

A growing number of plan sponsors overseeing both DB and DC plans are establishing their own funds to consolidate the two investment structures. **By Annie Blouin**

A fund of their own

Out with the old, in with the new. That's the story today in Canada's pension industry. More companies are opting to close down defined benefit (DB) plans to new members, or do away with these plans altogether. Often, the DB plans are replaced with the more cost-predictable defined contribution (DC) plans. And while that might be good news for plan sponsors, plan members are a little less enthusiastic.

It's caused a seismic shift in the pension industry. Employees are generally more comfortable with DB plans, many of which have been in place since the years after the Second World War. In fact, DB plans are often referred to as the "good kind" of pension plan. But they have become increasingly expensive for companies to sponsor. The main reason is the prolonged decline in long-term interest rates, which increases the cost of a DB plan's liabilities.

The problem is DC plans place the onus on members when it comes to investment strategy. In a DB plan, the responsibility for making sure the investment performance is appropriate, as well as the selection of investment managers, is entirely with the sponsor (or pension committee in Quebec). With a DC plan, members are given a menu of investment options to choose from.

The shift from DB to DC plans has left many plan sponsors wondering how they can help build retirement wealth for their plan members, many of whom are uncomfortable making important financial decisions, while limiting the costs of running a pension plan.

It's a dilemma. And industry experts say too often employees lack the knowledge to make crucial investment decisions. "Employees are risk-averse, and they do not have access to user-friendly tools to manage their expectations," says Laurier Perreault, worldwide partner at Mercer Human Resource Consulting in Montreal. "Many end up with default options, and many others

are poorly diversified such that they have too much money in short-term investments and Canadian equities, instead of a well-diversified portfolio.”

THE MOM APPROACH

To tackle the problem, a number of pension plan sponsors—many of whom find themselves overseeing both DB and DC plans for the foreseeable future—have taken a “manager of managers” approach, setting up their own funds for the benefit of their various DB pension plans and DC plan participants. The sponsor then oversees the investment manager(s) investing the fund, the same way it does under the DB structure.

Why would a pension plan sponsor choose to open its own fund? Well, on one hand, the strategy consolidates DB and DC investment structures, simplifying oversight. This approach also gives DC participants the benefit of professional oversight of the DB model.

There are several steps needed when adopting this strategy. First, sponsors must communicate to their members the nature of such a program and ensure members understand the choices presented to them. Second, if a company were to set up its own fund and offer it to individuals, the sponsor would have to register it with various provincial securities commissions, which entails certain disclosure requirements. To avoid this, some sponsors have taken a “fund of funds” approach: DC funds set up with an insurance company, which then holds units of the sponsor’s DB fund(s).

The strategy also requires increased record-keeping. DB plans are typically valued once a month, and the day-to-day values are not considered important since time horizons are very long. These pension plans can often have thousands of participants in them, many of whom will not retire for 30 or 40 years. If a sponsor creates its own fund, however, there can be transactions going through every day. Much like mutual funds, the funds must provide daily Net Asset Values (NAV’s) to ensure the funds can be bought by individuals on a daily basis in the same manner as mutual funds.

The accounting and valuation processes involved are different from what most DB plan sponsors are

accustomed to. In a daily NAV environment, the need for timeliness is paramount. This means “closing the books and striking the price” daily, with all the information you have on hand at the time. In the DB environment, accuracy is the top priority—even if this means waiting for information not available on the valuation date.

It may sound like hard work, but there are real benefits to be had. DC plan members get the benefits of professional oversight that the plan sponsor brings—and at potentially lower fees than the regular investment options of the DC platforms. Furthermore, they do not have to choose between fund managers or check up on the fund’s performance every quarter. Members also get the benefit of best-in-class fund managers for each asset class.

“Having best-in-class managers of each asset class together in one fund, it’s certainly very appealing for members,” says Anne Meloche, principal and head of DC consulting practice, Eastern Canada, Mercer Human Resource

Consulting in Montreal. “It’s difficult for a single manager to be a good performer in each asset class of a balanced fund.”

Plan sponsors experience the benefits as well. Sponsors maintain a certain degree of control over the plan, instead of simply offering a variety of investment manager funds and leaving the selection to members. In addition, sponsors retain more active involvement in building retirement wealth for plan members, providing DC members some of the benefits of the DB model—lower fees and professional oversight.

These strategies may not be appropriate for all situations, and plan sponsors should seek qualified advice before changing investment structures. Having said that, it’s a great example of an innovative approach to a dilemma facing more and more Canadian pension sponsors today.

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APPOINTMENT NOTICE



Paul Vanderkoff
CFP



Mara Canal
BA



Rahim Peera
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Michael Marmoreo, Regional Sales Director Pensions, Toronto at Industrial Alliance Insurance and Financial Services, is pleased to announce the following appointments in the Toronto Sales and Service Office.

Paul Vanderkoff, CFP, has been appointed Business Development Manager. Paul has 18 years of pension experience acquired in various roles at another firm in our industry. In his new role Paul will be responsible for new business development.

Mara Canal, BA, has been appointed Senior Customer Relations Manager. Mara has over 10 years of experience in the group retirement services industry. Mara will be responsible for ensuring we provide an outstanding level of service to our Toronto client base.

Rahim Peera, BA, has been appointed Financial Education Specialist. Rahim has completed his IFIC and IFIC Operations and the CSC. He has five years of experience in the industry, which he acquired as a Customer Service Representative, Quality Assurance Specialist and as a Development Trainer. Rahim will be responsible for providing financial education to the members of our clients' retirement plans.

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