



Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

June 29, 2012

Bill Morneau
Special Advisor - BPS Pension Efficiencies
via: pension.feedback@ontario.ca

Re: Consultations to Enhance Pension Fund Investment Efficiencies

Dear Mr. Morneau,

This submission is made by the Pension Investment Association of Canada (“PIAC”) in response to the request for comments by the Pension Investment Advisor appointed to lead the implementation of a pooling of pension fund assets in the broader public sector in Ontario.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management 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 welcomes the opportunity to participate in the consultation process as its membership covers a broad range of fund sizes as well as investment and governance structures, and includes a number of Ontario broader public sector (BPS) plans.

General Comments

PIAC supports actions that strengthen the ability of its members to secure the pensions that are promised to their defined benefit funds' beneficiaries. Pooling of assets may help some small funds access more investment opportunities and therefore better manage their funding risks; however PIAC has some concerns with the current approach:

- The focus of the consolidation initiative appears to be mainly on cost reduction. Several attractive asset classes and strategies can be more costly to access, and so returns (net of costs) as well as risk management and governance should also be part of the analysis and discussion.
- The cost savings, and therefore improved returns, of larger funds in the referenced Rotman study are largely driven by the higher allocations of larger funds to real estate and private equity and the ability of these larger funds to access these asset classes more economically than smaller funds. Solutions other than consolidation that allow smaller funds to access these classes at comparable terms to the larger funds would be attractive.

- It should be noted that although economies of scale can yield significant cost savings in many deep, efficient public markets (e.g. U.S. large caps), other less liquid and narrow public markets may be more difficult to manage with sizeable assets under management (e.g. Canadian small caps). In the latter case, improved management fees may be dwarfed by lower realized returns, resulting in lower returns net of fees.
- Pooling of assets into one or two investment management organizations would increase the systemic risk to the province of Ontario, and therefore to plan members, of underperformance of one (or both) managers. Spreading the management of BPS pension assets among several mid to large size organizations would mitigate this risk.

There could be merit in the budget proposal to consolidate pension plan assets with existing large pension plans, specifically when benefit administration, governance, communication and education are consolidated. Greater efficiencies and improved risk management are available under these models. However, we will focus our comments on the requisite characteristics of a new investment management organization.

Responses to Questions

1. *What is the appropriate mechanism(s) for pooling the investments of BPS pension plans?*

PIAC believes that any structure or organization that is put in place to facilitate pooling of assets of Ontario BPS plans should have the following characteristics:

- The organization should be a professionally run not-for-profit investment management entity that is independent from government, and
- There should be a broad range of public and private asset categories available in a structure that facilitates the development of different asset mixes appropriate for plans with different liability profiles and investment objectives.

Possible models that could be investigated to determine what has and has not worked well for plan sponsors are those in place in other provinces, i.e. Alberta Investment Management Corp., British Columbia Investment Management Corp., New Brunswick Investment Management Corp., and Caisse de dépôt et placement du Québec.

2. *Should participation in the model be voluntary or mandatory?*

Participation in the pooling model should be voluntary. Pension plan fiduciaries must have the flexibility to choose the investment managers of the assets for which they have responsibility. Ideally it would be possible to use the pooled offerings as part of a portfolio that includes other investment management firms or funds.

3. *What is the appropriate governance model to ensure effective leadership and representative decision-making?*

The governance model of the pooled organization should incorporate the following elements:

- Run as an investment management entity with effective communication, transparency and reporting to participating plans,
- Operate independently without any governmental influence, and

- A Board made up of investment, financial and governance experts.

4. *How can the model meet plan-specific investment needs in a manner that is consistent with the fiduciary responsibilities of plan administrators?*

The participating plans' fiduciaries must be able to define their own risk levels and return targets through customized asset mix and asset class selections. This requires unitization of asset classes. The selection of available asset classes and categories has to be broad enough to allow for:

- Liability driven investing (LDI) strategies specific to the participating plans' liability profiles, including different duration and inflation exposures.
- Tactical positions if deemed appropriate by the plans' fiduciaries, e.g. shifts between asset classes, temporary positions in credit strategies, etc.
- Currency hedging with a range of hedge ratios available.
- Active or passive exposures with a choice of active exposures that includes various investment styles, e.g. value, growth, core.

5. *How can the model be implemented? What is the appropriate transition period for implementation? How should transition costs be allocated?*

The model can be implemented through the creation of a new investment management corporation or building on an existing organization (currently there are no organizations in the Ontario pension sector that offer the options described above).

It is expected that the formation and transition time period would be three to five years.

Transitions costs should be borne by the province, as it expects that the formation of the pool will provide cost savings to the province in the future.

6. *What role should pension plan design, asset allocation models and the size of plan play in determining participation?*

If the pooled organization offers a broad selection of asset classes and strategies through a unitized structure, pension plans of different designs, with different asset allocation strategies, can customize their portfolios accordingly.

As mentioned under question 2, participation in the pool should be voluntary to the respective BPS, who would assess the significance of any cost efficiencies and other benefits to be achieved by joining the pool.

7. *Are there any obstacles to the inclusion of defined contribution pension plans in the model?*

If the asset offerings are unitized, the inclusion of defined contribution plans could be easily accommodated. However this would require additional resources allocated to communication, education and reporting. As well there could be concerns about frequency of valuations of some private market asset classes.

8. *Should the model include other BPS Investment Funds?*

If the asset offerings are unitized, other BPS Funds could be included as long as different tax statuses are considered.

PIAC would be pleased to discuss this further with you at your convenience. We thank you for this opportunity to share our views with you.

Sincerely,

A handwritten signature in blue ink that reads "Julie Cays". The signature is written in a cursive, flowing style.

Julie Cays
Chair