in early October in Washington, DC. This is an important step for our industry. In taking industry-wide positions wherever we can, our federation can raise our industry’s profile, distinguish us from other financial services sectors, and reap greater influence with decision-makers.

The insurance industry is not new to change. Improvements to the regulatory system can always be made, but even well-intentioned regulation can sometimes backfire. The industry, through our newly-formed federation, will remain engaged with the FSB, IAIS, and others to ensure that new international regulation is headed in the right direction.

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**EMERGING MARKETS**

**Strong Tailwinds For Fundamental Investing**

Emerging markets are no longer the unexplored, niche asset class they were more than a decade ago. Many well-known factors have fuelled an evolution throughout the 2000s and many changes are still incubating. As the world continues to shift, and developed markets muddle through the weight of prior fiscal mismanagement and slower economic growth, emerging markets remain poised to deliver the opportunity for attractive returns, with potentially less risk than history or common perception might suggest.

Looking forward, there are three trends we believe will continue to provide strong tailwinds for investors in emerging markets:

- The historical boom/bust cycle will become more muted.
- Economic growth will continue at overall higher rates than developed markets.
- Active management can provide an important advantage.

Although not yet extinct, the boom/bust cycle will, we believe, continue to become more muted as emerging markets advance even further. Many sources of previous instability have been addressed by enhanced monetary and fiscal policies which should continue to reduce the risk to investors in these regions.

**Debt Costs**

Debt costs have decreased. There has been a dramatic decline in borrowing costs in emerging markets. In 1998, the spread between the U.S.-market and emerging market borrowing costs was as high as 15 per cent. While borrowing costs in all regions have decreased, the spread has fallen to just five per cent and borrowing costs are now seven per cent in emerging markets compared to two per cent in the United States, a significant reduction in the risk premium.¹

Inflation is becoming manageable. Historically, it has been a major deterrent to investing in emerging markets as memories of triple-digit inflation still haunt some wary investors. But the majority of emerging market countries have made remarkable progress in recent years and no longer merit the reputation of having uncontrolled inflation. Average inflation rates have declined to close to six per cent and, over the past decade, have tended to move more in sync with those in developed markets. Decreased debt levels, flexible policy rates, and more stringent monetary controls may continue to help minimize inflation going forward.²

Sovereign debt levels have declined. While many developed nations (United States, Spain, Italy, France, etc.) have received credit rating downgrades, ratings in emerging markets have been improving. As a percentage of gross domestic product (GDP), aggregate government debt for emerging market countries is less than 40 per cent compared to developed markets where it is more than 100 per cent.

Corporate governance and disclosure at emerging market companies is improving. In December 2000, companies representing less than five per cent of emerging market capitalization conformed to the
International Financial Reporting Standards (IFRS) or the generally accepted accounting principles. Ten years later, that has grown to more than 40 per cent. This means easier access to more reliable financial information on companies.

Local equity ownership is growing. While equity investing is still in its infancy in many emerging market countries, local equity ownership is growing. Citizens of developing countries have not historically invested heavily in equities, making their domestic equity markets more subject to the whims of overseas investors. In Brazil, Russia, India, and China (the BRIC countries), domestic households own between eight per cent and 19 per cent of their financial assets in equity markets, whereas American households hold 42 per cent of their financial assets in equities. With expanding economies and a growing middle class, domestic equity investment in emerging markets will likely also increase, potentially adding a base of longer-term shareholders and further stabilizing markets that have historically been dominated by foreign capital inflows and outflows.

**Still Growing**

Emerging market nations are still growing in areas such as middle class populations, GDP, corporate productivity, and equity market size.

A burgeoning middle class has arisen in many thriving emerging economies and has driven rapid growth in consumption. While developed world consumption levels may taper, the Goldman Sachs Group, Inc. forecasts that the consumption demand curve for emerging markets will exhibit a steep upward slope until at least 2030.

There are continuing signs of economic growth: the populations and economies in emerging markets continue to advance and thrive. The growth rate of GDP in emerging economies has outpaced developed economies for more than a decade. In 2011, emerging market growth more than tripled the growth rate of developed nations and this trend is expected to continue well into the future. By 2016, it is estimated that emerging market GDP will represent more than 40 per cent of global GDP, more than doubling its share from just 20 per cent in 2000.

The growth rate of industrial production in emerging markets has also remained above developed markets for the better part of the past decade. As of December 2011, it was above five per cent compared to only 2.5 per cent in developed markets. Since 2004, corporate earnings growth has been positive for six out of eight years and is expected to be five per cent to 15 per cent for the next two years.

The market share of emerging markets equity continues to grow as well. Since 2004, emerging markets have grown from 5.2 per cent to 12.8 per cent of global equity markets (measured by the MSCI All Country World Index).

**Active Managers**

The majority of North American money recently flowing into emerging markets has been in passive strategies causing excessive concentration in the larger names in the index – large BRIC-based companies in materials, energy, and financials, for example. Exhibit 1 shows the percentage that the five largest stocks represent in the BRIC countries compared with the United States. In all BRIC countries, the top five stocks represent more than one-third of the market compared with only 14 per cent in the United States.

Investing passively means allocating primarily to the big names in emerging markets and missing out on opportunities in smaller – and frequently more promising – companies. As money continues to flow into exchange traded funds and other index-sensitive strategies, this concentration will likely only deepen, creating more opportunity for active managers to capitalize on lesser-known names.

**Exhibit 1**

**Concentration Of The Five Largest Companies in BRIC**


<table>
<thead>
<tr>
<th>Country</th>
<th>Brazil</th>
<th>Russia</th>
<th>India</th>
<th>China</th>
<th>United States</th>
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<tr>
<td>%</td>
<td>70%</td>
<td>60%</td>
<td>40%</td>
<td>36%</td>
<td>36%</td>
</tr>
<tr>
<td>%</td>
<td>60%</td>
<td>50%</td>
<td>36%</td>
<td>36%</td>
<td>14%</td>
</tr>
</tbody>
</table>

**Exhibit 2**

**Trailing P/E MSCI Emerging Markets Index Versus MSCI World Index 2000-2012**

outperform. Patient, methodical managers have the opportunity to capitalize on the over-concentration and focus on the under-researched smaller companies that are often more directly tied into the local emerging-market consumer.

Amid the impressive growth statistics in emerging markets, valuation metrics have remained solid. Historically, strong earnings have tempered price ratios and have created a fertile investing ground for active managers. Emerging markets are still more attractive than global developed markets, and have competitive dividend yields (see Table 1).

This situation is not new. Exhibit 2 illustrates the consistency of lower P/E ratios in emerging markets compared to global developed markets.

### Potential Opportunities

Many investors have been too quick to discredit value investing as the choice style in a market labelled ‘growthy.’ The Brandes Institute, which investigates potential opportunities arising from the influence of behavioural and structural factors on global investing, embarked on an independent study to assess the viability of value investing in emerging markets. The study assessed the performance of emerging market equities and grouped them by market cap and P/B ratios. Stocks with the lowest P/B ratios have historically delivered the highest returns in stocks of all sizes.

With uncertainty in developed markets a seeming certainty, investors – institutional and retail alike – will likely continue to look to emerging markets to help diversify portfolios and meet financial obligations. As the historical boom/bust cycle continues to become more muted, and economies continue to grow at relatively higher rates, emerging markets offer strong tailwinds for fundamental investors going forward. And given current valuations, we believe it’s the right time to be looking at the full opportunity set available in emerging markets today.

### Table 1

<table>
<thead>
<tr>
<th>Market Valuations</th>
<th>S&amp;P/TSX</th>
<th>MSCI World</th>
<th>MSCI Emerging Markets</th>
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</thead>
<tbody>
<tr>
<td>Price to Book (P/B)</td>
<td>1.8x</td>
<td>1.7x</td>
<td>1.6x</td>
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<tr>
<td>Price to Earnings (P/E)</td>
<td>13.8x</td>
<td>13.5x</td>
<td>11.6x</td>
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<tr>
<td>Price to Cash Flow (P/CF)</td>
<td>8.0x</td>
<td>8.5x</td>
<td>7.8x</td>
</tr>
<tr>
<td>Dividend Yield</td>
<td>2.9%</td>
<td>2.8%</td>
<td>2.9%</td>
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<tr>
<td>Return on Equity (ROE)</td>
<td>13.3%</td>
<td>11.9%</td>
<td>12.9%</td>
</tr>
</tbody>
</table>


1. Bloomberg L.P., JPMorgan Chase & Co. and UBS Wealth Management Research, as of November 15, 2011
2. Source: The International Monetary Fund (IMF) as of October 1, 2012, based on consumer price index inflation (percentage change year over year, average consumer prices)
5. Source: The IMF as of October 1, 2012
6. Source: Canada Employment Insurance Commission as of December 31, 2011; growth calculated year over year based on monthly data; mid-weighted
7. Source: UBS Wealth Management as of October 17, 2012
The Future Is Co-operative

What do Land O’Lakes, Home Hardware, State Farm Insurance, Desjardins Group, Best Western Hotels, and the Real Madrid football club have in common? Besides the fact that they are large and successful, they are also all co-operatives, owned by their members not by shareholders or private investors.

That may come as a surprise because many people have this image of co-operatives either as tiny neighbourhood non-profits or quasi-government or social agencies.

Huge And Growing

That couldn’t be further from the truth. Co-operatives are part of the business world and work within the market economy. They are also a huge and growing – if sometimes forgotten – part of the Canadian and world economies.

Co-ops vary widely and include everything from small co-op daycares to agricultural collectives to member-owned retailers and to huge financial co-operative organizations such as Desjardins or Crédit Mutuel in Europe, which has almost 30 million members and clients.

Here in Canada, co-operatives have more than $300 billion in combined assets, employ more than 155,000 people, and serve more than 15 million members. Globally, there are about one million co-ops and mutuals operating in 100 countries around the world. They employ 100 million people and have one billion members. Moreover, the 300 largest co-ops and insurance mutuals in the world combined generate about $1.9 trillion in revenue. That’s more than the entire GDP of Canada, the world’s 10th largest economy.

Late last year, the United Nations declared 2012 ‘The International Year of the Co-operative.’ The timing couldn’t have been better. It gave those of us in the co-operative sector an opportunity to better tell our story at a time of growing public disillusionment with more conventional business models.

One way Desjardins Group contributed to this effort was by organizing the first ‘International Summit of Co-operatives,’ which was co-sponsored by the International Co-operative Alliance and St. Mary’s University in Quebec City in early October. It was similar in many ways to the ‘World Economic Forum’ in Davos. But it was designed for and about the co-operative sector and attracted almost 3,000 participants from 91 countries.

Co-operatives Different

So how exactly are co-operatives different from other businesses?

Essentially co-operatives are associations of people, rather than capital. Obviously, financial performance is critical and co-operatives do distribute some of their profits to members in the form of dividends. But, it is not the be-all and end-all. Other factors are also important including creating and sustaining jobs, supporting local communities, and providing financial and democratic education to members.

Because they are not owned by shareholders and traded on stock markets, co-ops don’t have to worry in the same way about quarterly results, analysts’ ratings, or fluctuating stock prices. As a result, there is no incentive for co-ops to take big risks to maximize profits. Instead, they can focus on prudent, longer-term strategies for growth.

They are also immune to hostile takeovers, and their operations and jobs can’t be exported to low wage or environmentally slack areas of the world.

As a result of all this, co-ops are generally more resilient and more successful over the longer term than other businesses.

The survival rate of co-operatives in Quebec, for example, is roughly double that of other businesses – 62 per cent of co-operatives are still operating after five years versus 35 per cent for other Quebec businesses.

But the true value and strength of co-operatives are best appreciated during times of crisis.

A 2009 study for the International Labour Organization that tracked the resilience of the co-operative model found that at the end of the 2008 crisis, although they had received no government support, the balance sheets of co-operatives were generally in good shape, certainly much better than their shareholder-owned competitors.

In the United Kingdom, the comparison between the corporate and co-operative sectors is even more startling. While the overall UK economy has contracted by 1.7 per cent over the past four years, the co-operative economy has grown by almost 20 per cent.

Big Role

That’s not to suggest that co-operatives are a panacea. However, they do have a big role to play in a more balanced, pluralistic economy that includes a dynamic private sector, a highly-effective and affordable public sector, and, last but not least, a co-operative sector that provides stability and enjoys solid, sustained growth.

Although The International Year of the Co-operative is coming to an end, the next chapter in the growth and success of the co-operative sector is only just beginning. And that’s a story worth telling.
Ontario employers face growing costs and complexities as a result of recent changes to the Ontario Pension Benefits Act. Under these changes terminated employees who participate in Defined Benefit pension plans will be entitled to so-called ‘grow-in’ benefits that will, in many cases, result in significantly greater benefits than was previously the case.

Ontario has long required enhanced benefits for pension plan members when the pension plan is wound up. If the combination of a plan member’s age and years of service exceeds 55, the member is entitled to ‘grow in’ to enhanced benefits under the pension plan, as if the person’s membership in the pension plan continued past the date of wind-up.

**Benefits Extended**

The changes to the Ontario law now extend these enhanced benefits beyond plan wind-up situations. An Ontario employee will be entitled to the ‘grow-in’ benefits as well if the following are satisfied:

- The employer terminates the member’s employment effective on or after July 1, 2012 (i.e., this does not apply retroactively) and as a result he/she ceases to be a plan member
- The termination of employment is not a result of wilful misconduct,
  disobedience, or wilful neglect of duty by the member that is not trivial and has not been condoned by the employer (this phrase will be referred to herein as ‘wrongdoing’)  
- The combination of the member’s age plus years of continuous employment or membership in the pension plan equals at least 55 on the effective date of termination

Multi-employer and jointly sponsored pension plans may elect not to provide grow-in benefits. Employers with employees in these types of plans will need to check with the plan administrator.

The Ontario government has published draft regulations dealing with these new requirements. The draft regulations propose both expanding and restricting the scope of the statutory requirements. The scope of ‘grow in’ will be expanded to include eligibility where an individual resigns during a period of notice. It will be restricted to exclude from eligibility those employees hired for a specific task, construction employees, and employees on temporary lay-off.

Other expansions and restrictions may be introduced based on public comment on the draft regulations.
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Some of the speakers already confirmed (by order of appearance on the program)

PETER SHEAHAN
International Expert on Leveraging Business Trends and New Market Opportunities

DONALD G. M. COXE
Strategy Advisor, BMO Financial Group, Chairman, Coxe Advisors LLP

LEO DE BEVER, PH.D.
Chief Executive Officer, Alberta Investment Management Corporation

KEITH AMBACHTSHEER
Director of the Rotman International Centre for Pension Management (ICPM)

DAVID P. RICHARDSON, PH.D.
Senior Economist, TIAA-CREF Institute

JEFFREY SIMPSON
National Affairs Columnist, The Globe and Mail

CHRIS GILES
Economics Editor, Financial Times (United Kingdom)

STEVE MILLER, MD
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The consequences of having a terminated employee qualify for grow-in can be significant. We have seen examples of the grow-in right adding six figure amounts to the value of the pension benefit.

The new rules make termination of employment more expensive and, in some circumstances, more complex. With respect to the exclusion for ‘wrongdoing,’ the criteria under which grow-in benefits are excluded are not the same as the employment law concept of ‘just cause,’ but are substantially the same as the exclusion from termination and severance pay under the Ontario Employment Standards Act, 2000. In many cases, ‘wrongdoing’ will be the same as ‘just cause.’ In some circumstances, however, employees may be excluded from grow-in due to ‘wrongdoing,’ but remain entitled to a severance package because there is not just cause for dismissal, or the opposite may occur: employees may be entitled to grow-in because there has been no ‘wrongdoing,’ but be disqualified from a severance package because there is just cause for dismissal. Employees may also be more reluctant to resign as part of a termination arrangement, as resignation will not trigger the grow-in rights.

When terminating an employee, employers will need to carefully consider the following:

- Does the employee meet the 55 threshold of age plus service?
- Is the termination due to ‘wrongdoing’?
- Are any of the other exceptions available in the circumstances?

Corporate Restructurings

Employers will also have to review these new rules in the context of corporate restructurings, employee transfers, and purchase and sale transactions. Employers may also wish to consider the implications of this new entitlement when drafting employment contracts. The implementation of the new grow-in rules will undoubtedly have a significant impact on DB pension plan administration and the costs of termination. HR professionals will have to consider the impact of grow-in when terminating employees, in particular in those situations when ‘wrongdoing’ may have occurred, to decide whether to take the position that grow-in does not apply due to ‘wrongdoing’ and to ensure that the decision to terminate is appropriately communicated.
PIAC has been the national voice for Canadian pension funds since 1977. Our 140 member funds are responsible for the oversight of over $1 trillion in assets on behalf of millions of Canadians. PIAC’s mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

PIAC is a forum for education and the exchange of member ideas, and through its research and advocacy activities, is the leading voice on legislative and regulatory issues affecting pension investment and governance.

Professionals responsible for the investment direction of their organization’s pension funds are invited to request a membership information package.
The economic turmoil of the last decade has called into question the ability of traditional pension plans, whether Defined Benefit or Defined Contribution, to adequately deliver sustainable retirement benefits. With the whole point of sustainability being to avoid severe corrections to both contributions and benefits, to be sustainable, a retirement plan must consistently deliver, through favourable and adverse circumstances, an appropriate range of benefits within an acceptable range of costs over the long-term.

A great example of how to define sustainable pensions can be found in the recommendations contained in what is commonly referred to as the ‘Hutton Report’ from the UK. Lord Hutton of Furness was tasked with recommending the reforms needed in the UK to ensure the sustainability of public sector DB pension plans. The report is essential reading for anyone interested in pension plan sustainability.

Plan Sustainability

That said, there are several excellent Canadian examples of pension plans that have taken steps to enhance plan sustainability. The first that comes to mind is the Canada Pension Plan where adjustments have been made over time to the funding, benefit, and investment policies, based on regular long-term projections of the plan’s financial position. Changes have been made far enough in advance of adverse circumstances to materially influence the expected results.

Sustainable solutions have been introduced into a number of large public sector plans in Ontario, with a move away from automatic full CPI post-retirement indexation to a combination of some automatic indexation and some indexation contingent upon the funded status of the plan. Three plans that have gone in this direction are the Ontario Teachers’ Pension Plan, the Healthcare of Ontario Pension Plan, and the Colleges of Applied Arts and Technology Pension Plan. We’ve seen similar action taken by the large jointly sponsored public sector plans in British Columbia.

Most recently, the province of New Brunswick went through an extensive review of its pension plan system via its ‘Task Force on Protecting Pensions,’ in collaboration with a number of union leaders. The result is a new pension model based on a well-established Dutch model that incorporates a holistic risk management approach with greater flexibility in the benefit design (increased retirement age, conditional indexing, a shift to enhanced career-average earnings, and higher contributions). The new model is initially applicable to four public sector plans and one private sector plan.

What we would say is most notable about these examples is that they seem to be DB-leaning philosophically and fit more of a ‘managed DB’ model than a true target benefit model.

The Target Benefit Approach

Where traditional DB and DC plans have fundamentally failed is the one-sided nature of their risk allocation and their inability to adapt to changing times. With weak equity markets in recent years and continually declining interest rates, DB plan sponsors, who tend to shoulder the funding risk inherent in these plans, have been unable to invest their way out of their DB pension deficits. Meanwhile, DC plan members, who shoulder the risk to benefits inherent in these plans, have seen the value of their retirement nest egg struggle to grow and eroded by increasing longevity.

The target benefit approach leverages the best aspects of DB and DC while minimizing the main disadvantages of each. A Target Benefit pension plan has fixed contributions, a targeted defined benefit level, and a benefits/funding policy that prescribes the methods for varying benefits based on affordability, with pre-set reserve levels and a pre-determined order of benefit adjustments.
The key difference between TB and other sustainable approaches is that with TB contributions are set first – at a fixed level or within a fixed range – and benefits are based on affordability, with the ability to adjust benefits as experience develops. TB can be seen to operate more as a ‘pooled DC’ approach, rather than a DB approach, in terms of trying to fix its costs. Other elements key to the success of TB are the margins built into the cost-}

ing of the targeted benefit promise and the ongoing testing of the sustainability of the contribution/benefit combination.

TB is far from a new concept in Canada. Many of the principles on which TB plans are based have existed for years in the traditional multi-employer pension plan (MEPP). Furthermore, the UBC Staff Pension Plan is a perfect example of an existing situation where the target benefit approach has succeeded for decades. The plan administrators embraced the concept of sustainability testing almost 20 years ago, ensuring the plan maintained sufficient reserves in good times to deal with turbulent times and, most recently, introducing cost neutral changes to increase lifetime benefits while enhancing overall equity amongst members.

Another perfect example of where TB works is Resolute Forest Products. The Resolute interest in TB arose out of a company restructuring. The new company needed a more stable pension cost than that provided by its existing DB pension plans and, given the significant union presence, traditional DC wasn’t a viable option. The DB benefits, in effect prior to the adoption of TB, were kept in place and not converted to TB. Features of the TB design that contributed to its adoption included a fixed contribution going into the plan, maintenance of an adequate benefit level for current and new members, joint governance with half of the board of trustees comprised of plan member representatives, and a complete review of the investment policy to take into account the change in the nature of plan risks in moving from traditional DB to TB.

Some situations seem particularly ripe for TB. The ideal private sector situation might be one where the employer is suffering with poorly funded plan(s); hasn’t been able to invest its way out of its pension deficit; is contemplating getting out of DB; and has strong unions and/or a culture that limits the viability of a move to DC. TB also has great potential for public sector situations where the cost of the existing plan is becoming unsustainable for members and/or employers and intolerable for taxpayers; existing benefits have no levers for adjustment in adverse times; the scale permits effective risk pooling and cost efficiency; and human resources requirements, and the nature of the career path, mean there is a need for a compromise solution that involves something other than traditional DC.

Plan Feature

Thus far in Canada, TB is generally being promoted as a plan feature or concept, not necessarily as a new type of pension plan. This means that the TB approach can be adopted for qualifying single employer pension plans, multi-employer pension plans, and jointly sponsored pension plans, based on the regulations of the applicable pension jurisdiction. So far, several pension jurisdictions have committed to making TB possible. While four jurisdictions have enabled some form of target benefit plan (British Columbia, Ontario, New Brunswick, and Nova Scotia), only one, New Brunswick, has so far issued its regulations that will govern TB. We understand that Quebec is hoping to release something by the end of the year and the federal government is satisfied that its rules for negotiated contribution plans will be sufficient for TB.

Given that provincial legislation is not, as yet, treating TB as a completely new type of plan, it remains to be seen whether TB will need to have its own tax regulations or whether it will fit within the Income Tax Act’s DB or DC rules depending on the nature of the TB feature. Further, there is no doubt that employers undertaking a TB approach would want to treat their plan participation under the accounting rules applicable to DC pension plans.

So, what do we see as the key issues for the acceptance and growth of TB. First and foremost, there is the lack of uniformity of regulations across the country. As well, will they be allowed outside of collectively bargained situations and will they be treated as DC for tax reporting purposes. There is also the issue of ease of transition from existing traditional DB and DC to TB and the impact of pension accounting standards.

In Canada, we have taken two relatively simple tools, DB and DC design, and regulated them to death, but with little positive impact on actually delivering sustainable retirement systems. Sustainable pensions are essential for the prosperity of our country – especially in light of the general aging of the population. While it is time for change, we don’t necessarily need radical change. We actually have the tools in place, we just need to use them more effectively and permit more flexibility in their application.

Barry Gros is vice president for Aon Hewitt

Karen Hall is vice president, retirement, for Aon Hewitt.
Managing Human Capital In The Cloud

By: Chaayanath (MK) Mysore

Human capital management is garnering more and more attention among HR executives these days, especially when it comes to attracting and retaining talent in today’s competitive market. Rewarding and attracting good people is vital to the health of a company and in analyzing how to keep people, companies are placing a greater focus on hanging on to top talent. ‘Talent management’ is just one area where HR departments should be spending their time. Where they shouldn’t be spending their time is on tedious administrative or transactional tasks and piles of paperwork.

Increasingly, companies are coming to the conclusion that it is most effective for them to use an outside service provider for their HR, compensation, and benefits management needs rather than doing much of this in-house. In doing so, this gives back hours to the HR department and allows them to start managing their people instead of spending time handling administrative needs such as processing payroll and benefits.

To The Cloud?

Cloud computing is a new buzz word for a well-established model, but there is still a fair bit of confusion about what it is and whether it’s safe or not. Cloud computing has existed for decades, but went under the much-less-sexy name – Software-as-a-Service (SaaS). As the name suggests, this model had large amounts of data processed remotely, usually on a powerful mainframe or server array. So while the name may seem new, in truth, cloud computing has been around for a long time.

When it comes to cloud computing, it is important to understand that there are two models: public and private. A private cloud is a processing facility that is proprietary and owned by an organization and used exclusively for its own data. A public cloud represents an infrastructure hosted and managed by an external service provider, one that an end user customer pays for either as they use it or on an ongoing subscription basis. The benefit to an employer of using a public cloud is that they can effectively offload processes they were once doing manually in-house such as payroll and benefits, but without expensive IT resources managing applications or infrastructure.

For applications such as payroll or human capital management, a hybrid cloud environment is often the best approach. In this case, an employer would use a third party’s private cloud, including their proprietary applications. This offers the security of a private cloud environment with the cost savings of a public model. This is particularly effective for smaller employers who may not have large IT departments.

Regardless of the model, however, there is a strong trend in Canada of companies moving towards using cloud-based HCM services.

Why This Shift?

The prima facie benefit is cost. A recent Conference Board of Canada study revealed that cost containment remains one of the top short-term priorities for employers, with an increase of 41 per cent in 2009 to 50 per cent in 2012 who feel it is ‘very important.’ The average cost of providing benefits to active employees is 10 per cent of gross annual payroll, or just slightly more than $7,000 per full-time employee.

We often hear about the cost savings of cloud solutions, but it’s difficult to find hard numbers. A PricewaterhouseCoopers study completed earlier this year found that companies are able to reduce their total cost of ownership (TCO) of payroll and time and attendance by up to 43 per cent by automating processes with an outside service provider using a cloud-based business model.

Beyond basic cost savings, however, cloud computing also
AVRIO invested in BROOKSIDE FOODS in 2006 and the company was acquired by The Hershey Company (NYSE: HSY) in February 2012 for $175M. Over the course of the investment, total invested capital of approximately $7M generated an internal rate of return (IRR) of 54% representing approximately 7.5 times the original investment.

The award was accepted by Aki Georgacacos of Avrio Capital at the CVCA’s AGM Dinner in Toronto. “We’re thrilled to have been selected for this honour. We appreciate the CVCA’s support in highlighting innovative, best in class Canadian companies such as Brookside Foods Ltd. as Avrio continues to pursue its investment thesis based on the importance of innovation in food and agriculture in addressing global challenges related to health, wellness and sustainability. With the recent closing of Avrio II with $91.6M of total commitments, we are very actively looking for investment opportunities, and look forward to investing in the next Brookside story over the course of our next fund.”

Beginning in 2002, over 8 years and in 9 rounds, a group of angels and their institutional partners including BDC & NBIMC, invested approximately U.S. $42 million in aggregate in Q1 Labs. In October, 2011, Q1 Labs was sold to IBM. The investment generated an internal rate of return (IRR) of 32.8% and a multiple of 9.0 times original investment.

“This transaction generated one of the highest returns on investment ever obtained by BDC Venture Capital. It clearly demonstrates our ability to build successful technology companies. It also shows that very profitable exits are possible in the Canadian venture capital market,” said Tony Van Bommel, Managing Partner of the Energy/Cleantech Venture Capital Fund with BDC. “We are pleased to have contributed to the growth of a firm from Atlantic Canada and to have been there right from the start to support a team of entrepreneurs and managers as strong as those at Q1 Labs. At BDC Venture Capital, once again we see that Canadian companies can take their place among the best in the world, provided they get the support they need for their development. According to John Sinclair, President and CEO of NBIMC, “Q1 Labs is an excellent example of where New Brunswick based public sector pension funds, under our management, have been able to benefit from developing a world-class, knowledge based company with a significant employee base in our own backyard.”

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enables agility. Deploying applications such as payroll or HR management to a cloud environment is generally very quick compared with an internal deployment.

As well, cloud-based HCM solutions are inherently configurable and flexible. So companies are able to deploy a highly-customized, scalable system very quickly.

Leading cloud-based HCM solutions are also usually modular, meaning employers can add capabilities to their system as their needs change. For example, a smaller company may deploy payroll and time and attendance applications initially and, as they grow, they might add a recruiting module, a performance management piece, and, later on, a full HR management suite.

Complexity and focus are also key. If there is an option to shift high-complexity work to an expert, external provider, then HR departments are free to focus on innovation, strategy, and value. This flexible, customized, agile approach to human capital is key to enabling transformative change in a business.

Demystifying Barriers Of The Cloud

When you mention the cloud, people may picture their information floating in cyberspace which can seem risky and ambiguous. Recent articles in Canadian media have fed this thinking as cyber attacks have been on the rise so naturally organizations considering cloud computing have the right to feel skeptical.

In reality, cloud computing and security go hand-in-hand. A cloud model is often more secure than on-premise data storage since it has fewer points of vulnerability. A cloud computing facility managed by an experienced vendor can offer substantially greater security than an in-house data centre in large part because of the vendor’s ability to invest substantially more in the security apparatus that wraps around its service delivery.

That being said, security needs to be balanced with access and usability. A cloud service that is fully secure, but difficult to use or access, will also fail.

Companies considering a cloud-based HCM solution should begin by benchmarking the costs of their current processes, including the time staff spends on lower value tasks. Comparing these metrics against the cost of services from a reputable supplier should be the basis of a business case for cloud-based HCM. The piece, of course, is the renewed focus by HR professionals on those things that can’t be automated – strategy, innovation, and leadership.

Chaayanath Mysore is vice-president and chief information officer for ADP Canada, a provider of HR, payroll, and benefits solutions.

www.adp.ca
Increasing portfolio yield and stability amidst uncertainty and reinventing endowment models to meet obligations will be among the sessions at the ‘10th Annual Foundation, Endowment & Not For Profit Investment Summit.’ Other sessions will examine weathering volatility with diversification and risk management; implementing responsible and impact investing; and addressing inadequate returns using global tactical asset allocation. It takes place January 16 and 17 in Toronto, ON. For more information, visit www.foundationendowment.ca.

CPBI Ontario’s ‘8th Pension Investment Forecast’ will examine topics including macro-economics and global trends in institutional portfolio management. Paul Summerville, of the Centre for Global Studies at the University of Victoria, will present an up-to-date view on how the social, political, and economic forces will shape the world. Simon Hopkins, of Milltrust International Group, will share his findings about the investment strategies that pension plans from around the world are considering in light of current and anticipated market conditions. It takes place January 22 in Toronto, ON. For more information, visit www.cpbi-icra.ca.

The theme of the CPBI Ontario region’s ‘2013 Benefit Ball’ is ‘A Night at the Carnival.’ The event supports the Crohn’s & Colitis Foundation of Canada. It takes place February 7 in Toronto, ON. For more information, visit www.cpbi-icra.ca.

‘Global Challenges; Canadian Solutions’ is the theme for ‘CPBI FORUM 2013.’ Sessions include the ‘State of Global Markets’ with Donald G. M. Coxe, strategy advisor, BMO Financial Group, and chairman, Coxe Advisors LLP; and Leo de Bever, CEO, Alberta Investment Management Corporation (AIMCo). Keith Ambachtsheer, director of the Rotman International Centre for Pension Management (ICPM), and David P. Richardson, senior economist, TIAA-CREF Institute, will examine ‘How to Improve Canada’s Pension System.’ It takes place May 27 to 29 in Chicago, IL. For more information, visit www.cpbi-icra.ca.

The Association Of Canadian Pension Management (ACPM) has set the date for its 2013 national conference. The conference sessions will feature leading national and international pension experts and focus on the latest developments and solutions for the Canadian retirement income system. It takes place September 10 to 12 in Ottawa, ON. For more information, visit www.acpm-acarr.com.

The following was not available for the Money Managers annual directory in the September issue of Benefits and Pensions Monitor.


Burgundy is an independent discretionary global investment manager for pension funds, foundations, endowments, insurance companies, corporations and private individuals. The company's focus is high-quality companies that are undervalued and meet strict criteria through a fundamental research process.

Ken Jesudian, CEO of Burgundy Asset Management Ltd., is pleased to announce the following appointment:

John Gort, CA, CFA, to Vice President and Chief Financial Officer

John joined Burgundy in January 2012 as Controller, with responsibility over the operations of the Corporate Accounting and Fund Accounting departments. He has quickly made a significant contribution, becoming a valuable and highly respected member of the firm.

Before joining Burgundy, John spent six years at EdgeStone Capital Partners as CFO. He has also gained experience from his time as Director at BISYS Private Equity Services (New York) and his years as a Vice President with Deutsche Bank (New York and London).

John earned his BA in Accountancy from the University of Waterloo.
Many At Fault For DB Woes

Re: Editorial in June 2012 issue of Benefits and Pensions Monitor, ‘Central Banks Killing DB’

The true answer to what is killing DB plans is ‘all of the above,’ but central banks which may be ‘driving in the nails’ are not to blame. Wells Bentley in the ’60s and ’70s was in the business of promoting and regulating pension plans. It outlined that plan sponsors who essentially self-insured their pension plans did not have the size or requirements of the insurance industry selling annuities and thus had to be more conservative in their assumptions. Thus we saw long-term valuation interest rate assumptions less than the annuity market.

As investment returns increased, so did rates used to determine annuities and so did valuation interest rates. This reduced the cost of the DB pension and contributed to growth in surpluses. As investment returns decreased and as annuity interest rates decreased, the interest rates used in valuations did not follow and this is one of the reasons for higher volatility and growth in deficits.

Had these rates followed the trend downward, two things would have occurred – more money would have been paid into pension plans and benefit improvements that were granted may not have been put into place.

The question then becomes who is responsible for the fact little pressure was put on valuations to become more conservative. The actuaries should surely have led this, but they are only one element of the process.

In the late ’80s, two things occurred. The original view of the pension commission being both a regulator and a promoter of pension plans ceased and rather than the PCO challenge the designs and the valuations, the view became ‘let the plan sponsor decide with its investment manager, his auditor, and his actuary. So if long-term assumptions in the ongoing valuation were seven or eight per cent, we had best estimates in the 10 per cent plus range with liabilities spread over a much longer working lifetime.

The result was, along with great investment returns, that few looked down the road and what was hitting company books was not a significant issue waiting for the perfect storm to hit.

Essentially, the financial officer contacted the investment manager and said ‘do you think our returns will be about 10 per cent.’ The investment manager said that may be aggressive, but if your auditor and actuary accept it, then we are okay with that assumption. The same question was posed to the actuary and the actuary said, ‘it may be aggressive, but if your investment manager and your auditor are in agreement we will use it.’ The auditor, of course, answered in the same manner.

Since the accounting best estimate hit the books, and there was not a great deal of pressure to reduce it, why would anyone support or push to reduce the ongoing valuation rate. While it did not hit the books, it was cash and the pre-paid expense on the books was already growing. Where was the pension commission and Wells Bentley’s view? They were nowhere to be found.

So as interest rates dropped and as annuity interest rates dropped, we did not see the funding or expensing rates drop. As the tech bubble broke, as the recession hit in 2007, as baby boomers approached retirement (surprise), unfunded levels grew, volatility grew, and DB plans were a problem. This was known in the ’90s, but no-one wanted to address it until it hit the wall and then we decided the DB plan is the problem.

The problem is, like many, a variety of factors and professional groups did not want to address the situation that all knew or should have known was coming.

Who is at fault, we all contributed in some fashion.

Bob Tangey
Compensation, Pension and Benefit Director
The Woodbridge Group

PRPPs Limit Fiduciary Responsibility?

Re: Article in the September 2012 issue of Benefits and Pensions Monitor, ‘Coming of the PRPP: Death of the DC Superhero?’

Gimme a break, the PRPP rules add certainty that providers have fundamental fiduciary responsibility. This no doubt reduces some doubt about their role in DC arrangements. But do PRPPs really restrict employer fiduciary responsibility? I don’t think so.

In his article, Jean-Daniel Côté makes many great observations, but, like many others writing about PRPPs, he simply tosses off a line about his expectation that “employers will end up being off the hook’ as far as fiduciary liability is concerned. How is that possible?

Under PRPPs, employers will choose the providers. Employers also have the right to change providers. From a legal point of view, this imposes fiduciary obligations, especially if employees are required to participate. Under PRPPs, employers will still have full fiduciary responsibility for documenting and monitoring all fees and services and for making formal periodic determinations of reasonableness on an ongoing basis. This means they need to understand what is being provided and they must be able to make some assessment about its appropriateness. In other words, they...
have homework to do upfront and on a continuing basis to ensure the provider is providing the appropriate mix of services and cost – usually known as value. Even if the provider bears primary responsibility for communications, the employer will still have a role in monitoring the communications and keeping up to speed on best practices in order to fulfill that role.

I doubt all PRPP providers will simply provide the same barest of bare bones, low cost, retirement plans. In a competitive market, one might expect some differentiation of cost, services and value. It seems to be well understood that various services can enhance investment understanding and participation by plan members, not to mention retirement income outcomes. So there will be monitoring to be done and decisions to be made by employers.

It is foolhardy to think employers will escape fiduciary responsibility. The real conundrum for employers who embrace PRPPs will be how to handle the conflict of interest the government has baked into the legislation whenever an employer determines another provider may be more appropriate. Under the PRPP legislation, if an employer decides to switch providers, it must pay all the costs associated with the change.

There is only one way to get employers off the fiduciary hook. Let employees choose their own provider. Other countries have done that with broad based low-cost DC arrangements – India for one.

Randy Bauslaugh
National Practice Leader, Pensions and Employee Benefits
McCarthy Tétrault LLP

In the October issue of Benefits and Pensions Monitor, the article on page 20, ‘Liability-Driven Governance – A More Holistic Approach,’ by Heather Cooke, made a reference to a chart. However, the chart was unfortunately omitted from the article.

We apologize for any inconvenience this may have caused.

CORRECTION

Chart 1
History Of Average Yields

Source: CANSIM Series V122487 Statistics Canada

The CPBI Benefit Ball is a charity event for the pension, benefits & investment industries; donations go to the Cronin’s and Calitis Foundation of Canada.

For More Information & Tickets For The Event, Please Contact
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More Market Anomalies

By: Jim Helik

This month, we continue the discussion started in the October issue of Benefits and Pensions Monitor of recently examined equity market anomalies. Interestingly, the root cause of the following anomalies is the less-than-perfectly-rational humans who populate the financial world.

Some of the behavioural finance literature that seeks to ‘nudge’ people into making certain financial decisions that may go against their own judgment (such as enrolling in DC plans or diversifying their holdings within these plans) assumes that we financial professionals are free of any behavioural biases ourselves. It turns out that, at least in some cases, financial professionals exhibit behavioural biases that negatively impact their decisions.

‘They Sure Do’

From the paper ‘Do Sell-side Analysts Exhibit Escalation of Commitment?’, by John Beshears, at Stanford University, and Katherine Milkman, at the University of Pennsylvania, the short answer is ‘they sure do.’

The authors note that other research has shown that sell-side stock analysts show many behavioural biases, including overconfidence in their analyses and a tendency to make upwardly biased forecasts. Beshears and Milkman explore the possibility of another behaviour bias: that people become irrationally overcommitted to a previous course of action, especially when they have invested large amounts of time in making that decision. This is known as escalation bias. In the stock world, this translates into a sell-side analyst reaching a conclusion that may end up being very different from those of their peers. This difference will require more of a justification as to why the analyst came up with this position in the first place. Once they stake out this position, escalation bias will kick in, making them slow to change their minds, even in the face of new, contrary information.

The authors tested for this bias by looking at analyst estimates for quarterly earnings from 1990 to 2008. They found that when a company announced an earnings surprise that was substantially different from the consensus estimates, analysts who had made forecasts in the wrong direction were slower to update their forecasts for the next quarter than were analysts who were closer to the consensus. For example, Analyst A issues a forecast for $1 a share for the next quarter for a stock, while analyst B issues a forecast of 90 cents, which is also the consensus estimate. The company releases its earnings, and they come in at 85 cents. Analyst B would adjust their full year’s earnings by dropping their estimate by, say, three or four cents a share, whereas Analyst A, who was substantially wrong in the initial estimate, stuck stubbornly to the initial incorrect estimate. In this example, they would downgrade their full year estimate by one cent, if they even changed their forecasts at all. Such behaviour is obviously harmful to an analyst’s forecasting accuracy.

Perfect Rationality

In other cases, less than perfect rationality is imposed on some investors. Many investors, such as some pension funds and mutual funds, have limitations on the amount of leverage they can undertake. This can help explain a long noticed market anomaly: that low beta stocks (those that move less aggressively than the market as a whole) outperform, on a risk-adjusted basis, high beta stocks (those that move more extremely than the market as a whole). Standard economic models predict the opposite: that highly volatile stocks should produce a higher return, as investors seek that return to balance increased volatility.

A paper by Andrea Frazzini and Lasse Pedersen, both at AQR Capital Management, ‘Betting Against Beta,’ constructed sample portfolios across different time periods and countries. It shows that it is better to buy low beta stocks using leverage (if they can), than high beta stocks. They postulate that this anomaly is caused by those parties who are restricted in their use of leverage and, therefore, seek to increase their returns by buying high beta assets. This extraordinary buying drives down the prices of these high beta stocks, resulting in lower returns.

So it turns out that our efficient market has some gaps to it. These are useful ideas to keep in mind when our current love affair with bonds ends and we decide to wade into the equity markets once again.
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