Benefits and Pensions

The Canadian Magazine Of Employee Pension Fund Investment And Benefits Plan Management

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Annual Report & Directory

Managers of U.S. Assets for Canadian Plan Sponsors

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Supreme Court Rules On Indalex  pg 38
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Yours truly,

Robin Lacey
Vice Chair, TD Asset Management
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FEFPARY 2013

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Demographic Impact Overlooked

By: Joe Hornyak, Executive Editor

is the season for economic forecasts. At this time of the year, any organization involved in financial affairs brings their chief economist to town to share their thoughts on the next 12 months.

For the most part, these are informative sessions. However, the message seems to be the same. We suppose this is not unusual given that they are working from the same information, from the same backgrounds. It is inevitable that they arrive at the same conclusions.

What is puzzling is that there is nary a word about the impact of demographics on future economic growth. Certainly, some have cautioned about the impending labour shortages. How ever, we are still waiting to hear an economist who discusses aging Baby Boomers and future economic growth.

Some Rumblings

Maybe our lament is premature. We have started to hear some rumblings about this. A report from Manning & Napier, ‘Potential Macroeconomic Consequences of an Aging Population with Insufficient Savings,’ suggests the mass of Baby Boomers retiring and their potential lack of adequate savings will present challenges for the whole economy. Economic growth will be hindered as Boomers – notorious for their consumption – age and move out of their prime spending years. Since many have insufficient savings, face higher healthcare costs, and will live longer, the results could be a strain on government support programs.

Add into this that government support systems are already strained from the impact of quantitative easing to stave off a full blown recession/depression and you end up with an ugly picture. If these aging boomers retire without adequate savings, they are going to be counting on government to sustain them for 20 to 25 years. And this is potentially a lot of people, starting with the 60-plus per cent of Canadians who do not have an employer sponsored pension plan.

Does pension reform come to the rescue? Probably not. Other than the youngest of the Boomers, those born after 1955, most will not have enough time to save for retirement.

Fortunately, maybe, many of them will keep working for as long as they can for a whole host of reasons. For example, the Employee Benefit Research Institute ‘2012 Health Confidence Survey’ found many Americans want to keep working to maintain their employer benefits. Numerous other studies suggest the number who want to keep working into retirement is growing because, simply, they can’t afford to retire.

Healthcare Costs

Yet, this too is not without an economic impact. One report from the U.S. suggests changing workplace demographics are increasing the need for group disability insurance and related services such as absence management. Since many Baby Boomers are forced to delay retirement, they are inadvertently creating a workplace with higher likelihood of serious illness or injury, which can strain employer healthcare costs.

So aging Boomers will tax government support programs. Those that stay on the job may drive employer costs up as a result of the health problems associated with aging.

All of this must impact forecasts for future economic growth. So why aren’t we hearing about it?
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Aegon
Marc Goldfried is chief investment officer and head of fixed income at Aegon Capital Management Inc. He has more than 20 years of investment experience and, as senior vice-president and head of fixed income, currently oversees domestic and fixed income investments on behalf of its retail, institutional, and insurance clients. He joined the firm in 1999.

Canadian Urban
Charles S. McConnell is a member of the board of directors and investment committee at Canadian Urban Limited. He held a variety of positions with ATCO over the course of 29 years, culminating in his role as corporate treasurer. He also served as managing director in the establishment of its Portugal office and was responsible for ensuring its compliance with regulatory requirements and the development of local business relationships.

Mackenzie
Yvonne Davidson is vice-president, global client relations, at Mackenzie Institutional. Previously, she held a similar position at a Canadian-based global investment management company.

STRATA
Kris Kubin is a consultant at STRATA. He has an extensive background of almost 25 years in the group benefits industry, including experience and knowledge in renewal analysis, claims payment, administration, and business development.

Cira
Karen Seward is president of Cira Medical Services, a provider of independent medical evaluations, clinical risk management, prevention, and intervention services for a variety of industries across Canada. Most recently, she was executive vice-president, marketing and business development, at Morneau Shepell. In this position, she led and implemented high-growth strategies and ensured market leadership.

BMO GRS
Jad Chakour is director, enterprise business development, at BMO Group Retirement Services. In this role, he will be responsible for sales for BMO Group Retirement Services across internal BMO and other channels. He has been with BMO GRS for two years and has been responsible for its investment platform, new product development, and sales support.

Greystone
Jay Wiltshire is vice-president, business development, at Greystone Managed Investment Inc. In this role, he will deliver strategic marketing initiatives and identify development opportunities. He has gained extensive experience in management, business development, marketing, and servicing institutional clients over the past 25 years.

Mercer
Ted Singeris is Canada market leader within Mercer’s North America region. Since joining Mercer in 1986, he has held several leadership roles, including leader of its investment consulting business for Canada and Latin America, growth strategist and sales leader for its retirement risk and finance business in Canada and Latin America, and head of its Vancouver, BC, office.

Fiera
Peter Cuthbert is senior vice-president and partner at Fiera Properties Limited. He will initially be focused on the establishment of the new Fiera Properties CORE Fund and will serve as the fund manager. Prior to his appointment, he was the head of Canadian real estate for the investment management arm of a large multi-national life insurance company.

ISCEBS
Joan Bonkowski, of Manion Wilkins & Associates Ltd., is president of the Toronto chapter of the International Society of Certified Employee Benefit Specialists (ISCEBS). Joining her on the board are Kathy Bannon, of Sun Life Financial, as vice-president; Brenda Lock, of Standard Life Assurance Company of Canada, as treasurer; and David Wheelock, of Medavie Blue Cross, as secretary. This year, the Toronto chapter is entering its 19th year. The ISCEBS provides educational resources, innovative thinking, and collective wisdom to help members.

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Factor-biased Strategies Fail To Outperform

Constructing portfolios based on a single favourable characteristic or style can lead to the exclusion of a significant number of strongly performing stocks (in addition to capturing many underperformers), says Pyramis Global Advisors. Research in its ‘The Search for Consistent Returns: An Analysis of Style-Biased Strategies in Canada’ finds no factor-biased strategy consistently outperformed the others when examined through different market cycles. As well, constructing portfolios based on a single favourable style can lead to missed opportunities to invest in strong-performing stocks. The analysis suggests that an approach to portfolio construction based on more flexible and factor-agnostic security selection criteria offers the potential to generate relatively strong, and perhaps more consistent, risk-adjusted returns across varied market conditions.

Search For Yield Leads To ‘Maples’

The search for yield in 2013 may take investors to ‘maple bonds,’ says Richard Usher-Jones, vice-president of Canso Investment Counsel Ltd. Speaking at a Pembroke Private Wealth Management session, he said corporate bonds performed strongly last year, particularly ‘maple bonds.’ “We still see very good value in corporate bonds and, as a subset of corporate bonds, ‘maple bonds’ as well,” he said. Maple bonds are bonds issued by foreign entities on the Canadian bond market in Canadian dollars. These types of bonds are a good fixed income investment because they offer higher yields than their domestic counterparts.

Alternative Fees Falling

Asset management fees in alternatives have fallen due to supply and demand dynamics, says a report by Mercer. In particular, asset managers are under pressure to negotiate fees for hedge funds, direct private equity, and infrastructure funds. Its ‘2012 Global Asset Manager Fee Survey’ found given the plentiful supply of good quality active management, the level and structure of active fees has been remarkably resilient to a slowdown in demand. While the majority of managers left fees relatively unchanged, where fee reductions have occurred, the greatest falls have been in equity mandates.

NHL Players Get DB Plan

Part of the agreement which put National Hockey League players back on the ice was a new Defined Benefit pension plan. The 10-year collective bargaining agreement which ended a four-month lockout will see the establishment of a pension plan to be administered by a benefits committee comprised of three or four representatives of both the NHL and the players’ association. Players previously had two Defined Contribution plans – the National Hockey League Retirement Plan in the United States and the NHL Club Pension Plan and Trust in Canada. The DC plans were created during the last league lockout in 2005. They will be restructured into voluntary contribution plans and neither plan will be terminated.

AIMA Sets Up Regional Committees

AIMA Canada has established regional committees in Alberta and British Columbia. This follows the 2010 creation of a regional committee in Quebec and reflects the growth of the alternative investment industry across Canada and AIMA Canada’s growing national footprint. The leadership team of the Alberta committee will include Leslie Vickers, controller, Grafton Asset Management; and Basil D’Souza, director, Auspice Capital Advisors; as co-chairs. In British Columbia, the co-chairs are Jonathan Lotz, partner, Heenan Blaikie LLP; and Roland Wood, sales manager, Fiera Capital Corporation.

SRI Assets Continue To Climb

Socially responsible investment (SRI) assets in Canada continue to climb, showing growth in virtually every major market segment and outpacing the growth of total assets under management, says a report by the Social Investment Organization. ‘The Canadian SRI Review 2012’ shows that assets managed under sustainable and socially responsible guidelines in Canada grew by 16 per cent between June 30, 2010, (the effective date of the last report) and December 31, 2011. By comparison, total assets under management grew by nine per cent in the same time period. Total assets managed under SRI guidelines are $600.9 billion, up from $517.9 billion.

Manion Celebrates 40 Years

Manion Wilkins & Associates Ltd is celebrating its 40th anniversary as one of Canada’s foremost third-party administrators with a new look and a new website. It has simplified its name to Manion and is using the theme ‘We Care, You Benefit.’ With more than 100 employees, it continues to look for ways to create new and innovative benefit programs and solutions for its clients. “We will continue to work diligently to secure the best value and deliver the best service. To that end, we are now rolling out a series of client promises and setting new targets for ourselves,” says Mike Neheli, its president.
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Our global fixed income team strives to provide consistent, risk-adjusted excess returns.

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- International Equity
- Global Equity
- Asset Allocation
- Alternatives

Assets noted are as of June 30, 2012.
Investment professionals described include the combined resources of Pyramis and Fidelity Investments as of June 30, 2012.
Fixed Income assets include investment grade and high income products, bond sub-portfolios of multi-asset class strategies and money market cash management vehicles.
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**Investors Need Pension Risk Vigilance**

As structural deficits become a target in the Eurozone and beyond, it is fundamental to evaluate the extent to which the increasing funding needs and the decreasing funding basis of public pensions could add to public deficits, says a study by EDHEC-Risk Institute. It recommends that investors must be more vigilant on pensions risk when evaluating the solvency of sovereign issuers: European institutions should continue to work towards more transparency and information in the area of public finances, notably with regard to the data available and the modelling of public and private pensions liabilities; and ultimately, one should envisage the inclusion of explicit criteria on pension liabilities, in addition to the goals of the stability and growth pact and the budgetary pact. This inclusion would allow all stakeholders to better evaluate pensions risk and would favour the implementation of indispensable reforms. However, due to the variety of national systems, obtaining a clear view of pension liabilities is not straightforward.

**Baby Boomers Challenge Economy**

The mass of Baby Boomers retiring and their potential lack of adequate savings will present challenges for the whole economy, says a report from Manning & Napier. ‘Potential Macroeconomic Consequences of an Aging Population with Insufficient Savings’ says Baby Boomers, born between 1946 and 1964, began to reach their full retirement age of 66 in 2012 and the 65 and older group will double in size between 2010 and 2050. The economy’s growth will be hindered as Boomers, notorious for their consumption, age and move out of their prime spending years. Since many have insufficient savings, face higher healthcare costs, and will live longer, the results for the economy could include decreased output and productivity, as well as a strain on government support programs.

**Germany Likely Interventionist**

Germany is likely to be interventionist as opposed to secessionist in terms of the European Common Market (ECM), says Stephen Way, senior vice-president and portfolio manager at AGF Investments Inc. Speaking at its ‘2013 Market Outlook,’ he said this is because it is a major exporter and the ECM common currency is below the value of what a standalone Germany’s currency would be. A higher valued currency would make it less competitive when it comes to exports. As well, the average German sees the result of the reunification of Germany on every pay cheque as it has cost the country trillions of dollars. They would be opposed to any economic repercussions that might result from dissolution of the ECM.

‘The Progress of Balance Sheet Repair’ that western economies will be dealing with the aftermath of the debt crisis bubble for this decade and the one to follow. The recovery starts with businesses and individuals trying to reduce their debt loads, followed by governments taking similar action. However, the government debt also includes the funds put into the economy to avoid recessions. Developed economy governments hate recession so they increase spending, but they need to borrow to finance this spending. The U.S. is further ahead on this balance sheet recovery and is well on its way to full recovery. The UK private sector is making some progress, albeit minimal.

**BlackRock Buys Credit Suisse ETF Business**

BlackRock will purchase Credit Suisse’s exchange traded-funds business, adding $17.6 billion in assets under management across 58 funds to the iShares ETF range. The transaction will bring BlackRock’s total ETF assets under management in Europe, the Middle East, and Africa to about $158 billion. It says one of the reasons for the acquisition is that it does not currently have a product in Switzerland, a key European market for potential growth in ETFs. Credit Suisse’s range of funds is dominated by ETFs investing in equities, fixed income, and gold.

**Employers Spend More On DC**

Private industry employers in the U.S. now spend more per employee hour worked for Defined Contribution retirement plans than for Defined Benefit retirement plans, say Bureau of Labor statistics. It found private industry employer costs for DC plans in March were 60 cents per employee hour worked, compared to 43 cents for DB plans. Employer costs for DB plans were highest for natural resource, construction, and maintenance employees ($1.10), and the cost for union workers ($2) is approximately seven times higher than the cost for non-union workers (26 cents). Employers with 500 or more workers have DB costs (99 cents) that are approximately four times higher than the DB cost for employers that have one to 99 employees (23 cents).
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.

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www.piacweb.org
Nine-to-five Headaches And Migraines
By: Caroline Tapp-McDougall

Whether it’s because of the environment or the stress and responsibilities, many jobs or workplaces are blamed for triggering or worsening headaches and migraines. While many employers see headaches as minor health conditions that do not require accommodation or prolonged absenteeism, headaches and migraines can actually be more detrimental than you might think.

A whopping 59 per cent of Canadians have reported some type of headache. They are most commonly experienced by those between the ages of 25 and 39 – the working age. A 2010/2011 survey also highlighted that 12 per cent of female workers and four per cent of male workers have reported getting annoying migraines. There are an estimated two million Canadian sufferers.

Headaches
In fact, the World Health Organization has ranked headaches as one of the 10 most disabling conditions affecting people. And research shows that the number of workdays lost due to headaches is three times higher than days lost due to migraines.

The most common types of headaches are:
- Tension-type headaches which are usually described as a feeling of pressure or squeezing around both sides of the head that often spreads down to the neck.
- Cluster headaches aren’t very common. However, they are very severe, with knife-like one-sided head pain being experienced, often around the eye. These short attacks, which usually last between 15 minutes and three hours, start without warning, and occur one or more times each day. Men are five times more likely to suffer from cluster headaches, with first attacks usually occurring between 20 to 40 years of age.
- Headaches due to environmental toxins can occur when workers are exposed to chemicals or scents in the workplace. The cause seems to be related to pain-sensitive blood vessels of the head that dilate during exposure. These headaches are throbbing and diffuse and get worse with activity.
- Chronic daily headaches are not an official diagnosis, but a convenient description for headaches that occur 15 or more times a month for over three months. A fairly ordinary type of headache, they affect approximately one in 20 people, more often women than men.
- A neurological condition that results in episodic attacks, migraines can stem from many different sources such as allergies, asthma, arthritis, rheumatism, hypertension, and depression. They are usually accompanied by sensitivity to light and sound, dizziness, and nausea or vomiting, and are often exacerbated by physical activity or movement. Almost eight per cent of Canadians are afflicted, usually those between the ages of 25 and 39, with 75 per cent of sufferers being women.

Many headache and migraine sufferers are fearful for their employment when they have no other option but to call in sick or leave early. Setting up a place where employees can discuss the problem in an open environment can help negate feelings of isolation and open the gateway to effective communication with employers and co-workers.

Effects On Workplace
Many sufferers will struggle through a headache or migraine to stay at work and get the job done. But if a headache occurs at work and isn’t relieved right away, it can impede daily work, leading to reduced productivity and absenteeism. Helping your employees prevent headaches or migraines by making reasonable adjustments to the environment, or at least treating them to reduce their impact, can significantly reduce the blow these conditions will have on your company’s bottom line.
Up to 36% of your annual drug spend is waste

For many companies, that’s a tough pill to swallow

Research from Express Scripts, a Fortune 25 company, has repeatedly demonstrated that better care and zero waste often go hand-in-hand. In other words, the most effective care often costs the least. Sadly, private plans in Canada waste more than $5 billion in drug spend per year by paying for higher-cost maintenance medications that generate no additional health benefits.

The challenge is to reduce waste in a way that benefits both a company and its employees.

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1. 2012 Express Scripts Canada Research
2. Express Scripts Canada 2011 Drug Trend Report
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Canadian employers may not be aware of the growing use of drug manufacturer programs that offer reimbursement of an employee’s coinsurance, deductible, and/or co-pay for prescription drugs. This article will help employers understand these programs in Canada, the cost implications, and potential issues surrounding these payments and outline options to manage them.

Coupons and other programs to ensure brand loyalty are not new to consumers. In fact, manufacturer programs to allow employees to receive 100 per cent reimbursement for contact lenses have been available through online providers for several years. What is new is that this practice is now in use for drug sales. There are several variations of these programs, but, generally speaking, a drug manufacturer reimbursement program is a mechanism by which a drug manufacturer reduces or eliminates an employee’s coinsurance, deductible, or co-pay for a prescription drug and/or reimburses the difference in price between a brand and a generic drug. These payments are typically provided in one of two ways:

- A drug savings card that is presented by a patient to a pharmacist at the time of dispensing. The pharmacist electronically directs the plan member’s coinsurance, deductible, or co-pay and/or the difference in price between a brand and a generic drug to a pharmaceutical manufacturer.
- Information is submitted by the patient to the pharmaceutical manufacturer for a refund of the coinsurance, deductible, or co-pay.

Savings Cards

Savings cards for brand-name medicine prescription are available to Canadians for use at participating pharmacies. To use these cards, individuals must receive one from their physician or pharmacist or register to receive one through a drug manufacturer or a website such as www.rxhelp.ca. Patients will receive a card that can be used to fill an eligible brand-name prescription at a participating pharmacy. According to the rxhelp.ca website, its card is accepted at most pharmacies in Canada. Because these cards work through a secondary claims adjudication process, plan sponsors and their claims adjudication providers are likely unaware that the plan member was reimbursed for their out-of-pocket expense by the drug manufacturer.

Many drug manufacturers of biologic drugs provide refund programs for employees who may have difficulty paying their...
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out-of-pocket expense. For example, if an employee requires a drug that costs $50,000 annually and their employer plan reimburses 80 per cent of that cost, the employee would have to pay $10,000 out-of-pocket. Most manufacturers of high-cost drugs recognize that this cost may prevent patient access to the drug, so they provide reimbursement assistance. Although drug manufacturers do not publish details of these programs, it is known that assistance can be provided to those that meet income level and financial hardship eligibility requirements.

**Cost Implications**

Drug savings card programs could present significant cost implications to employer-sponsored drug benefit programs as they may direct purchasers to higher cost drugs. This could result in increased cost to the employer drug plan. A recent study in the U.S. identifies that these cards could raise prescription drug costs by $32 billion in the U.S. over the next decade. These cards could influence physicians and patients to choose higher cost drugs when less expensive chemically or therapeutically equivalent alternatives exist.

In this example, an employer plan pays 80 per cent and the employee pays 20 per cent for a heartburn drug. The physician may choose to prescribe the brand drug with no substitutions in order to reduce patient cost instead of prescribing the generic alternative or the therapeutic alternative.

In **Chart 1**, the cost to the plan sponsor would be $161.84 for the brand name drug instead of $100.30 for the generic alternative drug or $50.98 for the therapeutic alternative drug. The plan member has a real financial incentive to use the brand with a drug savings card.

It is important to understand that drug savings cards subsidize the patient’s share of the cost, but not necessarily the overall cost. For plans with premium sharing, savings may come at the expense of the employer drug plan and other employees by increasing benefit costs for everyone resulting in higher premiums.

In addition to the cost implications, there are other elements that plan sponsors should be aware of:

- **Transparency** – Drug savings card programs are largely invisible to plan sponsors and their providers because they occur after the adjudication of the prescription. There is no easy way to detect transactions because pharmacists submit claims for the patient’s out-of-pocket amounts directly to the pharmaceutical manufacturer as a secondary transaction.
- **Privacy** – Participants are often required to submit confidential personal information to drug manufacturers in order to use the cards. Manufacturers can collect and store patient data to help them determine who, how, and where these programs are being successfully marketed. In addition, these coupons may facilitate access for direct-to-consumer advertising of prescription drugs.
- **Co-ordination of Benefit (COB)** – Insurer contracts and industry guidelines typically prevent claimants from being reimbursed more than 100 per cent of the out-of-pocket cost, but programs from the pharmaceutical manufacturers have not traditionally been recognized by insurance companies as a source of reimbursement. This may give employees the opportunity to collect the reimbursement from the drug manufacturer while, at the same time, submitting their receipts to their spouse’s insurance plan through COB. This could allow plan members to receive more than 100 per cent reimbursement.
- **Out-of-pocket maximums** – Many plans have out-of-pocket maximum provisions that allow 100 per cent reimbursement once the employee has incurred a specific dollar amount out-of-pocket. Employees may reach the out-of-pocket threshold and receive 100 per cent from the employer plan without having paid anything.
- **Consumerism** – Under this concept, plan sponsors offer programs with coinsurance with the objective of engaging plan members and encouraging educated and responsible purchasing behaviour, including choosing less costly generic or therapeutic alternatives, without adversely affecting medical treatment. Being aware of the full cost and having a stake in the cost of drugs encourages appropriate use and reduces waste. If plan members have no cost, the benefit of consumerism is lost.

There are number of options sponsors can consider.

**Generic Equivalent**

They can redesign the plan to reimburse only the generic equivalent when one exists or lowest cost alternative regardless of whether or not the physician indicates ‘no substitution.’

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**Chart 1**

<table>
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Another option is to consider reimbursing generic drugs at a higher coinsurance than all other drugs. This potentially puts generic drugs on par with manufacturer coupons and offers little or no cost to the employee when they take a generic drug.

Talking to your insurance provider about enhancing communications and co-ordination of benefits procedures can lead to requirements that plan members disclose all sources of reimbursement. They should know that receiving reimbursement from pharmaceutical companies without disclosing these payments is not within the intent of the plan design.

Consider asking your insurer to introduce prior authorization for higher cost drugs and introduce a step therapy process that selects the initial drug based on cost effectiveness and clinical effectiveness. The Canadian Agency for Drugs and Technologies in Health, an independent body, has identified initial biologic drug therapies for rheumatoid arthritis based on cost and effectiveness. If these therapies prove ineffective, the claimant is eligible to change to a more expensive drug.

**Cost Implications**

Plan members need to be educated about the cost implications of drug savings cards on the overall cost of benefits and premiums. An informed employee is the best defense against escalating costs. Educating employees to talk to their physicians about the implications of these cards on premiums can help to create awareness in the medical community.

Manufacturer programs have been around for years and are available for many consumer products. Not only can they be found for traditional retail products, but also for health-related products such as contact lenses and medical equipment such as blood sugar monitoring devices. But drug savings cards for prescriptions drugs are a fairly new phenomenon and growth in their use should be monitored.

There may situations where these programs enable patient access to drugs they need to be healthy and at work. Reimbursement from a drug manufacturer may also improve compliance with essential, but high-cost, medications that an employee could not otherwise afford. Such programs, however, should be transparent to the plan sponsors and insurers who administer the plans.

Plan sponsors need to consider their plan’s purpose, their position on these programs, and introduce plan management features that mitigate all risks and cost escalation. In the end, the health of plan members and the sustainability of the employer sponsored benefit plan need to be thoughtfully considered.

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**Francois Joseph Poirier**

is a partner, H&B market business leader for Central Canada, and executive sponsor of the pharmacy team at Mercer.

francois-joseph.poirier@mercer.com

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1. Visante Report ‘How Copay Coupons Could Raise Prescription Drug Costs By $32 Billion Over the Next Decade’ prepared for Pharmaceutical Care Management Association
InVESTORS IN U.S. EQUITIES MAY BE EXCUSED IF THEY ENTERED 2013 FEELING SOMEWHAT TORN.


BAD NEWS

ON THE OTHER HAND, INVESTORS DID NOT HAVE TO LOOK VERY HARD FOR BAD NEWS. IT RANGED FROM TEPID U.S. GROWTH TO HIGH DOMESTIC UNEMPLOYMENT AND FROM THE EUROPEAN CRISIS TO A SLOWDOWN IN CHINA. MOREOVER, CORPORATE EARNINGS GROWTH IS DECELERATING, CASTING PALLOR OVER STOCK PROSPECTS.

“EVERY TIME I READ THE PAPER, IT’S ALWAYS ANOTHER NEGATIVE PIECE OF NEWS,” SAYS JOHN LINEHAN, T. ROWE PRICE’S DIRECTOR OF U.S. EQUITY. “THERE’S BEEN THIS HUGE DICHOTOMY BETWEEN MARKET PERFORMANCE AND MARKET SENTIMENT.

“The market climbed a very steep wall of worry last year, but it is well-poised to climb it again this year.”

FOR 2013, LINEHAN SEES A CONTINUATION OF THIS “TUG OF WAR BETWEEN THE MARKET’S SIGNIFICANT HEADWINDS AND ITS SIGNIFICANT TAILWINDS.”

AMONG THE TAILWINDS ARE THE EXTRAORDINARILY ACCOMMODATIVE STANCE BY CENTRAL BANKS AROUND THE WORLD, GREEN SHOOTS OF RECOVERY IN THE U.S. LABOUR AND HOUSING MARKETS, DE-LEVERAGED CONSUMER AND CORPORATE BALANCE SHEETS, IMPROVED CORPORATE FUNDAMENTALS, AND THE POTENTIAL END TO (AND ULTIMATE REVERSAL OF) THE MASSIVE CASH OUTFLOWS FROM STOCKS TO BONDS.


DESPITE THIS CONTINUING STRUGGLE BETWEEN THE MICRO POSITIVE AND THE MACRO NEGATIVES, LINEHAN SEES THE POSITIVES PREVAILING FOR U.S. STOCK PRICES, PRIMARILY BECAUSE OF ATTRACTIVE VALUATIONS.


“ONE OF THE REASONS THAT VALUATIONS ARE SO LOW IS THAT MARKETS ARE VERY EFFECTIVE AT DISCOUNTING BAD NEWS AND RIGHT NOW...”
current valuations reflect a great deal of bad news in the future,” he says. “If we don’t get that bad news, it then will be very positive for equities.”

**Upcoming Economic And Policy Issues**

However, in the coming weeks and months, a number of economic and policy issues could determine the course of U.S. equity markets:

► The continued recession in Europe could have negative consequences for U.S. markets. European demand has declined, and this could continue to pressure earnings for U.S. businesses. However, U.S. companies have done a good job preparing for the possibility of further pressures in the Eurozone.

► China appears to have managed a soft landing, with recent manufacturing and growth rates showing signs of rebounding. Whether this trend continues could affect global market performance. Even so, opportunities persist in many of the emerging markets that feature strong consumer demand from a growing middle class – particularly in some smaller emerging markets where weakening Chinese demand has less impact.

► While there has been decisive monetary action on behalf of various central banks, U.S. economic policy remains in flux. Though the U.S. passed a continuation of most tax cuts in January, there still are major spending and budget decisions on the table.

► The ‘Great Recession’ began with the housing market, so improvements in the sector should bode well for consumer spending.

► The buildup of corporate cash reflects current uncertainty about growth and investment opportunities. Increased spending would suggest improved business opportunities.

**Durable Growth**

Still, no matter what happens in the near term, the U.S. and world economies likely are going to grow slowly over the next couple years, notes Joe Milano, a U.S. large- and mid-cap growth portfolio manager at T. Rowe Price.

As a result, he is looking for “secular growth” stocks instead of cyclical growth stocks – companies with high levels of stable or recurring revenues that have the potential to grow even in a slowing earnings-growth environment because of innovation, better management, or the ability to take market share.
“My vision is to buy great companies that can grow in any environment,” he says, citing two examples, neither of which could be considered flashy, but both of which are growing off of solid bases by serving clients in new ways.

The first company sells industrial nuts and bolts, as well as supplies for non-residential construction sites such as welding supplies, safety glasses, and gloves. It has pioneered on-site vending machines that distribute and track such supplies to each worker, which pays off in greater productivity and less theft. “Within 10 years, their vending machine business could be bigger than the entire company is now,” Milano says.

The second company is a big player in the medical waste business, a company that picks up those red bags of hazardous waste from medical facilities. While the firm has steady recurring revenue from its long-term client relationships, it has branched out into new services such as managing medical offices’ patient communications. “Now they’re upselling,” he says.

Neither stock is cheap, “but when the economy gets tougher, investors shouldn’t buy lower quality stocks – buy the best.”

Sudhir Nanda agrees. The firm’s director of quantitative equity research sees a “muted, steady-Eddie environment” without big valuation disparities among stocks. That tells him that “high-quality” stocks – stocks with the metrics showing high recurring revenues, high free cash flows, and high return on equity – should do well. In late 2012, these sorts of stocks already began to show evidence of some outperformance, he says.

“There’s not going to be a sharp upshift in the economy this year, so it’s likely going to be an environment in which the quality companies will rise relative to others, a stock-picker’s environment,” Nanda says.

Opportunities

Overall, managers of T. Rowe Price’s asset allocation portfolios entered 2013 with a strong tilt toward large-cap stocks over small caps and a less pronounced tilt toward growth stocks over value plays.

Within that, Linehan sees a wide range of opportunities, among the following investment themes:

- U.S. and internationally-based companies with exposure to the explosive growth in emerging market consumers
- Derivative plays on the nascent housing recovery, such as regional banks
- Companies with growing dividend payments (versus high dividend yield stocks, whose valuations have become expensive)
- Providers of new treatments in healthcare.
- Companies with exposure to mobile and cloud computing
- Compelling ‘sum-of-the-parts’ valuations in energy, in which certain firms are trading significantly below their breakup values
- Not particularly prominent within that list are companies within 2012’s top S&P 500 sector, financials.

Financials did well in 2012 because, first, they started the year with very cheap valuations, says Eric Veiel, a financial services portfolio manager at T. Rowe Price. The sector had singularly underperformed the market for each of the prior five consecutive years.

Second, he says, “While there’re still a lot of problems in financials, a lot of things stopped getting worse for the sector last year. So these companies started bottoming and the market reacted positively.”

For 2013, Veiel believes that the sector’s returns may keep up with or exceed that of the overall market, but not notably so, unless the low-interest rate environment significantly improves. Low rates have muted returns for banks and other financial institutions.

As for small-cap stocks, Greg McCrickard, a U.S. small-cap portfolio manager at T. Rowe Price, notes that the asset class does best coming out of recessions when economic growth has been negative. That will not likely be the case in 2013’s muted-but-positive growth environment, he says.

Moreover, he says, while small-cap valuations relative to large caps have fallen some, they’re still higher than large caps and the long-term trend is for them to be even with or at a small discount to large caps.

“Even if we solve our other problems, we’re still looking at a fairly slow economic recovery,” McCrickard says, “and that implies relatively middling performance for small caps. Until we get valuations at a discount to large caps, it’s going to be a challenge to outperform the S&P 500.”

Bruce Winch, vice-president and director, institutional sales, T. Rowe Price (Canada), shares the views of T. Rowe Price Equity Managers.
The ocean gets warmer. The Peruvian anchovy harvest suffers. It raises the price of fishmeal, cattle feed, and beef.

**We turn global insights like these into powerful investment strategies**

for a university endowment. The endowment funds the work of a brilliant marine biologist. She studies the Peruvian anchovy. Proving small fish can lead to big insights. Invested in the world.
### MANAGERS OF U.S. ASSETS FOR CANADIAN PLAN SPONSORS

**Statistics**

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All assets reported in $C million as of September 30, 2012, unless noted otherwise.


AVIVA INVESTORS Doug MacDonald, President; 121 King St. W., Ste. 1400, Toronto, ON M5H 3T9 PH: 416-360-2766 eMail: doug.macdonald@avivainvestors.com Web: www.avivainvestors.com Managed U.S. Since: 2000 Other Assets Managed: Fixed Income (Stable Value, US High Yield, Global High Yield, Core Aggregate, EMD, Private Fixed Income, Canadian Core, Canadian Core Plus), Equities, Small Cap Value, SMID Cap Value, Dividend All Cap Value, Independent Value, Long-Short, Real Estate, (REMM, Global REITs), LDI, Fixed Income Macro, Private Equity


BRANDES INVESTMENT PARTNERS Michael Parsons, Director, Institutional Group; 20 Bay St., Ste. 400, Toronto, ON M5J 2N8 PH: 416-306-5633 Fax: 416-306-5750 eMail: michael.parsons@brandes.com Web: www.brandes.com

BROOKFIELD ASSET MANAGEMENT INC. Eric Bonnor, Senior Vice-president, Private Funds Group; Angela Vidakovich, Director, Brookfield Investment Management; 181 Bay St., Box 762,
MANAGERS OF U.S. ASSETS FOR CANADIAN PLAN SPONSORS
ANNUAL REPORT & DIRECTORY

Toronto, ON M5J 2T3 PH: 416-956-5152 Fax: 416-365-9642 eMail: eric.bonnor@brookfield.com, angela.vidakovich@brookfield.com Web: www.brookfield.com Managed U.S. Since: 1989 Other Assets Managed: Real Estate (Core Plus, Value Add, Opportunistic), Infrastructure, Timber, Mezzanine Debt, Restructuring, Core, Fixed Income, Mortgage-backed Securities, High Yield Corporates, REITs


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GE Asset Management Canada

GE ASSET MANAGEMENT INCORPORATED Keith Smith, President, GE Asset Management Canada; 2300 Meadowvale Blvd., Mississauga, ON L5V 6E9 PH: 905-858-6663 Fax: 905-858-5218 eMail: keith.smith@corporate.ge.com Web: www.ge.com Managed U.S. Since: 1988 Other Assets Managed: International (EAFE), Emerging Markets, Global, Europe, China, Canadian; Private Equity; Real Estate; Fixed Income


GOLDMAN SACHS ASSET MANAGEMENT, LP Craig Russell, Managing Director, Head of the Americas Institutional Business; 200 West St., New York, NY 10282 PH: 212-902-1000 Fax: 212-428-3150 Web: www.gs.com

GREYSTONE MANAGED INVESTMENTS INC. Louis R. Martel, Managing Director & Chief Client Strategist; 300 Park Centre, 1230 Blackfoot Dr., Regina, SK S4S 7G4 PH: 800-213-4286 Fax: 306-585-1570 eMail: louis.martel@greystone.ca Web: www.greystone.ca Managed U.S. Since: 1988 Other Assets Managed: Fixed Income, Mortgages, Real Estate, Canadian Equity, Non-North American Equity

GUARDIAN CAPITAL LP Robert Brolay, Senior Vice-president; Commerce Court W., Ste. 3100, Toronto, ON M5L 1E8 PH: 416-947-4086 Fax: 416-364-9634 eMail: rbrolay@guardiancapital.com Web: www.guardiancapitallp.com Managed U.S. For: 10 years Other Assets Managed: EAFE, Emerging Markets GPS, Global, Global GPS


HILLSDALE INVESTMENT MANAGEMENT INC. Allan Hutton, Vice-president, Institutional Investment Services; 100 Wellington St. W., Ste. 2100, Toronto, ON M5K 1J3 PH: 416-913-3600 Fax: 416-913-3901 eMail: ahutton@hillsdaleinv.com Web: www.hillsdaleinv.com


JANUS CAPITAL GROUP INC. Susan Oh, Senior Vice-president, Head of Janus Capital Institutional; 151 Detroit St., Denver, CO 80206 PH: 800-227-0486
MANAGERS OF U.S. ASSETS FOR CANADIAN PLAN SPONSORS

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LEG MASON GLOBAL ASSET MANAGEMENT


LINCLUDEN INVESTMENT MANAGEMENT Wayne Wilson, Vice-president; 1275 North Service Rd W., Ste. 607, Oakville, ON L6M 3G4 PH: 905-825-3543 Fax: 905-825-9525 eMail: wayne.wilson@lincluden.net Web: www.lincluden.net Managed U.S. Since: 1982 Other Assets Managed: Canadian, US, EAFE, Global Equities, Canadian Bonds of varying mandates including Universe, Short Duration, Long Duration, Liability Matching, Real Return Bonds


LOUISBOURG INVESTMENTS INC. Luc Gaudet, CEO; 770 Main St., 10th Floor, Moncton, NB E1C 8L1 PH: 506-853-5410 Fax: 506-853-5457 eMail: luc.gaudet@louisbourg.net Web: www.louisbourg.net Managed U.S. For: 11 years Other Assets Managed: Canadian, EAFE, Emerging Markets


MANULIFE ASSET MANAGEMENT Adam Neal, Head of Canadian Sales & Relationship Management; 200 Bloor St. E., Toronto, ON M4W 1E5 PH: 416-852-7498 Fax: 416-926-5700 eMail: adam.neal@manulife.com Web: www.manulifefamily.com Managed U.S. Since: Late 1800s Passive Products: US Equities, Canadian Equities, DEX Universe Bonds Other Assets Managed: Canadian Equity, Global Equity, EAFE, International & Regional (e.g. Hong Kong, China, Japan, Taiwan) Equity, Domestic & Foreign Fixed Income (including Money Market & Mortgages), Emerging Markets, Balanced, Alternative (including Real Estate, Timber, Agriculture, Oil & Gas)

MFS McLEAN BUDDEN Christine Girvan, Managing Director, Sales, Canada; 77 King St. W., 35th Floor, Toronto, ON M5H 1J8 PH: 416-361-7273 Fax: 416-862-0167 eMail: cgirvan@mfsmb.com Web: www.mcleanbudden.com or www.mfs.com Managed U.S. Since: 1924 Other Assets Managed: EAFE, Emerging Markets, Global Equity, Single Country Regional, Bonds, Multi-asset, etc.

MONTRUSCO BOLTIN INVESTMENTS INC. Karl Gauvin, Vice-president, Corporate Development; 1510 McGill College, Montreal, QC H3B 3M8 PH: 514-282-2451 Fax: 514-282-2550 eMail: gauvin@montruscobolton.com Web: www.montruscobolton.com Managed U.S. Since: 1985 Other Assets Managed: Canadian Equity, EAFE, MSCI World


ONE FINANCIAL CORPORATION Paul McKenna, Senior Vice-president; Ste. 1600, 200 King St. W., Toronto, ON M5H 3T4 PH: 416-860-8720 Fax: 416-360-8947 eMail: pmckenna@onefinancial.com Web: www.onefinancial.com


PHILLIPS, HAGER & NORTH INVESTMENT MANAGEMENT* John Skeans, Vice-president; #2010-200 Burrard St., Vancouver, BC V6C 3N5 PH: 604-408-6000 Fax: 604-685-5712 eMail: data@phn.com Web: www.phn.com Relationships: The firm may, to some degree, work with RBC GAM subsidiaries (e.g. RBC GAM US for US Equities & BlueBay for US Bonds) in managing US assets on behalf of Canadian pension assets. Managed U.S. For: 48 years Other Assets Managed: Canadian Cash Management, Canadian Fixed Income, High Yield Bonds, Canadian Equities (GARP, Value, Core), EAFE Equities & Bonds, Derivative Overlay, Alternatives

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UBS GLOBAL ASSET MANAGEMENT David Coyle, Director; 161 Bay St., Ste. 4000, Toronto, ON M5J 2S1 PH: 416-681-5100 Fax: 416-681-5100 eMail: david.coyle@ubs.com Web: www.ubs.com Managed U.S. Since: 1981 Other Assets Managed: Global, EAFE & Regional Equity, Global & Regional Fixed Income, Emerging Markets Equity & Debt, Real Estate, Infrastructure, Hedge Funds


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A Comparison of Volatility Management Techniques

By: Michael Augustine

The last several years of capital market volatility have redefined risk appetites across the institutional investor landscape. Many institutional investors, ranging from public disability plans and property casualty insurers to pension plans and life insurance companies, have either proactively implemented programs to de-risk their portfolios relative to their liabilities or are actively engaged in discussions about how to do so.

In its December 2012 ‘Financial System Review,’ the Bank of Canada highlighted two types of Canadian institutional investors that are actively reducing their asset liability mismatches due to a lowered tolerance for volatility – life insurers and pension funds. While each is driven by different priorities, it is interesting to compare and contrast the two, as the liabilities each seeks to invest against are similar. While a pension plan, for many reasons, need not operate as conservatively as a life insurer, plan sponsors seeking progressive solutions to help them better manage their plans’ volatility can incorporate some of the tools of these liability driven investment pioneers.

Risk Budget

Life insurance companies operate within a holistic risk management framework, with board approved earnings-at-risk tolerance policies and volatility budgets. Insurance companies that avoid surprises by adhering to these risk budgets are rewarded with higher credit ratings, more favourable borrowing terms, and stronger equity valuations. Firms managing Defined Benefit pension plans can similarly benefit by creating a risk budget. However, when doing so, they need to be sure to consider the portfolio as a whole. Plan sponsors must remember that incremental degrees of precision with respect to any one part of their portfolio may be expensive, create a false sense of security, and add very little to mitigating the plan’s overall volatility.

The first step in creating a comprehensive risk budget is to determine how much plan volatility the sponsor can tolerate, which is generally articulated as a maximum contribution level or one-year funded status shortfall. Plan sponsors can loosely think of the risk budget as the number of ‘units of volatility’ they are comfortable being exposed to. Portfolio construction then becomes about deciding how to best allocate these ‘units of volatility’ to different asset classes so as to maximize the portfolio’s expected outcomes. The key for the plan sponsor is to strike the right balance between short-term downside risk avoidance and long-term upside return potential.

Investment Strategy Spectrum

Traditional pension plans and life insurers have the same broadly defined common goal: ensuring their asset portfolios can sufficiently meet their long-duration liability obligations. However, their priorities differ. Life insurers tend to place a high priority on minimizing short-term earnings volatility. Pension plans primarily focus on maximizing long-term expected returns. These differences drive each to opposite ends of the investment strategy spectrum and result in very different portfolio construction processes.

For example, Canadian insurers are required to perform periodic tests to ensure that the expected cash flows from their investment portfolios will sufficiently meet their expected liability obligations. To the extent that the insurers are not perfectly cash flow matched, they are exposed to costly reinvestment and/or disinvestment risk. In addition, regulators require insurers to hold additional capital (surplus assets) to ensure the company can remain solvent in future, potentially stressful environments.

To mitigate these risks, life insurers generally adopt strict cash flow matching (or slightly less onerous key-rate duration matching) strategies composed of fixed income or liability-hedging assets only. Because return-seeking assets, such as equities, do not have liability cash flow matching properties and attract significant additional regulatory capital requirements, they are generally excluded from a life insurer’s asset mix.

On the other hand, asset-only focused pension plans generally construct portfolios using long-run expected returns and risk premium assumptions, typically allocating 60 per cent of the portfolio to market cap-weighted equities and 40 per cent to DEX Universe bonds.

Since insurance companies operate within smaller risk budgets, portfolios are constructed with prudence and conservatism. As a result, this low tolerance for volatility may be passed along in their product pricing. According to a third quarter of 2012 Canadian Institute of Actuaries survey of actual insurer quotes for a retiree group, the three most competitive annuity quotes averaged a yield of 2.86 per cent. This represented a 64 basis points spread over risk-free gov-
ernment of Canada bond yields, roughly the same amount of credit compensation a plan sponsor would have expected to earn from a conservative portfolio of Canadian provincial bonds.

For pension plans with very limited risk budgets, purchasing a buy-out annuity may provide the comfort level a particularly risk averse plan sponsor is looking for, in spite of the expense and the potential need to crystallize past losses.

However, for most pension plans, moving from an asset-only framework all the way across the risk spectrum to the life-insurer framework is too much of a change and, perhaps, even sub-optimal as it would require the pension plan to shed all of its return seeking assets. What is becoming increasingly clear is that a prudent approach is one that falls somewhere between the ultra-low risk tolerance insurance company portfolio and the typical highly volatile, market sensitive pension plan portfolio. Striking the right balance by creating a customized volatility risk budget and maximizing that budget through the use of progressive solutions is the key.

Progressive Solutions

Progressive solutions don’t simply replace equities with bonds or extend the duration of an existing bond portfolio. Rather, they seek to maximize expected outcomes relative to a set of liabilities while operating within a customized volatility risk budget. Thus, the risk budget is the starting point to constructing a customized progressive solution. Once the risk budget has been created, plans can choose from a number of solutions to help them achieve their goals, including active fixed income management, synths, and low volatility equities.

Carefully managed credit portfolios are the hallmark of a life insurer’s risk mitigation strategy. The insurer allocates almost all of its ‘units of volatility’ to actively managed credit and, absent a market-based benchmark, manages its credit portfolio directly to the liability cash flows, reducing volatility while maximizing expected returns. Much like the insurer, a pension fund should look for a seasoned active fixed income manager with a good track record of adding value. The manager will construct and manage the liability hedging assets so that the credit component itself can be viewed as an additional source of returns. The credit allocation can be diverse and may include global bonds, emerging market debt, and high yield and inflation linked bonds. This sort of customized active management could be further tailored to suit plan diversification, sector limit, and quality constraint guidelines.

Acknowledging the often un-investible nature of the obligations they seek to hedge, many plans recognize the need to introduce leverage into their portfolios. Using synthetic strategies, such as bond overlays, can enhance their liability hedging portfolios (similar to an insurance company’s use of interest rate swaps). An overlay strategy provides a plan with additional exposure to bonds and lowers interest rate volatility relative to plan liabilities. By optimizing the liability hedging portfolio, more ‘units of volatility’ can be allocated to the return-seeking assets.

Within the return-seeking asset part of the portfolio, low volatility equity investments are a popular progressive solution. Traditional benchmarks include stocks based on their market value or capitalization, without regard to volatility, correlation, or other risk factors. Contrast this with an equity benchmark that includes stocks based on their level of risk (volatility). That’s the essence of a progressive equity solution. Investing in a portfolio of low volatility equities can produce market-like returns with up to 30 per cent less risk, allowing plan sponsors to maximize their risk budgets without sacrificing the upside potential of equity market exposure.

De-risking Continues

As Canadian pension plan sponsors continue to focus on de-risking and better managing volatility, they can look to the risk budgeting, key-rate duration matching, active credit, and synthetic interest rate risk management tools used by their institutional investment counterparts. Plan sponsors who stretch their risk budget dollars by embracing progressive solutions will be rewarded with customized portfolios that meet their unique needs and priorities. They will also gain the peace of mind that comes from knowing their strategies are in line with leading-edge institutional investment best practices.
Disconnecting The Disconnect Of Transitioning To A Comfortable Retirement

By: Jennifer Gregory

Pension plan members require more information, educational services, and support to guide them through the final stages of retirement planning. But plan sponsors and members often have different perceptions and expectations of pre-retirement approach and retirement. What members may want and need during these critical years is quite different from what sponsors are prepared to provide or are in a position to offer.

Reconciling these differences may be mutually beneficial to both parties. This is one of the conclusions of two 2012 surveys on attitudes toward workplace retirement plans commissioned by Standard Life. One, ‘Retirement Transition Needs,’ is a survey of plan sponsors (employers) and members (employees) conducted by Crunch Research & Insights. The other, ‘SME Opportunities’ is a three-part survey conducted by Environics Research Group. It measures the outlook and attitudes of employers and employees of small and medium-sized enterprises, in addition to those of insurance advisors, Investment Industry Regulatory Association of Canada (IIROC) brokers, and Mutual Fund Dealers’ Association of Canada (MFDA) planners.

These surveys indicate that as employees near retirement, they want personalized information about their objectives and options and the associated risks. Survey results also show that employees benefit when their employers and pension plan service providers develop strong relationships. Employers may gain competitive advantages when these relationships are strengthened as well.

“The pension industry must examine several issues with regard to pre- and post-retirement counselling services in order to move forward,” says Christine van Staden, regional vice-president (Ontario), Standard Life. “For example, are the interests of plan members compatible or reconcilable with those of plan sponsors? Can sponsors offer or facilitate access to professional support while managing financial and fiduciary risks? Are automatic investment solutions the best way to serve members approaching retirement?”

For many employees, the years immediately prior to retirement are the most critical. Almost seven out of 10 employees (69 per cent) want information about their options at least three years before retirement and 32 per cent of them want it more than five years before retirement.

Competitive Benefits

Some of the more interesting survey findings relate to human resource planning, especially employee hiring, retention, and
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turnover. These issues are of major concern to employers. About retention, 62 per cent say it is a challenge and 20 per cent consider it to be a very significant challenge. But few employers connect these concerns to a lack of competitive benefits, such as workplace retirement plans. They fail to realize that benefits are a significant factor in their efforts to attract and retain employees.

Both prospective and existing employees say workplace retirement plans are important when evaluating job opportunities. These benefits become increasingly important as individuals age and their careers progress. In terms of job selection criteria, individuals seeking employment rank workplace retirement plans third in overall importance (at 89 per cent), behind salary and group insurance plans. When given the choice, employees prefer contributions to workplace retirement plans over yearly bonuses or extra vacation days. Only pay raises are more important to them (see Chart 1).

Employers, on the other hand, overemphasize the importance of pay raises and yearly bonuses to employees. They also downplay the value of contributions to workplace plans. As a tool for attracting and retaining workers, employers rank these benefits seventh, not third as do potential employees.

**Best Option**

As employees or plan members approach retirement, they begin to explore different options to estimate their after-tax revenue. But they need help to determine the best option. Four-fifths (83 per cent) of employees say it is important to have a formal written retirement plan. While 93 per cent of employers or plan sponsors agree, only 30 per cent of employees have one.

Generally speaking, there is a disconnect between what employees say they want in terms of transition services and what employers are prepared to deliver. Employees know they need support and say they want both employers and service providers to offer it. They also think service providers should take a more active role. Most employees (79 per cent) would like to meet with a retirement planner to facilitate both pre- and post-retirement planning. But many employers are reluctant to help with this process, especially if they have to pay for it. Yet, 75 per cent of them would assist pre-retirees with information and counselling services if no additional financial costs were incurred. Almost half (47 per cent) of employers believe their companies would be more competitive if they offered transition services to pre-retirees.

“These findings indicate the pension industry must examine the concerns of plan sponsors and review the role of service providers in order to develop counselling services that optimize results for pre-retirees,” says van Staden. “Sponsors must decide if they want to support employees in transition. If the answer is
'yes,' they can put a decumulation regime in place or they can let their service provider play a larger role. If the answer is ‘no,’ they must clearly define until what stage they will be involved and what services they will offer to employees.”

Employers offering pre-retirement counselling services try to engage employees. But experience shows it is hard to get employees to act. This is one of the biggest challenges facing the pension industry and is of increasing concern to service providers interested in optimizing member outcomes.

**Prepared To Engage**

Surveys indicate that some of the best outcomes occur when employers work closely with service providers to engage members in pre- and post-retirement counselling. The surveys indicate employers are prepared to engage with service providers by sharing a list of pre-retirees planning to retire in the next two years and facilitating one-on-one meetings between employees and service providers. Some employers would also consider adopting a ‘must-have’ discussion policy for all pre-retirees.

Plan members want personalized advice and guidance to address their financial and psycho-social needs, such as investment allocations after they stop working (82 per cent) and the emotional adjustments they need to make upon retirement (49 per cent). Many think service providers are best positioned to offer this support. When offered multiple service delivery choices, half of all employees (see Chart 2) say they want one-on-one planning sessions in the workplace (50 per cent) or outside the workplace (49 per cent). About a third also chose group seminars in the workplace (37 per cent) and online education modules (33 per cent).

There are a variety of tactics that can be used to engage employees. These include so-called ‘retirement days’ or group information sessions at the workplace followed by one-on-one meetings with employees, often to prepare a printed retirement plan. As well, online information sessions, such as training modules and webinars, can be provided. These services are necessary because many employees remain confused about their options at retirement. Most employers or plan sponsors (85 per cent) are aware that employees can switch to a service provider group plan after retirement, but employees wonder whether they can remain with their plan sponsor, switch to a plan offered by a service provider, such as Standard Life, or transfer assets to a bank or other financial institution.

This uncertainty confirms that employers, employees, and service providers can benefit if, as the surveys indicate, they attempt to find common ground. Plan sponsors and service providers should develop strong relationships to improve member outcomes.

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The last few years have seen a flurry of activity in the realm of pension reform. Aside from the federal pooled registered pension plan, Quebec’s voluntary supplemental pension plan, and the changes to the Saskatchewan Pension Plan and Canada Pension Plan, provincial legislatures are wrestling with new forms of plan designs such as target benefit pension and jointly sponsored pension plans. The stated goal of governments is to increase pension coverage, mainly in the private sector where millions of Canadians have nothing better than an RRSP to count on in terms of tax-assisted retirement plans. Some have argued that the pension coverage crisis extends to more than 3.5 million Canadians.

Ironically, if the goal of reformists is to ensure the provision of an adequate tax-assisted solution for individuals not covered by broadly-based employer-sponsored pension plans, it would seem that the media and many commentators have simply overlooked a solution that has been available since 1991 – the individual pension plan. This article will review some of the often forgotten characteristics of the individual pension plan, its strengths and weaknesses, and how, if properly structured, this particular vehicle could provide a partial solution to the pension coverage problem.

Growth In Check

Owner-operators have been allowed to save through an individual pension plan or IPP since the last major round of pension tax reform in 1990/91. While statistics on the numbers of plans in operation aren’t always up-to-date, it would appear that at least 15,000 currently exist in Canada. While all of the major banks and insurers offer IPPs as part of their comprehensive market offerings, the complexity of the product, and the popularity (and simplicity) of its cousin – the registered retirement savings plan (RRSP) – appears to have kept its growth in check. Advocates of the RRSP point out that the IPP is more costly to administer, that funds in an IPP are locked-in by pension rules, and that the investment rules are more restrictive. All of these criticism are valid. That said, as this article will demonstrate, the true potential of a well-designed IPP has not yet been truly realized on a large scale in the Canadian marketplace.

The IPP is now defined under federal tax rules as a Defined Benefit plan for less than four individuals. Being a registered pension plan, it must also be registered by the applicable pension authorities – for example, in Ontario by FSCO (the Financial Services Commission of Ontario.) Because it offers a defined benefit, the services of an actuary are required to determine the appropriate level of contributions. A DB plan, like an IPP, can also allow for the purchase of past service with an employer. Individuals who have owned and operated a corporation for a number of years can, if they can point to a history of employment income, have their corporation make a sometimes substantial tax-deductible contribution to fund the purchase of past service. While recent amendments to the income
tax regulations have made this deduction somewhat less substantial in certain circumstances, the ‘past service buy back’ is still alive and well. Many IPPs were marketed with that single feature in mind – to fund a generous pension with corporate income that would have otherwise been taxed inside of the corporation. In reality, the past service buy back is only one of many advantages that only an IPP can offer.

Perhaps the greatest feature of any IPP is the fact that the pension it promises can be delivered in retirement so long as the corporate sponsor has the financial wherewithal to make the necessary contributions. While risk cannot be pooled over a group of individuals with different life expectancies and ages as is the case with traditional registered pension plans, there is a measure of risk sharing between the employee and the IPP’s sponsor. As such, monies in non-registered accounts can be lent to the IPP sponsor who can then turn around and make the necessary contributions to ensure a fully-funded pension benefit. In effect, the IPP allows the ‘registration’ of additional funds above and beyond existing tax limits found in RRSPs. Most RRSPs and Defined Contribution plans are not designed to ensure that the contributor will have a fixed amount of pension in retirement.

**Key Advantage**

The other key advantage of the IPP over the RRSP is the ability to tax shelter a greater amount of corporate wealth without incurring additional market risk. In 2012, a 55-year-old business owner could put approximately $30,770 from his corporate employer into an IPP as a normal cost contribution. If a deficit exists in the IPP because of investment returns below the prescribed 7.5 per cent, additional special payments could augment this base contribution to approximately $33,000. Given that the RRSP limit for 2012 was capped at $22,970, this amounts to an additional $10,000 of income that is contributed in a tax effective manner. If we assume a corporate tax rate of 15.5 per cent, the owner-operator will now have both a tax refund of $1,550 and an extra $10,000 in his pension fund.

All pension plan and pension fund administrative and investment fees are also tax-deductible within the context of an IPP, something that few, if any RRSPs can do. The payment of fees by the corporate sponsor, instead of out of the pension assets, has two impacts. It allows for true compounding of invested assets since no fees are withdrawn and it means that the fees are paid with pre-tax income. Over time, this fiscal advantage can be considerable. By way of illustration, imagine an RRSP with $100,000 invested in a variety of investment options where the average management expense ratio is one per cent. Each year, in the best case scenario, a minimum of $1,000 is removed from the account. If we assume a conservative investment in GICs yielding two per cent per annum simple interest, the net growth of the account after a year will be of $980 ($2,000 interest minus $1,020 in fees). By way of comparison, in the IPP, the fees ($1,020) are paid by the corporate sponsor and deducted from the sponsor’s corporate income. At the same corporate tax rate of 15.5 per cent, the true cost of the fees amounts to $861.90. But more importantly, the account will now have $102,000 at the start of the second year, instead of $98,980 ($100,000 minus $1,020). Thus, the IPP member has increased his net worth by $3,178.10 (due to higher account balance and lower effective fees).

Seen another way, this client has generated an internal risk-free rate of return of 9.6 per cent ($3,178.10/$33,000), above and beyond what he might have tax-sheltered in his RRSP. The rate of return is risk-free because market risk does not form part of the value creation process, in this case, since it is assumed that the underlying investments in both the base case RRSP account and IPP accounts are identical. Where the investment manager of the IPP generates an alpha, the alpha would be added to the 9.6 per cent, in the above illustration, to create the total gross returns available to the plan.

**Core Drawbacks**

While the fiscal advantages of the IPP are undeniable, there are some drawbacks. Some of the core drawbacks are that the product is complex and highly regulated since both the Canada Revenue Agency and the Financial Services Commission of Ontario have an interest in ensuring that all legal requirements are being followed. Ultimately, it is the plan’s sponsor that typically undertakes to administer the IPP and it is that entity that is held to account in the final analysis. While service providers and consultants will prepare regulatory forms and reports, issues of compliance end up on the door step of the plan administrator/employer.

Another drawback is the fact that, unlike in RRSPs, IPP mandatory contributions are typically locked-in by pension legislation and cannot be withdrawn prior to retirement age (with some minor exceptions). Entrepreneurs with uncertain cash flows may not wish to adopt a strategy that works well when business is vibrant, but imposes an unbearable drain on scarce cash flows when it dries up.

Some also take issue with the fact that IPP monies must be invested in accordance with a statement of investment policies and procedures subject to the federal investment rules set out in Schedule III to the Pension Benefits Standards Regulations, 1985. One particular rule, colloquially known as the ‘10 per cent rule,’ prevents a plan administrator from using more than 10 per cent of the book value of the pension fund to purchase any one security. RRSPs are not constrained by these quantitative restrictions and are thus better suited for sophisticated investors who are willing to take large speculative market positions.

Where a business owner derives salary income from an active business, he or she would be well-advised to consider setting up an IPP instead of continuing to save for retirement through an RRSP. The ability to create a risk-free rate of return through the superior tax-sheltering rules available to all registered pension plans is an important competitive advantage, especially in times of market uncertainty. The ability to make up for bad investment choices through tax-deductible special payments also offers a way of ensuring that sufficient funds will be available for retirement.

Jean-Pierre Laporte
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Supreme Court Overturns Indalex

By: Mark Newton

The financial community breathed a collective sigh of relief following the release of the Supreme Court of Canada decision in the landmark pension/insolvency case of ‘Sun Indalex, LLC v. United Steelworkers, 2013 SCC 6.’ The court reversed the decision of the Ontario Court of Appeal and ruled in favour of Sun Indalex. However, because the decision was split three ways, the exact implications of the case are unfortunately far from clear.

The case revolves around events from 2009 when Indalex Limited (a Canadian company) and its U.S. parent sought protection from their creditors under the federal Companies Creditors Arrangement Act (CCAA) and Chapter 11 of the U.S. Bankruptcy Code respectively. The court authorized a loan to Indalex (Canada) under a debtor-in-possession (DIP) credit agreement and gave the lenders a super-priority charge on Indalex property, in priority to “all other security interests, trusts, liens, charges, and encumbrances, statutory, or otherwise.” Its U.S. parent guaranteed the loan.

Later that year, the court approved a sale of Indalex assets on a going-concern basis. The proceeds of the sale resulted in a shortfall, with the result that Indalex (U.S.) made a payment to the DIP lender to honour the terms of the guarantee. From the sale proceeds, the court retained $6.75 million in reserve which equaled the sum of the deficiencies in the two pension plans that Indalex sponsored. The Indalex Salaried Plan had been wound up in 2006 and had an outstanding wind-up deficit; its executive plan had not yet been wound up, but was also in a deficit position.

Questions For The Court

The questions the court faced were:

- whether the deemed trust in pension legislation applied to the wind-up deficiency in the salaried plan
- if there were a statutory deemed trust, whether that trust would take priority over the DIP charge
- whether Indalex had fiduciary duties toward the plan members during the insolvency proceedings
- whether this would be an appropriate case for the court to use its equitable discretion to impose a constructive trust on the assets in order to remedy any fiduciary breaches by Indalex.

So, was there a deemed trust? Maybe! While the decision was five to two in favour of Indalex, only three of the five justices held that the deemed trust provisions in the Ontario Pension Benefits Act (PBA) do not apply to wind-up deficiencies. The other two in the majority held that the deemed trust does extend to wind-up deficiencies. The difference in opinion revolved around the meaning of “accrued to the date of the wind-up, but not yet due” in Section 57(4) of the PBA and other connected provisions in Section 75.

More specifically, Section 57(4) provides for a deemed trust in the event of a pension plan wind-up, equal to the amount of employer contributions accrued to the date of the wind-up, but not yet due to be paid. In Ontario, wind-up liabilities are determined actuarially as of the date of the wind-up and any outstanding wind-up deficiencies must be paid off over no more than five years following the date of wind-up.

Three of the five justices in the majority held that the deemed trust excludes wind-up liabilities as of the wind-up date because “to the date of the wind-up” means up to, but not including, the wind-up date. It sets out the legislative history in support of this position. In addition, the actual amount of the liability can be quite variable in the five years following wind-up. Essentially, the wind-up liability is not determinable until quite some time following wind-up.

The other two on the majority, plus the two writing the dissenting judgment, held that there was a deemed trust, based on the view that “to the date of the wind-up” includes the wind-up date. As a result, four of the seven justices held that the deemed trust under Section 57(4) applies to wind-up deficiencies.

If there is a deemed trust, does it take priority in insolvency? All seven justices held that the DIP super-priority under the federal CCAA prevailed, by virtue of the doctrine of paramountcy of federal legislation over provincial.

Then there is the question of whether Indalex had fiduciary duties toward the plan members during insolvency proceedings.

Clearly, Indalex had two roles and two sets of responsibilities. As an employer, it had a fiduciary duty to the company to act in its best interests. As a plan administrator, it had a fiduciary duty to act in the best interests of plan members. The PBA itself recognizes the dual roles of employers.

Conflicts of interest are inherent in an employer’s assumption of plan administrator responsibilities. According to the court, a conflict arises when there is a substantial risk that the employer’s fiduciary duties to the plan members would be materially compromised by virtue of the employer’s duties to the company.
The initial decision to seek CCAA protection is generally not one in which such a conflict will arise. That decision is often done on the basis of urgent life support of the company and often such applications are made without notice to any other parties. Even if Indalex had handed over plan administration to the third-party, there would have been no duty to give notice to the administrator.

True Conflict
The true conflict of interest did not arise until Indalex sought approval for the DIP financing because that would have had a direct impact on the plan members’ rights to recover in the event of financial failure. Indalex failed to take steps to address the conflict. The appropriate action would have been to bring the conflict to the attention of the CCAA judge, who would be well-equipped to make the appropriate orders to ensure that the plan members’ interests were adequately protected. Accordingly, the view of seven of the justices was that Indalex breached its fiduciary duties to the plan members.

Now the question is was the imposition of a constructive trust the appropriate remedy?

According to five of the seven justices, it was not. The imposition of a constructive trust is an equitable remedy that a court can use in order to bring fairness to a situation in which a wrong has clearly been done and which resulted in financial detriment to another party. However, there was no evidence in this case that the plan members would have acted any differently had they received proper notice of the order for the DIP loan. The CCAA judge was clear that there was no alternative to the DIP loan that allowed for the sale of assets on a going-concern basis.

Plus, in order for the constructive trust remedy to be used, there must be a particular property that is directly related to, or that can be traced from, the wrong that was perpetrated. That was not the case in this instance. The breach of fiduciary duties did not result in assets being in its hands. The issue the court had to decide on was the disposition of the funds held in reserve arising from the sale of the Indalex assets. The breach of fiduciary duties did not give rise to those funds so the constructive trust remedy in favour of the plan members could not be granted.

Welcome Relief
The court’s decision is welcome relief for lenders and borrowers alike, given that it is now clearly established that the rights of secured lenders under the CCAA trump those of provincial deemed trusts under pension legislation. The shadow lurking in the background in this case is that four of the seven justices concurred that the deemed trust under Section 57(4) of the PBA extends to wind-up deficiencies. This will likely continue to be a problematic factor in financing transactions.

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All Canadian institutional investors favour better corporate governance and many work hard to engage corporations and improve governance. Sometimes the benefits of these laudable efforts are hard to measure. But when corporate controls fail, it is easier to quantify how Canadian funds have been negatively affected. The cost to Canadian investors – whether the events giving rise to a loss occurred in the United States, Canada, or elsewhere – can be very significant. Many institutional investors’ portfolios have suffered large losses as a direct result, among other things, of false financial reports and the failure of corporate officers to live up to their fiduciary responsibilities.

**Primary Tool**

The primary tool for investors to redress corporate fraud has been securities class action litigation. In the United States, securities class action litigation has resulted in the recovery of tens of billions of dollars for investors. For example, this September a settlement was announced in a securities class action case against the Bank of America for $2.425 billion. Moreover, besides such U.S. litigation, similar securities litigation is on the rise elsewhere in the world. This increase has been particularly notable in Canada where, among other things, there has been litigation related to alleged fraud by Canadian-listed Chinese companies such as Sino-Forest. As a recent U.S. Supreme Court case, ‘Morrison V. National Australia Bank,’ held that U.S. securities laws do not apply to purchases on a foreign stock exchange except in limited circumstances, we can expect this trend to continue.

On the other end of the spectrum, monitoring isn’t applicable for those Canadian funds that hold only pooled assets. Most other Canadian pension funds either have not considered portfolio monitoring or believe their time should be focused on other matters.

Securities litigation typically takes many years, but for most institutional investors there are two specific times when it may be prudent to track or monitor what is happening. The first is at the outset when a case is initially filed and the second is at the end when the case settles. A quick review of the securities litigation process should explain why many investors appreciate information regarding newly-filed and newly-settled cases.

**Securities Litigation Process**

Securities class actions are collective legal actions to recover damages suffered by investors who paid inflated prices for securities due to a company’s misrepresentations or omissions. In the U.S. and Canada, investors are generally covered by a class action unless they ‘opt out’ (although some Canadian provinces require non-residents to ‘opt in’) and pursue their own action.
Under U.S. and Canadian securities laws, securities class action lawsuits are brought on behalf of those shareholders of a company who purchased during a specified period, the so-called ‘class period.’ The theory is that investors who purchased stock during this period did so at ‘an artificially inflated price’ because its market price was based on false and misleading financial data or other representations disseminated by the company during the class period. All investors who purchased stock during the class period may initiate or participate in the class action, except if they sold out their stock before the truth was disclosed (meaning the company finally reveals the true financial data or other information that was false) or if they sold their stock during the period for a profit.

In 1995, the U.S. Congress adopted the Private Securities Litigation Reform Act (PSLRA) with the objective of having those investors with the largest losses control securities litigation. To this end, the PSLRA established a time line for all cases which provides institutional investors an opportunity to decide if they want to participate. Specifically, the required publication of a notice that a case has been filed must be published after a U.S. federal securities case is filed. This starts a 60-day window for all investors. Before this window expires, any investor who wishes to assume the role of lead plaintiff must move for appointment as lead plaintiff. Typically, all such motions are filed on the 60th day. Sometimes, two or more investors will file a lead plaintiff motion together as a group depending on the size of their individual losses. The court then selects the lead plaintiff(s), which are presumptively the plaintiff or group of plaintiffs with the largest financial loss, bearing in mind that measuring the ‘largest’ financial interests may depend on how one calculates the loss.

As one can readily see, with this timeline set, it is almost a necessity for an institutional investor to have its portfolio monitored so that it is in a position to act if, and when, it desires to have a role. The securities litigation process varies among Canadian provinces, but investors contemplating litigation in Canada also need to have data on how they are affected as quickly as possible when cases are filed so that they can consider their options.

The second critical time for most investors is when it is announced that a case has settled. When there is a settlement, a proof of claim must be filed with the settlement administrator on the investor’s behalf by the deadline or the investor will forfeit any money it would receive under the settlement. Likewise, if an investor desires to opt out and pursue its own action, it must notify the court in a timely manner.

Portfolio Monitoring

Portfolio monitoring provides investors with data as to how they have been affected by alleged corporate fraud. Monitoring can provide this information in a timely manner and automatically. Assuming electronic access to trading data is available, law firms and others can provide institutional investors with data regarding their transactions in newly-filed and newly-settled cases.

Institutional investors, assuming they don’t want to undertake the task themselves, have two options for portfolio monitoring. One option is to hire a third-party claims advisory service and the other option is to engage an external securities litigation counsel.

Leading law firms in the securities litigation practice area have monitoring services which they typically provide at no cost to develop good will with the plan. As such services are free, some public pension plans have more than one law firm monitor their portfolio.

Three matters should be stressed regarding portfolio monitoring.

First, a portfolio monitoring program is easy to introduce. Besides a simple agreement where the law firm agrees to provide these services confidentially and at no cost, the only other required step by a pension fund is to send a letter to its custodian authorizing the law firm to access its transactions electronically. Once in place, well-designed monitoring reports should only take a few minutes to review, thus portfolio monitoring shouldn’t be a drain on staff time or resources.

Second, portfolio monitoring provides data promptly and automatically, which at times can be very valuable. As more and more Canadian pension funds are concerned with corporate governance, monitoring provides critical information very quickly as to how the pension fund has been affected after a corporate scandal hits. Not only can this data be disseminated to trustees and others as deemed appropriate, but the fund is in a much better position to consider its options whether it be in the area of governance or litigation.

Likewise, as the amounts recovered from securities class action cases are often very significant, receiving monitoring reports regarding settled cases can be helpful. Custodians presumably are doing a very good job for Canadian pension funds submitting their claim forms in a timely manner. Nevertheless, as fiduciaries, many pension fund administrators find it helpful to see a legal analysis of new cases and guidance regarding available options if the pension fund has significant losses. While many pension funds don’t expect to get involved in litigation on a regular basis, an unusual situation develops it is important to already have counsel on hand. However, the monitoring agreement should clearly provide that the pension fund should not be obligated to get involved in any litigation a law firm might recommend. Similarly, a fund should be reluctant to accept a provision requiring the fund to employ the monitor if the fund desires to pursue litigation.

Considering Litigation

Canadian institutional investors are in a somewhat unique position. Most have very significant investments in the U.S. which has a history of successful securities litigation and they should be
receiving an ongoing stream of funds from settlements in U.S. class action cases. At the same time, these investors have larger investments in Canada where shareholder litigation is historically less common, but is nevertheless growing.

Thus monitoring securities litigation developments is important not only in the U.S., but in Canada as well. Likewise, with respect to their legal options, many Canadian funds may find legal guidance is appropriate, in respect of both their U.S. and Canadian securities holdings. Moreover, because of situations involving dual listed stocks, Canadian investors may or may not have the option of accessing U.S. courts to recover their loss. Thus monitoring programs that provide guidance and recommendations from Canadian counsel, as well as U.S. counsel, may best serve the needs of many Canadian pension plans.

As noted above, occasionally a pension fund will be asked by their monitoring counsel to consider being a lead plaintiff in a legal action. It is also important to note that just because the fund has a large loss on a certain security does not mean that a legal claim will be available, nor that counsel will recommend the pension fund file a lead plaintiff motion. Counsel may not believe the case is particularly strong or may be aware of other funds with significantly larger losses that are likely to step forward.

If the fund selects monitoring counsel that are selective and understand their objectives, then the fund should rightfully expect few matters will be brought to its attention.

**Lead Plaintiff**

Occasionally whether the matter is in the U.S. or Canada, counsel may suggest that a fund consider joining with another fund to file a lead plaintiff motion. As one would suspect, this is done primarily to increase the chance of the group being selected. However, as with corporate governance, some pension funds prefer to work with other funds. Chemistry is important and prior to submitting any lead plaintiff motion, the funds should have discussions to see if they are in agreement as to how the case will be prosecuted.

The growth of securities litigation in places outside the U.S., including Canada, in particular, makes portfolio monitoring more compelling for Canadian investors. When alleged corporate fraud results in market losses, it is always beneficial for funds to know how they have been affected. Portfolio monitoring should make sense as a tool in a pension fund’s fiduciary toolbox.

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**LEGAL**

**BPM**
Taking A Fresh Approach
To Your Employee Benefit Plans

By: Stephen Frank

Taking A Fresh Approach
To your Employee Benefit Plans

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There have never been as many attractive options as there are today for plan sponsors when designing their employee benefit plans. For sponsors, this not only presents great opportunities, but it also provides additional complexity. The market is moving quickly with new solutions launched regularly, so making sense of it all can be daunting.

While any decision on the way forward should always be made in close consultation with your advisor and insurer, the following are four key considerations that you will want to keep in mind:

- Tolerance for risk
- Drug pooling protection
- Fees
- Flexibility of plan design

To start, a sponsor needs to know their tolerance for risk and, in this case, size matters. A plan with $2 million dollars of paid claims each year would not be as stressed by a large drug claim of $100,000 as would a plan with paid claims usually running at $50,000. As more high cost drugs enter the market, the frequency of very high cost claims being experienced by plan sponsors of all sizes is increasing. The smaller the plan, the more volatile the payments are likely to be going forward.

So cash flow becomes a consideration. At the end of an accounting period for an Administrative Services Only (ASO) plan, any shortfall from the plan year is due and payable upon presentation. Any shortfall in an insured refund arrangement can be collected over time through future rates or agreed upon payments. There are no shortfalls that come due on a fully insured plan.

As well, there are pooling options. Most insurers provide protection from this volatility on immediate financial results and/or future rate impacts that will smooth out the peaks, but will have an impact on cost in the valleys.

Drug Pooling Agreement

One of the most exciting changes in the market is the launch of an industry-wide drug pooling agreement by Canada’s insurance companies. As of January 1, this agreement required all participating insurers in Canada to offer standardized pooling protection – called EP3 protection – to all their insured non-refund clients. Under this agreement, insurers will not set premiums for these plans with any consideration to the number or value of any pooled claims.

They also agree that they will not take into account the number or value of any pooled claims if bidding on new business that already has EP3 pooling protection with their prior carrier. This effectively shelters plan sponsors from any disproportionate impact from high cost drug claims.

EP3 also allows sponsors with existing high cost claims much more flexibility to shop their business around than they had in the past. These pooled claims are then distributed across all clients as a small charge to smooth out the volatility for each client.

However, it should be noted that EP3 protection does not cover ASO or insured refund plans. That being said, ASO plans can be augmented with large amount or stop-loss pooling protection which operates outside of EP3. So, sponsors should understand what pooling coverage may be available to them if they proceed with an ASO solution as well as how it would compare to EP3 pooling protection.

Risk Has a Price

When it comes to fees, taking on additional risk has a price. Because plan sponsors are protected from the volatility of large drug claims in a pooling arrangement, pooling costs will reflect the dollars not directly assigned to a single case. Over time, the costs of these increasingly large drug claims will be reflected in the standard pooling charges for plan sponsors.

One of the key considerations for plan sponsors is the degree of flexibility they can have when designing benefit plan solutions. Both ASO and insured plans can be customized to provide a high degree of flexibility. For example, both options can be structured to offer healthcare spending accounts and graduated benefits. Ultimately, the key is to work with an advisor to identify best in class insured and ASO plans to design the one that works best.

Stephen Frank is vice-president, policy development and health, at the Canadian Life and Health Insurance Association.

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Many At Fault For DB Woes

Re: Letter in August 2012 issue of Benefits and Pensions Monitor, ‘Actuaries To Blame For DB Woes’

Blame the actuaries? Of course. And the accountants and regulators too. They all seem to be hell bent on destroying the Defined Benefit plan system. (Except for the regulators, who expeditiously modify the rules so their plans can operate to their advantage, but that is another story.)

If we were in the 1950s or even the 1960s, current funding rules would make sense and could be managed easily. Those were times of very conservative investing (mostly fixed income), fixed or career average benefits, and low wage growth. They had LDI and didn’t even know it.

Then, for 30 years we had inflation or fear of inflation, and the rules changed. Aided by encouragement from actuaries and, later, historically high real returns, we all jumped on the equity premium upfront bandwagon. This was an entirely rational decision as a way to combat the effects of inflation.

Later, with an embarrassment of real return riches, we all got a bit carried away, again with encouragement from our actuaries (and pushed a bit by Revenue Canada rules).

Now, crushed by low long bond rates (set as a government policy, not by market forces), plans are struggling with the effects of solvency rules. And the regulators, the actuaries, and accountants are telling us we were wrong. There may be an equity premium, but it is wrong to assume it upfront. Fine, but there are 40 years of funding evolution to first undo – benefits higher than they might otherwise be, rules written in different times, and so on. It is very difficult to undo this. Consequently, plans get cancelled and Defined Contribution becomes the norm.

In my view, this is crazy. The best way to have a secure retirement for most of us is to have a DB plan. Why then are so many causing the DB plan to die, all with the best of intentions I am sure.

Michael Beswick

Railroad Analogy Incorrect

Re: Article in the October 2012 issue of Benefits and Pensions Monitor, ‘Railroading DB Plans’

In your editorial you use a very apt metaphor for corporate retirement planning – the once pre- eminent railway’s decline and recent renaissance. However, you theorize that the reinvigorated corporate retirement programs will return to the Defined Benefit pension model and, in this regard, I think your analogy is largely incorrect.

It is true that the rail system is rebounding from what seemed terminal decline and that the key reason for the rebound is what has always been the advantage that it held over other land transport options – the ability to move massive amounts of freight for very low cost. But unlike the method for rail transport to achieve this in days gone by – the hand-loaded boxcar – the railways of today have almost completely adopted containers. The great advantage of containers over boxcars was their universal interchangeability.

And the same two phenomenon exist for the future of corporate retirement programs: DB plans are the hand-loaded boxcars of corporate retirement programs, while PRPPs are, by definition, universal in terms of options and they will, in time, become vast pools of capital, likely dwarfing any DB plan.

Like the railways, corporate retirement programs are not going to disappear. It is likely that they too will become a growing option. But like railways, those who do not adapt to the revolutionary changes that are underway in corporate retirement programs will be out of business.

Gordon Tulk
Slate Insurance Inc.

Correction

In the December issue of Benefits and Pensions Monitor, the article starting on page 28, ‘Investment Policy Changes Sustain Pensions’ by Tony Williams contained a chart. The corrected version of the chart follows.
Troy Milnthorp, an associate partner at Aon Hewitt, will examine target benefit plans and Michael J. Rouse, a strategy and organization professor at the Richard Ivey School of Business, will make the business case for wellness programs at the third annual ‘CPBI Saskatchewan Regional Conference.’ Theme of the conference is ‘Seasoned & Sound’ as it bills itself ‘A Recipe for Sound Professional Development.’ It takes place April 17 and 18 in Saskatoon, SK. For more information, visit www.cpbi-icra.ca

Keith Ambachtsheer, director of the Rotman International Centre for Pension Management; and Jennifer Gregory, vice-president, business development, group savings and retirement, Standard Life; will be among the featured speakers at the Conference Board of Canada’s ‘Aging Workforce Forum: Pensions, Performance, and the New Retirement.’ Sessions will look at Canada’s aging workforce and how pension innovators are transforming themselves to drive performance and competitiveness in a changing landscape. It takes place April 23 and 24 in Toronto, ON. For more information, visit www.conferenceboard.ca

The International Foundation of Employee Benefit Plans’ ‘Canadian Legal and Legislative Update’ will examine recently enacted and proposed legislation and regulations. It takes place May 9 and 10 in Charlottetown, PEI. For more information, visit www.ifebp.org

‘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 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

Jeff Aarssen, Vice-President, Great-West Life Group Retirement Services Sales & Marketing is pleased to announce the appointment of Ken Millard, FCIA, FSA, to the role of Vice-President, National Accounts.

Ken has more than 20 years of experience with Great-West Life which included roles within Individual Insurance, Group Benefits, and Group Retirement Services.

As Vice-President, National Accounts for Group Retirement Services, Ken will lead a team that provides business development and product support services for large-case group retirement services clients, working primarily through relationships with consultants.
Quantifying The Value Of Benefits

By: Jim Helik

The capital markets give us plenty of data to analyze. We have price and volume data for many equities, commodities, and other tradable instruments going back decades on almost all developed markets around the world. This has lead to extensive analysis, but far less agreement, on whether or not markets are efficient and, therefore, the best way to make money in those markets.

Hard Data

The benefits world, by comparison, gives us much less hard data, which is often examined over far shorter timeframes and using a case study methodology. A new benefits plan is implemented and employee absenteeism falls over the next year. A case study is written up, but is there a cause and effect relationship here? Might some other type of employee benefit produce the same result?

In addition, much of the benefits literature is survey based, with all of the problems that come with administering, and interpreting, any survey. I often think of how I would react if I were an employee of a firm that was just given a survey on my use of the employee benefit plan. Would I tell the truth or would I apply rational, yet self-serving, behaviour to answer a question being given out by some strange consultant who comes into my workplace and tells me that I have ‘nothing to worry about.’ Might I just say ‘Yes, I use all of my employer’s benefits, from the on-site daycare (even though I don’t have children) through to the health club (that I think is located somewhere in my building) and that all of this makes me a very happy and more efficient employee (hidden message: please don’t take away any of my benefits)?’

And if I were part of the executive team that proposed this benefits plan, might I also state that I was ‘Very happy with the plan, and that I could see the increased efficiency just bubbling out of my employees?’

So there are often problems with survey based data, as well as case studies. What is needed are controlled experiments which is no easy task in the real business world.

An actual controlled experiment on the effects of working from home has been conducted by Nicholas Bloom, John Roberts and Zhichun Jenny Ying, of Stanford; and James Liang, of Beijing University and co-founder of a company called Ctrip which is China’s largest travel agency, employing 13,000 people. Their paper, ‘Does Working from Home Work? Evidence From A Chinese Experiment’ documents what happened in a randomized controlled experiment run by the company to see the effects of having some employees work from home.

Employees in the airfare and hotel departments of the Shanghai call centre were divided into two groups: one group which worked at home and another team in the call centre. Both had the same equipment, faced the same work order flow, and were compensated in the same way (the control group). Thus, the only difference between the groups was the location of their work. They found some highly positive results. First, the home workers increased their performance due to a decrease in the number of breaks and sick-days taken, as well as greater efficiency in calls answered. The home work group also had lower attrition rates than the control group and reported higher job satisfaction. The company estimated that due to the reduced office rents for those who worked at home, as well as the lower attrition, it saved about $2,000 per year per employee who worked at home.

Element Of Choice

After the experiment was completed, the company allowed employees to choose what group they wanted to work in. The work from home group scored even higher on various performance measures when an element of choice was introduced, as top performing employees generally chose to work at home.

This is far from the last word on working at home, but is actually the first randomized experiment with a control group seeking to measure the impact of working at home. It shows that you can rigorously measure employee benefits, which is of use to employees and managers alike.

Jim Helik is a contributing author to the ‘Managing High Net Worth’ course and the ‘Commodities As Investments’ course published by CSI Global Education. He is also one of the first holders in Canada of the Human Resource Management Professional designation from the Society for Human Resource Management.

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