CIBC MELLON

In Search of New Value

A special thank you to the many clients, industry stakeholders and research partners that engaged with CIBC Mellon as we completed the multi-part "In Search of New Value" project. This research would not have been possible without a tremendous amount of input, commentary and feedback that informed the research. Thank you also to those who provided us with quotations, review commentary and indeed an array of forum to discuss the material.

Thank you!

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CHAPTER 1

In Search of New Value

CANADIAN PENSION FUNDS ARE ADAPTING THEIR INVESTMENT STRATEGIES FOR A POST-COVID-19 ENVIRONMENT

Chapter 1 of our research, presents our findings with respect to how pension funds are adapting their investment strategies.

Foreword

Canada's pension plans enjoy a well-deserved global reputation for strong management and resilient performance, but they are not immune to shocks in the markets in which they operate. The COVID-19 pandemic has been testing pension plans and their asset managers, prompting significant volatility in financial markets and reshaping the global economy.

This is the backdrop against which we surveyed 50 of Canada's leading pension plans, seeking insights into how they have coped with the crisis, the challenges and opportunities that now lie ahead, and how they are positioning themselves accordingly.

In the first chapter of our report, we present our findings with respect to how pension funds are adapting their investment strategies. Over the months ahead, we will invite you to join us as we explore other dimensions of Canada's innovative pension and investment landscape.

Investment strategy

1

What will life look like after COVID-19?

86% of pension funds expect to reduce investment in infrastructure over the next 12 to 24 months;

- 90% expect to increase investment in private equity.
- 86% say the same of fixed income.

22% of pension fund assets are currently managed in-house. Sponsors anticipate increasing this to 28% in the next 12 months.

Real estate **(58%)** and equities **(48%)** are the asset classes where the largest portion of pension funds plan to increase in-house management over the next 12 to 24 months.

Canadian pension funds have demonstrated their resilience through the COVID-19 pandemic, even after their performance was hit by market volatility caused by the crisis during the first half of the year.

With long-term investment horizons and, typically, a strong credit profile, most pension funds have the time and flexibility they need to work through the negative impacts of COVID-19. One factor may be the governance model: many Canadian pension plans also operate in the "Canadian Model", as independent organizations overseen by boards of directors on behalf of their employee and employer stakeholders.[1] These groups focus on meeting long-term pension obligations on behalf of members – a model the World Bank recognized[2] as enabling longer-term decision making. Long-termism is, of course, not exclusive to jointly-sponsored plans, with many large Canadian single-employer pensions, endowments and foundations taking a similar perspective.

Nevertheless, uncertainties remain, providing potential for further volatility in asset classes worldwide. The investment outlook for 2021 is clouded by many unknowns, including the trajectory of vaccination deployment, the emergence of new strains of the virus, pivots in U.S. policy brought about by the Biden administration, and to the post-Brexit evolution of Europe. In this context, pension funds continue to review their asset allocations, investment strategies and their investment operations models.

Ash Tahbazian
Chief Client Officer

> "Asset owners and asset managers require timely insights, effective solutions and responsive execution as they work to position their organizations to succeed in today's rapidly shifting environment. Canadian asset owners continue to reinforce their position as global leaders with the strategy and the resources to succeed and win on the global stage."

90%

expect to increase investment in private equity, while 86% say the same of fixed income.

86%

expect to reduce investment in infrastructure over the next 12 to 24 months.

22%

of pension fund assets are currently managed in-house. Pension managers anticipate increasing this to 28% in the next 12 months.

Real estate (58%) and equities (48%) are the asset classes where the largest portion of pension funds are planning to increase in-house management over the next 12 to 24 months.

Alistair Almeida
Segment Lead
Asset Owners

"A shift by 86% of Canadian pension asset manager respondents to decrease their allocations to infrastructure represented an unexpected departure from anecdotal global trends. It also represents a departure from the pre-pandemic expectations of Canadian alternative asset managers.

This suggests further discussion may be warranted; our enterprise will explore this further in the year ahead, and we look forward to conversations with clients navigating both sides of the trend."

Private equity on the rise, and a clear shift away from infrastructure

Investment decisions made by individual funds (or the outsourcing of those decisions) will inevitably reflect their specific circumstances – in particular, the maturity of their plans and their appetite for risk. Nevertheless, in several areas, large numbers of the Canadian pension funds surveyed have significant plans to alter the mix of their portfolios.

Notably, 86% of funds expect to reduce their exposure to infrastructure over the next 12 to 24 months. This may be surprising given the way many funds have sought such assets out in recent years, with falling interest rates encouraging managers to cast their nets more widely for returns. However, while the defensive characteristics of infrastructure remain attractive – including the offer of stable, long-term yields – some have warned of the dangers of over-exposure to illiquid assets.[3]

The COVID-19 crisis has underlined the importance of diversification as well as the vulnerabilities of illiquid assets and Canadian pension fund managers appear now to be rethinking their appetite for infrastructure.

This is not to suggest such exposures will necessarily be redeployed in the public markets. In fact, according to our survey, the asset class most likely to see a rise in allocations is private equity, where 90% of respondents say they intend to increase allocations over the next 12 to 24 months. Almost half of funds (42%) expect to raise their exposures to real estate.

As for more liquid investments, the dominant trend in the wake of this year's volatility is towards "risk-off" asset classes. Almost nine in 10 pension funds (86%) expect to invest more in fixed-income assets in the short term. However, not all funds are taking a defensive stance: 36% plan to increase their allocations to equities, almost twice as many as plan to trim allocations, while 20% anticipate a reduction in the size of their cash holdings.

Infrastructure: Canadians running counter to global consensus?

The shift by 86% of Canadian pension asset manager respondents to decrease their allocations to infrastructure represented an unexpected departure from anecdotal global trends. It also represents a departure from the pre-pandemic expectations of Canadian alternative asset managers, who anticipated maintaining their infrastructure allocations.[4] This shift could indicate repositioning to achieve liquidity goals, portfolio re-balancing to capture gains, or even a strategic departure by Canadian plans relative to their global peers. This suggests further discussion may be warranted; our enterprise will explore this further in the year ahead, and we look forward to conversations with clients navigating both sides of the trend.

Megan Gentilesco
Global Head of Private Equity and Credit Fund Services

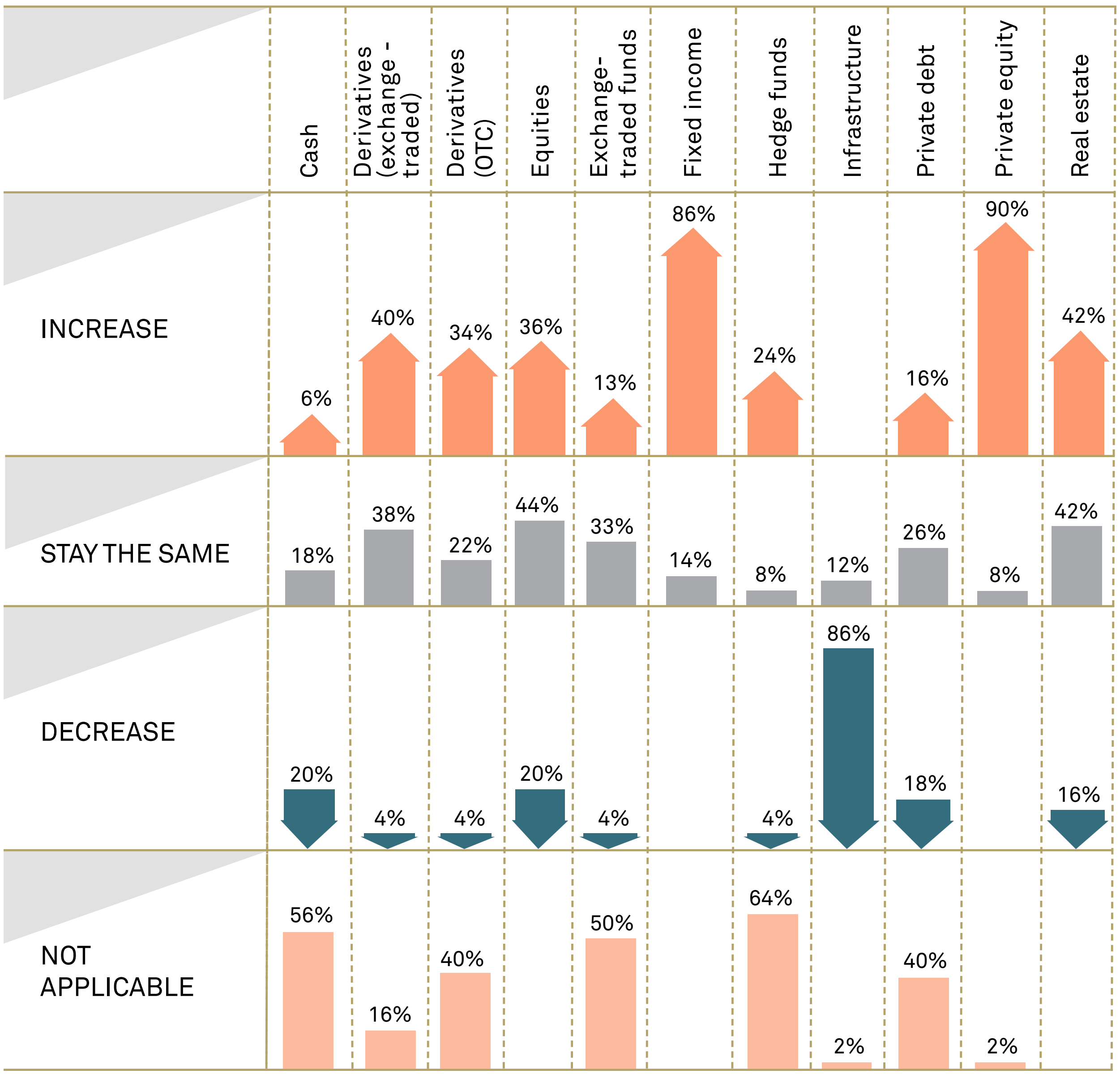
"The impact of the pandemic continues to be felt and the final outcomes are yet to be known.

As cashflow issues persist in certain sectors, some firms have become challenged. This has resulted in a rise in distressed loans and debt, and in turn to dislocation or distressed credit funds as an area of particular fundraising appeal.

Many asset owners seem to be focusing on known entities, and concentrating investment with asset managers where they have established relationships - both through the launch of new separately managed accounts or investment into newly launched comingled funds. In some cases these relationships have allowed asset managers to quickly launch targeted funds designed to take advantage of current market turbulence.

The challenge for many managers is the ability to originate well today, with more limited capability to undertake detailed due diligence on borrowers. Diligence processes have historically been reliant on a lot of paper and in-person meetings, which have not been possible in the remote pandemic environment. The large volumes of dry powder seeking opportunity, the disruption to paper-based business models, and indeed the rising allocations to classes like private equity mean we will likely see competition continue to rise aggressively across global markets."

How do you expect your level of investment to change in the following asset classes over the next 12 to 24 months?



Many investors are still interested in investing in private debt and with the retrenchment of bank lending this is an asset class that we believe will continue to grow.

Anecdotal evidence suggests Canadian managers are diverging from global peers in reducing allocations to infrastructure.

Pension funds are moving in-house

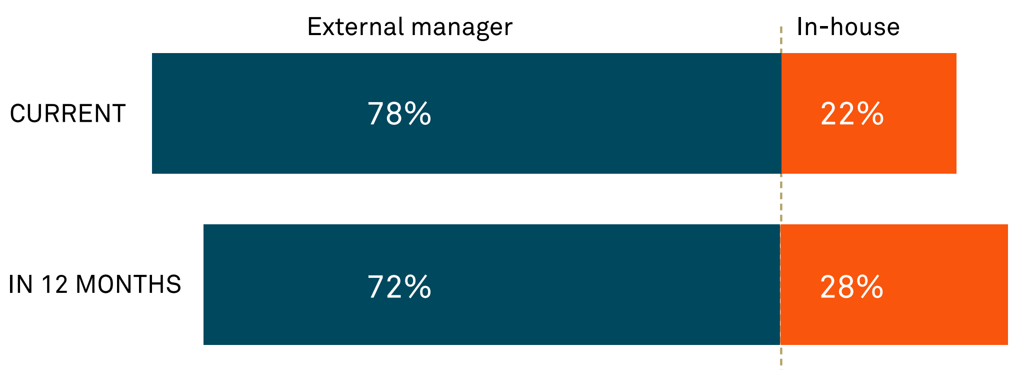
There is also evidence that pension funds are preparing to bring assets and investment activities back in-house. Currently, the funds in our survey manage an average of 22% of assets in-house, but this is expected to rise to 28% over the next year.

This may indicate a desire to bring costs down, with in-house teams often cheaper to manage than external mandates (look for more on this in the forthcoming second chapter of our research, but it also reflects the strong record of the Canadian pension fund sector in managing assets in-house. Studies have shown that the industry's strong performance compared to international peers is at least partly explained by its greater use of in-house management teams.[5]

At the same time, as the managing director of one fund points out, some funds simply want more control: "The investment and risk environment has been rapidly changing. We want better control of decisions and closer involvement will ensure that performance increases each year. We are aiming at a 10% increase in in-house management in the next 12 months, but this depends on how fast teams can adapt and recognize the opportunities and various risks attached to investing."

> "The investment and risk environment has been rapidly changing. We want better control of decisions and closer involvement will ensure that performance increases each year. We are aiming at a 10% increase in in-house management in the next 12 months, but this depends on how fast teams can adapt and recognize the opportunities and various risks attached to investing."
>
> Managing Director,
> Pension fund organization

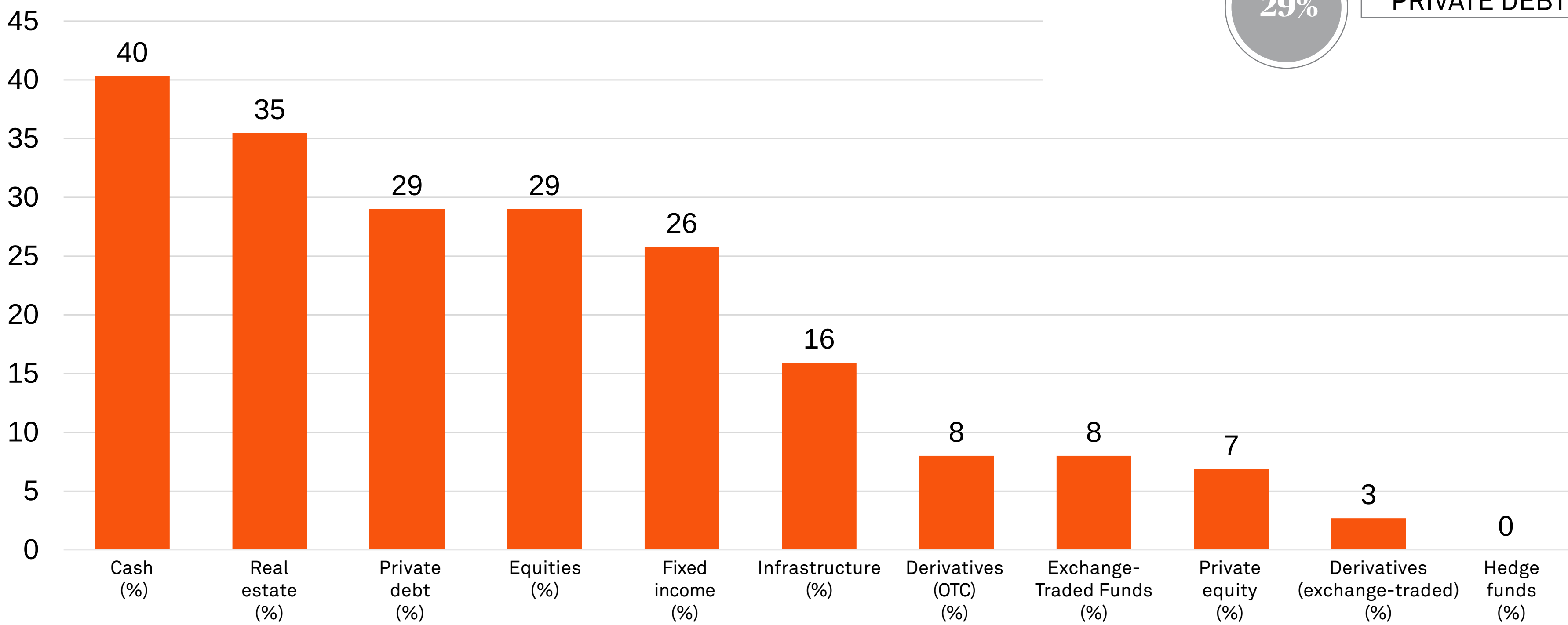
What percentage of your total portfolio is managed by in-house teams versus by external managers?



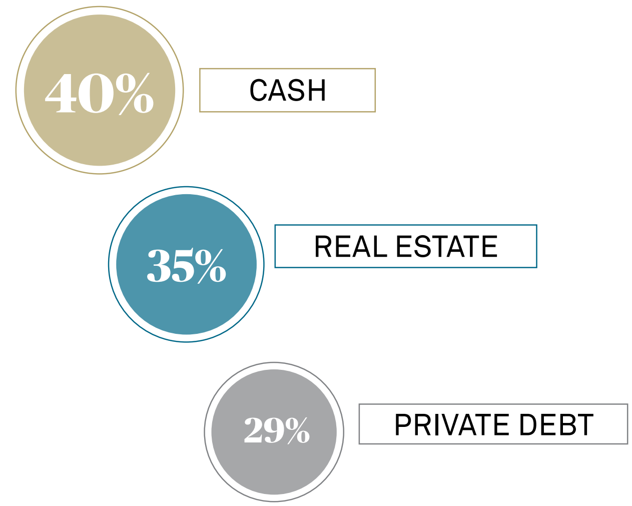
Some asset classes are more obvious candidates for in-house management than others. For example, pension funds are more likely to be managing real estate, private debt, equity and fixed-income investments in-house at the moment. By contrast, in more specialist areas, such as infrastructure and derivative contracts, the dependency on external managers is significantly higher.

Pension funds indicating an increased preference for in-house asset management are most likely to focus on those areas best suited to in-house management. This may be a matter of recognition that few organizations can be great at everything, and to achieve target investment results takes substantial investment in technology, talent and time.

What average percentage of asset allocations are managed in-house, by asset class? (percentage)



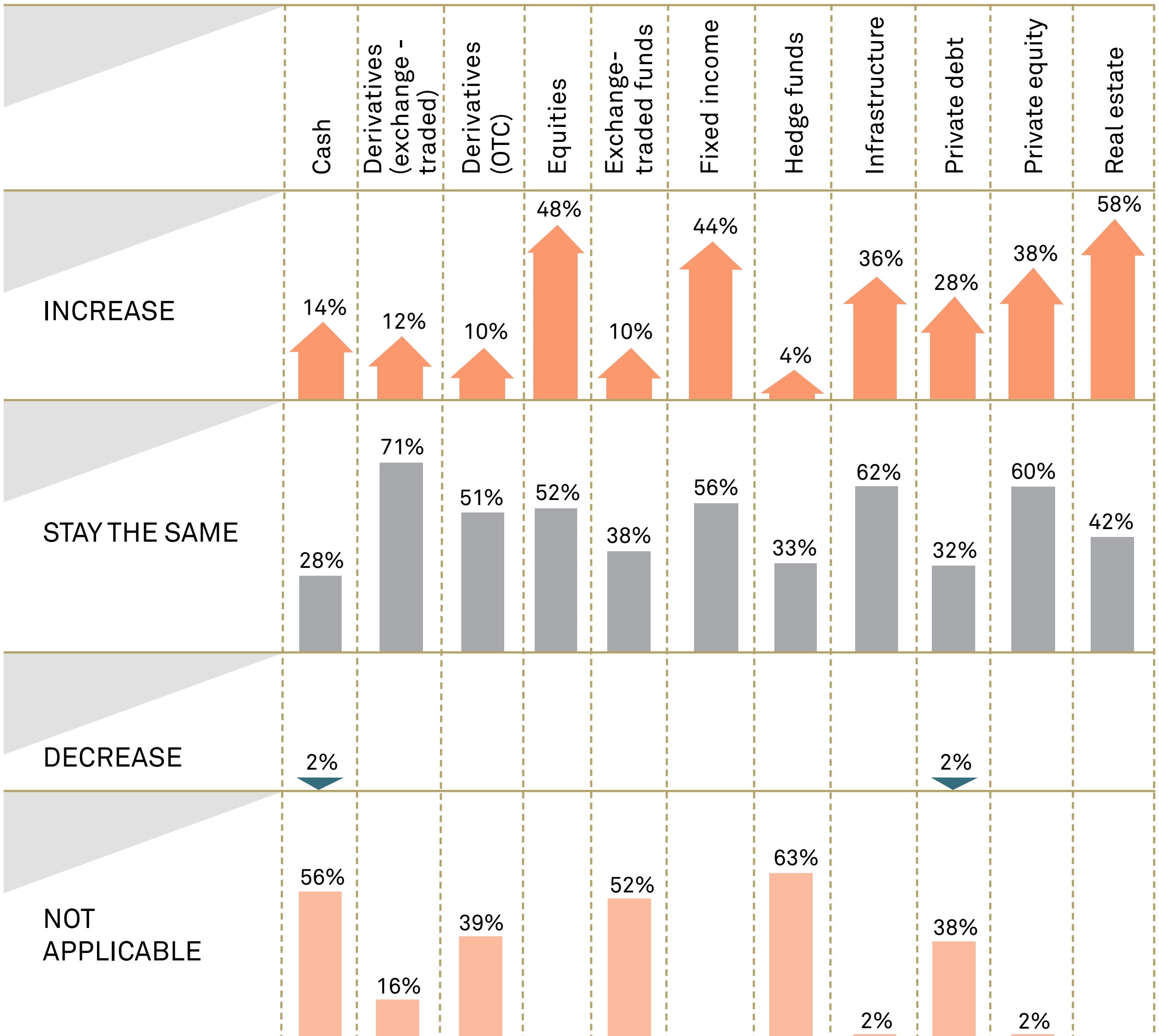
Asset classes with the highest ratios of in-house asset management



> "With pension plan sponsors and managers coming under increased scrutiny from regulators, plan members, employers, counterparties and other stakeholder groups, the fact that an in-house team can potentially enhance governance may become even more crucial."

Alistair Almeida
Segment Lead
Asset Owners

For each of the following assets held by your organization, how do you expect the proportion managed in-house to have changed in 12 to 24 months' time?



In-house asset management dramatically impacts a pension organization's requirements around talent, technology, governance and many other areas.

Canadian pension asset managers continue to show a lower appetite for hedge funds than many global peers.

Ash Tahbazian
Chief Client Officer

“As the Canadian investment industry works through the market turbulence, early indications are that investors may see this as an inflection point to secure increased transparency. From gathering information to assist in various risk and performance scenarios, to launching separately-managed accounts with trusted asset managers, initial feedback is that investors are keen to further the gains they have made in enhancing control in recent years.

The months ahead will be a test for asset owners and asset managers alike. Recent market pressures will undoubtedly change the relationship between asset owners and asset managers. Although the exact evolution of those relationships is unclear, initial feedback indicates that the desire for increased transparency and control will help define some of the changes ahead."

Alistair Almeida
Segment Lead
Asset Owners

"Many Canadian pension funds take a nuanced approach to asset management. Where appropriate, they operate with in-house teams and this appears to be increasing. Elsewhere, they are pursuing partnerships and collaborations, as well as full-scale outsourcing arrangements. There is no one-size-fits-all arrangement."

Innovation rather than one-size-fits-all solution

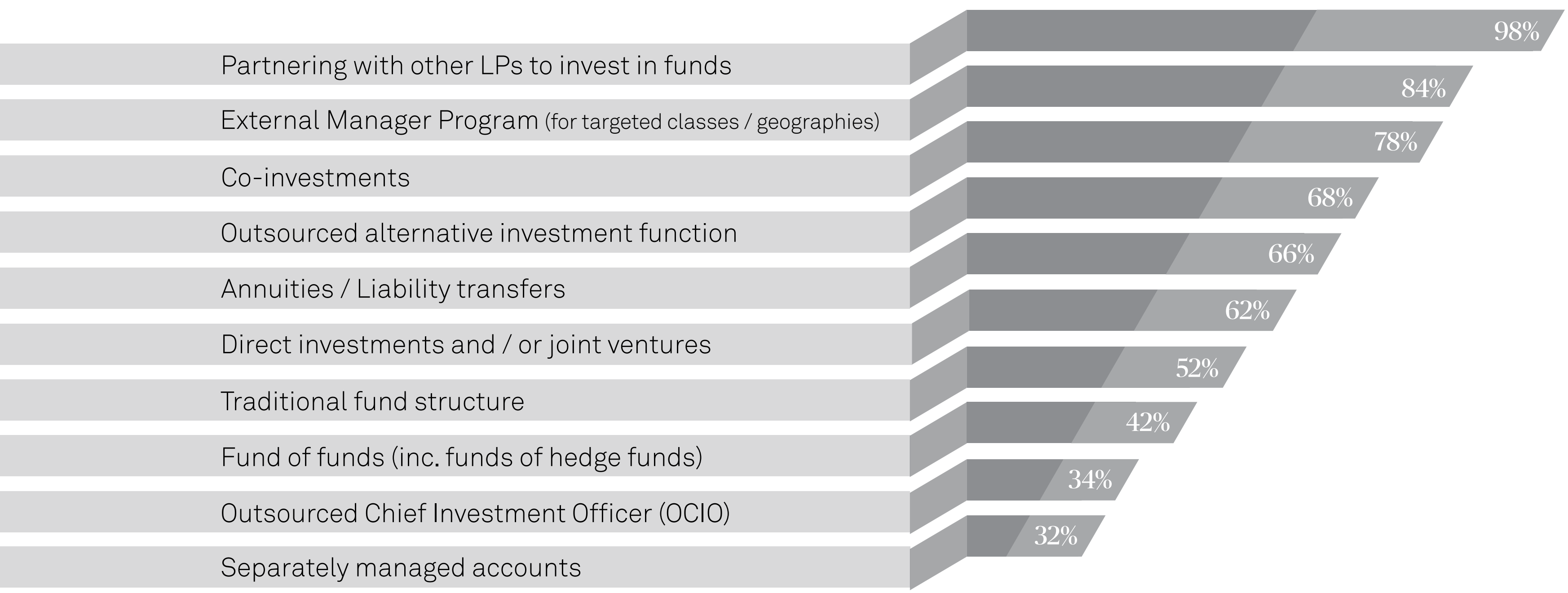
It would be a mistake to think of the debate between in-house and outsourced asset management as black and white. Our survey confirms that Canadian pension funds take a nuanced approach to investment models, employing a broad range of different operational strategies.

Some 98% of pension plans currently work alongside other limited partners (LPs) to invest in funds, for example, while 78% hold co-investments. Joint ventures (62%), external manager programs for specific asset classes or geographies (84%), direct investments (62%) and funds of funds (42%) are all popular options. It's also notable that, while many funds continue to outsource significant chunks of their portfolios, only a third (34%) have an outsourced chief investment officer (OCIO).

The picture is one of pension funds taking an imaginative approach to asset management. Where appropriate, they operate with in-house teams and this appears to be increasing. Elsewhere, they are pursuing partnerships and collaborations, as well as full-scale outsourcing arrangements. There is no one-size-fits-all arrangement.

We anticipate innovation and change will continue as Canadian pension fund managers focus on agility and responsiveness in the context of a fast-moving investment environment.

Which investment model(s) does your organization currently employ?



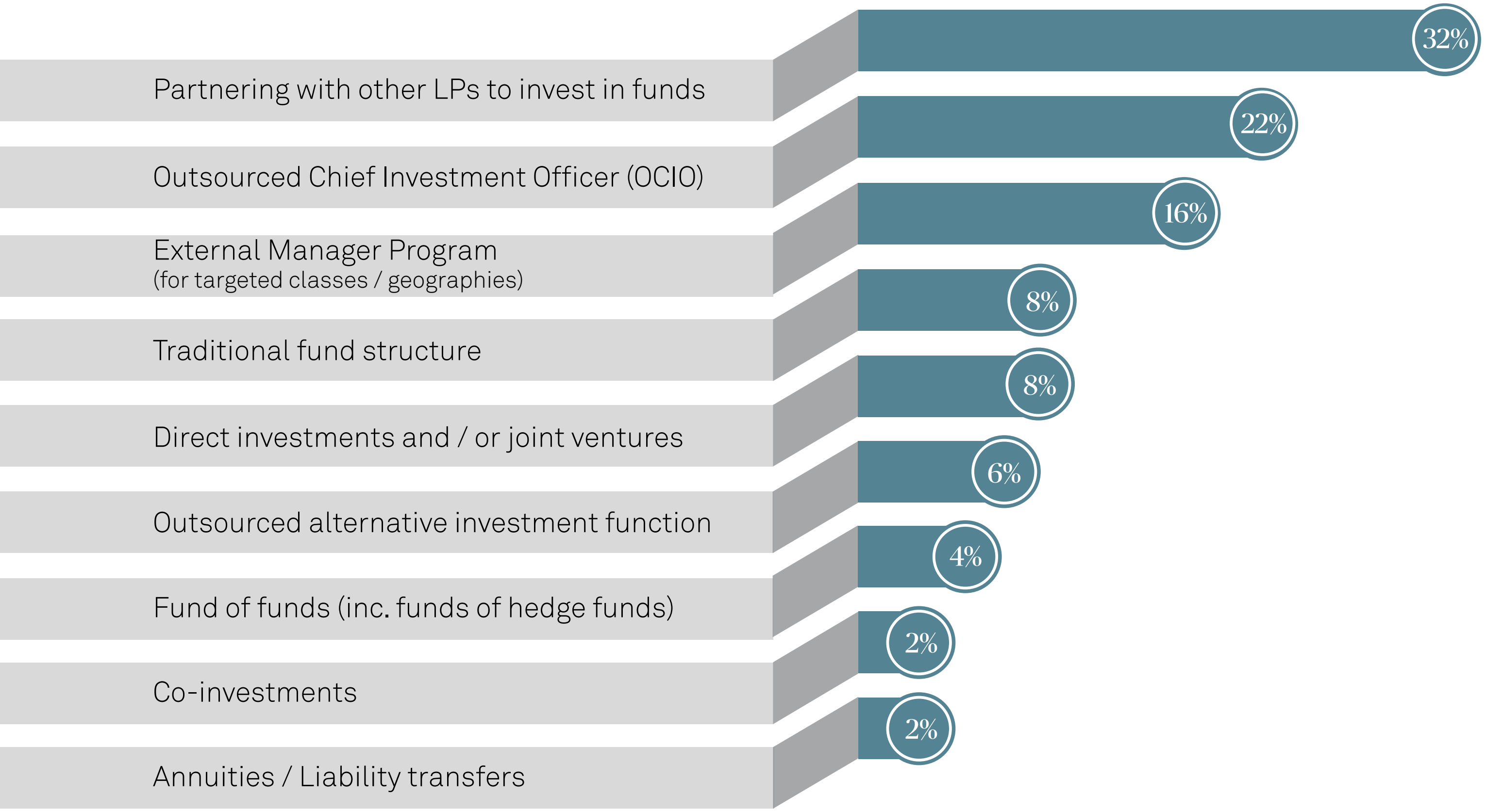
Top three most common investment models:

98% Partnering with other LPs

External manager program for targeted classes / geographies **84%**

78% Co-investments

What is the primary investment model your firm employs?



Ronald C. Landry
Head of Product

"In recent years, there has been a trend of increasing sophistication among asset owners, and they are changing the way they work with fund managers. Canadian pension managers are keen to play a greater role in their private market investments, but there is no one-size-fits-all approach. Direct and co-investment by sophisticated in-house asset management teams can operate alongside robust external manager programs."

Cynthia Shaw-Pereira
Vice President
Client Solutions & Business Development

"The majority of asset owners wish to enhance transparency to meet the rising demands of Boards, trustees, regulators and others - and are structuring their investments and operations to help them achieve this. Many Canadian asset owners have invested in alternatives for decades, having built internal teams knowledgeable about asset class nuances and equipped them with the necessary talent and technology to succeed. In some cases, pension managers are transforming into asset managers themselves, building robust investment operations, and consolidating in or taking on outside assets as they seek to build scale and generate return. Others are working to further refine their robust external manager programs designed to deliver results without the substantial costs associated with building in-house while achieving the necessary oversight."

Chapter 1: 10 Minute Video Recap Discussion

Investment strategy - what will life look like after Covid-19?

Our first chapter explores how pension funds are adapting their investment strategies based on the lessons learned through the pandemic. In this video, Ash Tahbazian, Megan Gentilesco and Alistair Almeida discuss challenges and opportunities, and explore how Canadian pension plans are evolving their allocations across asset classes and markets.

This video is available at **www.cibcmellon.com/isonv**

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CHAPTER 2

2

In Search of New Value

IN-HOUSE CAPABILITIES ARE ON THE RISE AMONG CANADIAN PENSION FUNDS, BUT OUTSOURCING REMAINS VITAL

Chapter 2 of our research, explores how in-house capabilities are on the rise among Canadian pension plans, even as outsourcing remains vital.

Investment strategy

2

In-house capabilities are on the rise, but outsourcing remains vital

64% of pension managers believe that clearer alignment of strategies to long-term objectives is one of the key benefits of in-house asset management.

66% of pensions report that bringing asset management in-house has generated cost savings, with 91% of those achieving savings of more than 10%.

Pension funds say the leading barriers to in-house management:

- **Internal expertise**
- **Technology**

86% of pensions using external managers intend to **look for lower fees** over the next 12 months.

Many Canadian pension funds anticipate an increasing proportion of their assets being managed in-house over the coming months and years and there are good reasons for this. Many view in-house management as the best way to understand the context in which portfolio choices must be made.

Almost two-thirds (64%) of pension managers say one of the most important advantages of in-house management is a clear strategic alignment of the long-term objectives for the fund. Just over half (56%) point out that in-house teams have a better understanding of the plans overall asset allocation.

The question of governance is also particularly important. With pension plan sponsors and managers coming under increased scrutiny from regulators, plan members, employers, counterparties and other stakeholder groups, the fact that an in-house team can potentially enhance governance may become even more crucial. Complexity rises further for multi-employer plans operating on behalf of a larger set of underlying organizational public and private sector stakeholders. Half of the respondents see stronger governance as a key benefit of operating with an in-house team.

64%

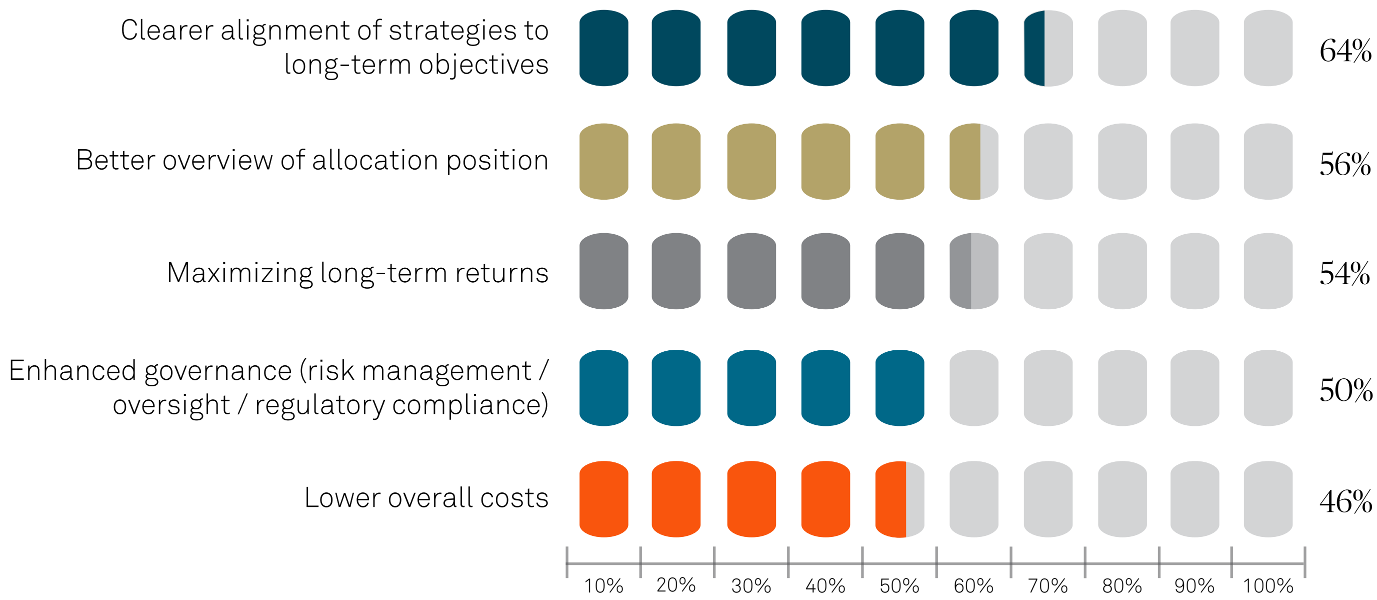
of pension funds believe that clearer alignment of strategies to long-term objectives is one of the key benefits of in-house asset management.

Pension funds say the leading barriers to increased use of in-house asset management are their **internal expertise** (70%) and their **technology capabilities** (60%).

86%

of pensions using external managers intend to look for lower fees over the next 12 months.

What are the top benefits of in-house asset management / insourcing? (Select top three)

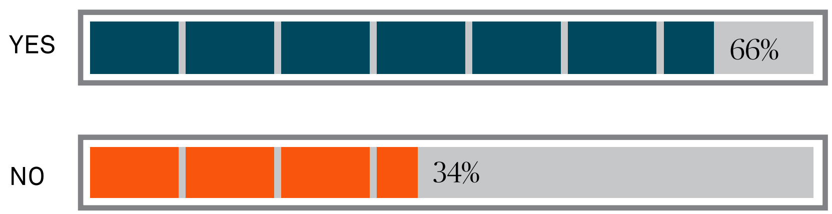



levels
ntal for storage
Birmingham
ive market share
London

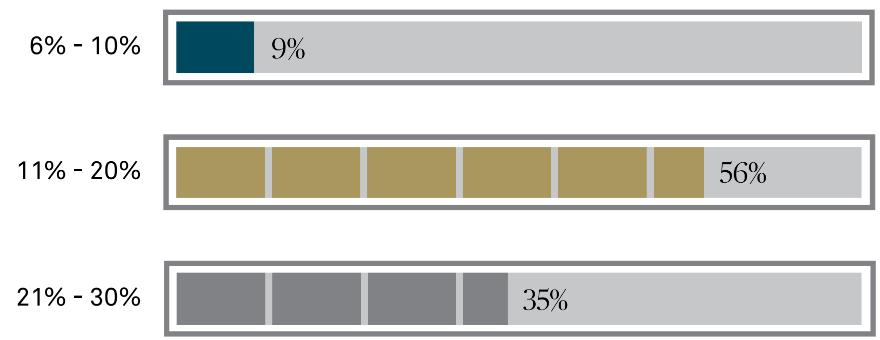
There is the question of cost: 46% of pension funds point to the lower costs of operating in-house management teams. In an era of low interest rates and low returns, this will be crucial – and some studies suggest that Canadian pensions are reducing their costs by as much as a third by favouring an in-house approach.[1]

Our research supports this finding. Of the pension funds that have taken asset management in-house, two-thirds (66%) say they have enjoyed savings as a result, with 91% of those reporting savings of more than 10% – including 35% who claim to have saved more than 20%.

Have you seen a cost saving since taking asset management in-house?



What has been the average percentage saving compared with outsourcing asset management?



Of the pension funds that have taken asset management in-house, two-thirds (66%) say they have enjoyed savings as a result, with 91% of those reporting savings of more than 10% – including 35% who claim to have saved more than 20%.

“Our plan operates a robust external manager program, and we have achieved strong results by outsourcing rather than building in-house. We appreciate the flexibility to seek out best-of-breed managers across Canada and around the world. For example, we are able to achieve a very competitive cost profile for the external management of our fixed income assets. It is also easier to replace underperforming external managers than in-house teams.”

Pension Plan Chief Financial Officer

Talent and technology are a challenge for in-house management

Given that in-house asset management appears to offer both superior alignment of investment strategy and lower costs, why are pension managers not embracing in-sourcing in even greater numbers? First and foremost, the move to in-house management is not straightforward, from the technology required to the talent involved.

“Maintaining in-house technology capabilities and in-house expertise are challenging,” says the chief financial officer of one fund. “Addressing skill gaps is difficult at a time when the economic situation is changing and most companies are looking to adapt. Increasing technology capabilities is challenging because of the significant downtime that is involved.”

Talent is indeed a key challenge and a focus area for many plans. Almost three-quarters (70%) of pension managers regard in-house expertise as one of the top three issues they have to confront in any shift to in-house asset management. As we have seen, Canadian pension funds are pursing investment strategies founded on portfolios with diverse assets, including significant holdings of alternative assets. Securing sufficient expertise in such a broad range of areas is naturally difficult.

It is also notable that 60% of pension fund respondents also cited concerns related to insufficient investment management experience on their Boards.

As for the question of technology, “with the asset management sector relying on a process of near constant renewal of its IT competencies, many pension funds worry about their ability to keep up in this arms race.“

Almost three-quarters (70%) of pension managers regard in-house expertise as one of the top three issues they have to confront in any shift to in-house asset management.

“

The top quartile returns delivered by the Trans-Canada Capital Inc. (TCC) investment team have been a major factor in the financial turnaround of Air Canada’s Canadian pension plans, in which a $4.2 billion solvency deficit was eliminated and replaced by a surplus of over $2 billion. Over the years, TCC has developed unique skills in managing pension assets with a specific expertise covering Canadian fixed income, absolute return hedge funds and alternative investments. Building on this valuable experience, TCC is now proud to offer its unique expertise to third-party institutional investors, including pension plans, foundations and endowment funds.

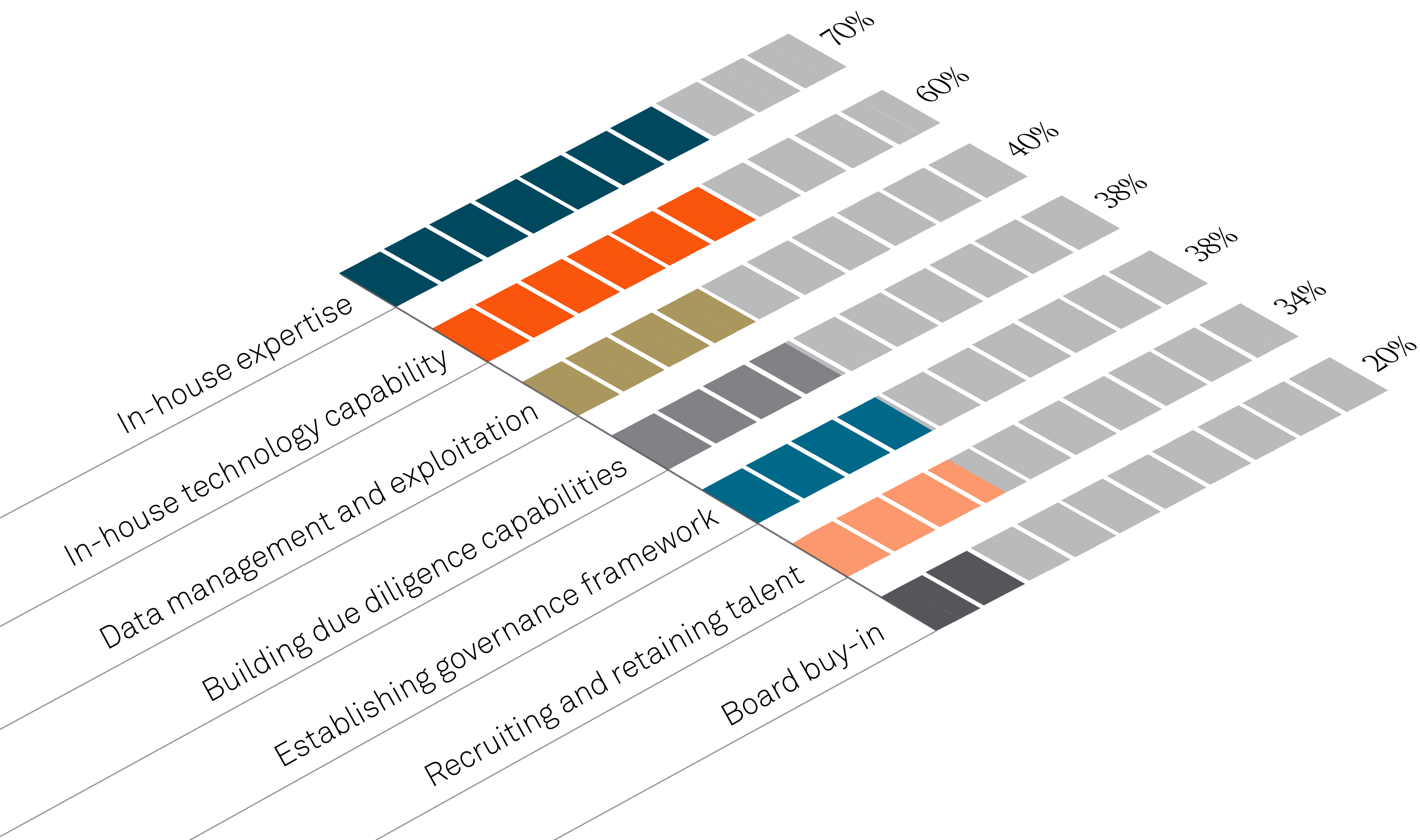
While innovation and sophistication are key elements of our ongoing success in these challenging markets, teamwork and the quality of our people provides us with a competitive edge.”

Julie Pominville
Chief Operating Officer
Trans-Canada Capital Inc.

Some 60% point to in-house technology capabilities as standing in the way of in-house asset management. That bar is only likely to move higher as tools and technologies such as data analytics, data science, machine learning and artificial intelligence become more embedded in the asset management sector. Data is increasingly the lifeblood of the investment process, with rapidly rising complexity across asset classes, global markets and information sources. Many asset owners, like many other institutional investors, have evolved technology environments over time through iteration, and are facing challenges as their goals and needs outstrip the capabilities available from their legacy technology platforms. Already, 40% of funds say they worry about their abilities in data management and exploitation.

The challenges of in-house management are further multiplied when plans move into private market investments, with cross-border complexities, data inconsistencies, transparency barriers and an intense and relationship-driven competition for deals. Given these challenges, the intense competition for talent that can deliver outsized results is no surprise.

What are the main challenges to in-house asset management? (Select top three)



Darcie James Maxwell
Lead Architect, Client Data Solutions

> **“With the asset management sector relying on a process of near constant renewal of its IT competencies, many pension managers worry about their ability to keep up in this arms race.”**

Top three challenges to in-house asset management

70%
In-house expertise

60%
In-house technology capability

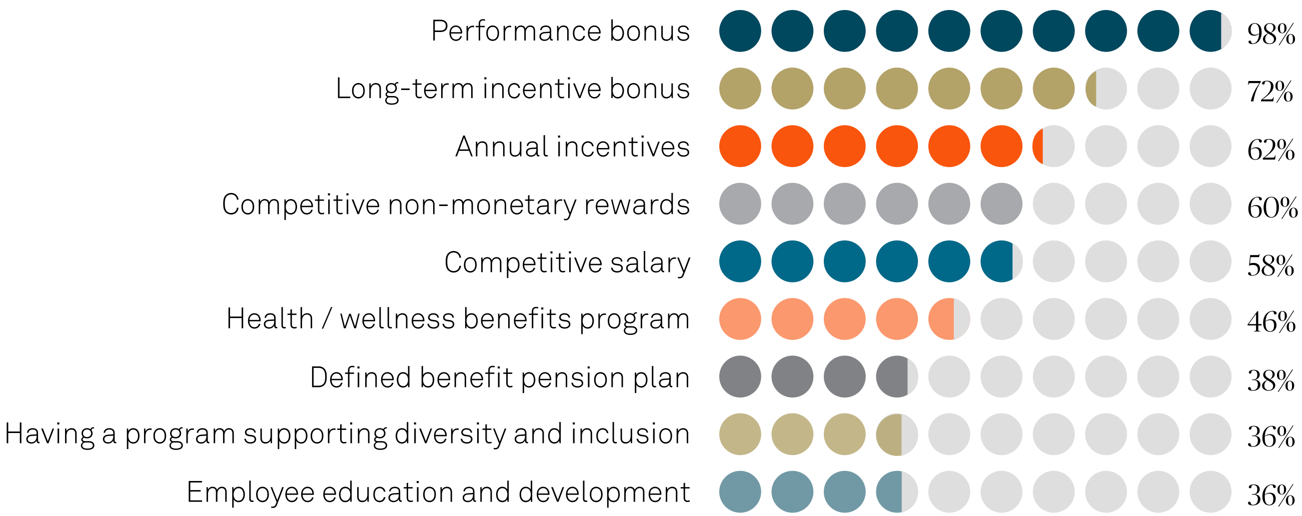
40%
Data management and exploitation

Pension funds are working hard to address these issues, with a significant number drafting in large teams of asset management professionals. A fifth of pension funds (20%) now have more than 100 members of staff employed directly in asset management. A further 10% employ between 51 and 100 asset management professionals, though in most cases the numbers are smaller.

With 34% of pension funds citing recruitment and retention as a significant challenge to in-house asset management, many funds are now focusing on incentives to address this issue. Almost all pension funds offer staff performance bonuses, but many are also looking at a wider range of broader benefits. Some 60% point to the non-monetary rewards they offer; 46% offer health and wellness programs; and 36% point to employee education and development initiatives.

Casting the net for talent more broadly may also be a crucial driver of success in recruiting and retaining the teams required. Already, more than a third of pension funds (36%) say they operate a program that supports diversity and inclusion. **With substantive research suggesting more diverse asset management teams deliver superior performance, this will no doubt be an area of increased investment in the years ahead.**[2]

What incentives do you have to recruit and retain appropriate talent? (Select all that apply)



With 34% of pension funds citing recruitment and retention as a significant challenge to in-house asset management, many funds are now focusing on incentives to address this issue.

Successful outsourcing: pension funds demand more

Despite their plans to manage more assets in-house, it is also clear that outsourced asset management remains important for Canadian pension funds. This makes sense given some of the barriers standing in the way of in-house asset management functions, but also because of the specialist expertise that external managers can offer.

“The majority of our assets are managed externally,” says the director of investments at one pension fund. “It limits the risk and liability for our organization, with an assurance of returns as well. We collaborate with managers on a regular basis to improve our understanding of the investment strategies employed and to gauge their suitability overall.”

Such pension funds will need to choose these managers carefully, with rigorous selection processes and performance and compliance measurement under-pinning their outsourcing programs.

Better returns are one of the top three drivers for those appointing external managers, cited by 58% of pension funds. This goes hand in hand with a desire to secure broader expertise and specialist services, which 56% of funds cite as important.

Many pension funds are identifying asset classes or investment specialties where they believe exposure is desirable and then appointing the managers they believe can deliver in these areas.

What are the key drivers for using external asset managers / outsourcing over in-house management? (Select top three)

A fifth of the Canadian pension funds surveyed (20%) have more than 100 staff employed directly in asset management.

Top three key drivers for using external asset managers / outsourcing over in-house management:

58%
Better projected returns

55%
Broader expertise / specialist services

52%
Complexity of funds

Canadian pension funds are determined to hold their external managers to account. Pensions know they will face rising reporting needs from their boards and trustees, which includes demonstrating strong oversight over their external manager or OCIO programs. Pension sponsors have taken the Canadian regulatory position to heart: they can outsource an activity or its execution but they cannot outsource the ultimate responsibility or duty.

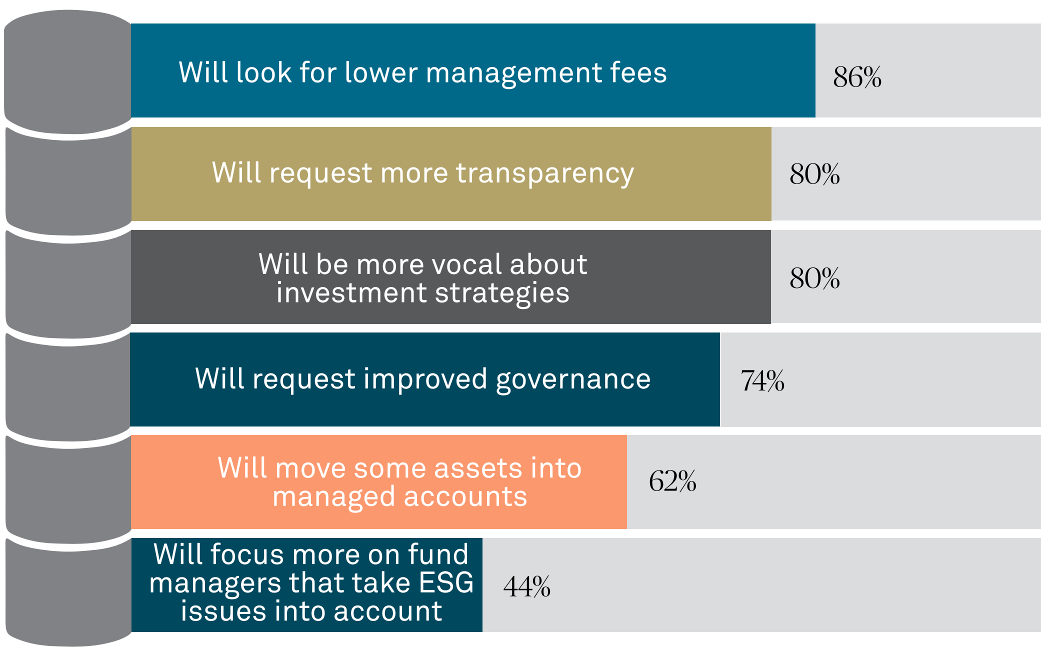
Many funds are not only looking for more from their external managers, they are also seeking to pay less for their services. According to our findings, 86% of pension funds say they intend to drive a harder bargain on investment fees over the next 12 months. As we have seen, in-sourcing asset management often secures considerable savings, but many funds are also keen to bring down on costs on outsourced contracts. The demand for greater transparency – highlighted by 80% of pension funds – is part of the same strategy.

It is also significant that 80% of pension funds intend to be more vocal about investment strategies over the next 12 months. Many funds recognize the benefits of in-house management but do not feel this is appropriate for them. Some may wish to focus in-house teams on specific asset classes, while leveraging external managers for other arenas. Others may lack the scale or organizational commitment to undertake the substantial investments into talent, technology and data systems necessary to support an in-house management program. However, where they are continuing to work with external managers, they intend to be more hands-on than in the past. This not only relates to performance, but to broader issues such as governance and – for some – the consideration of non-financial or values-driven factors such as ESG.

86%
of pension funds say they intend to drive a harder bargain on investment fees over the next 12 months.

80%
of pension funds intend to be more vocal about investment strategies over the next 12 months.

In what ways do you expect your approach to investing in fund managers to change in the next 12 months? (Select all that apply)



"The majority of our assets are managed externally. It limits the risk and liability for our organization, with an assurance of returns as well. We collaborate with managers on a regular basis to improve our understanding of the investment strategies employed and to gauge their suitability overall."

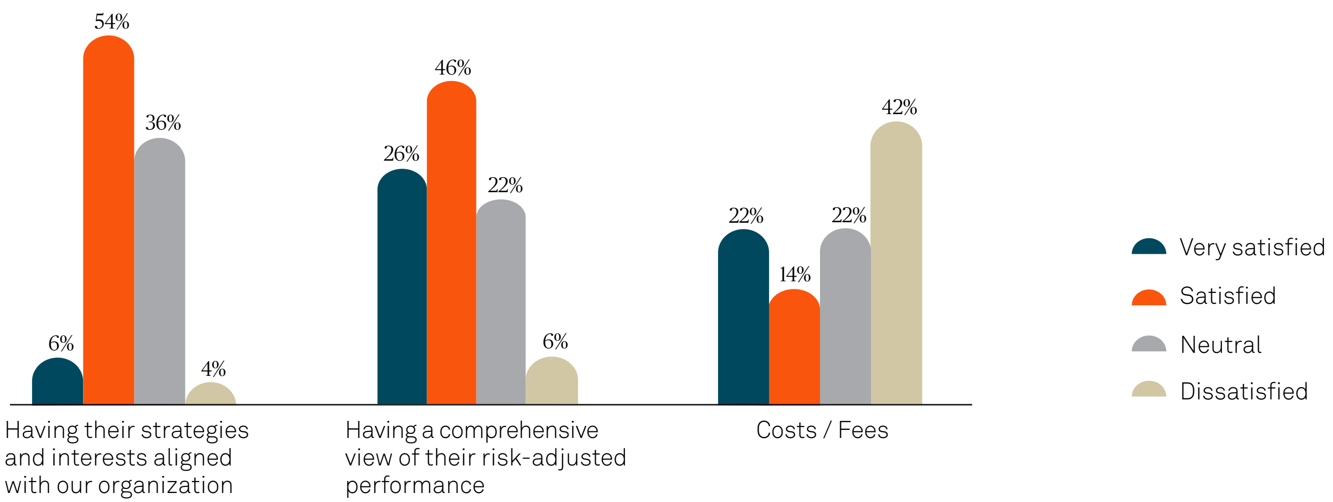
Pension Fund Director of Investments

External asset managers will need to be prepared to rise to the challenge – while many pension funds say they are satisfied with the performance of their external managers in key areas, there is plenty of room for improvement.

On cost, 42% of pension funds say they are not happy with the current fees involved. This focus on cost is likely to feed through into charging models. Already, more than half of pension funds (54%) expect to increase fixed hurdles in performance fees over the next 12 months, including 34% who expect use to increase significantly. Similarly, two-thirds (66%) of funds expect the use of indexed hurdles to increase.

On aligning strategy with investment goals – a key driver for a move to in-house – only 60% of pension funds say they are satisfied or very satisfied with their managers' performance. The number rises to 72% on the extent to which managers have a comprehensive view of funds' risk-adjusted performance, but here too there is room to go further.

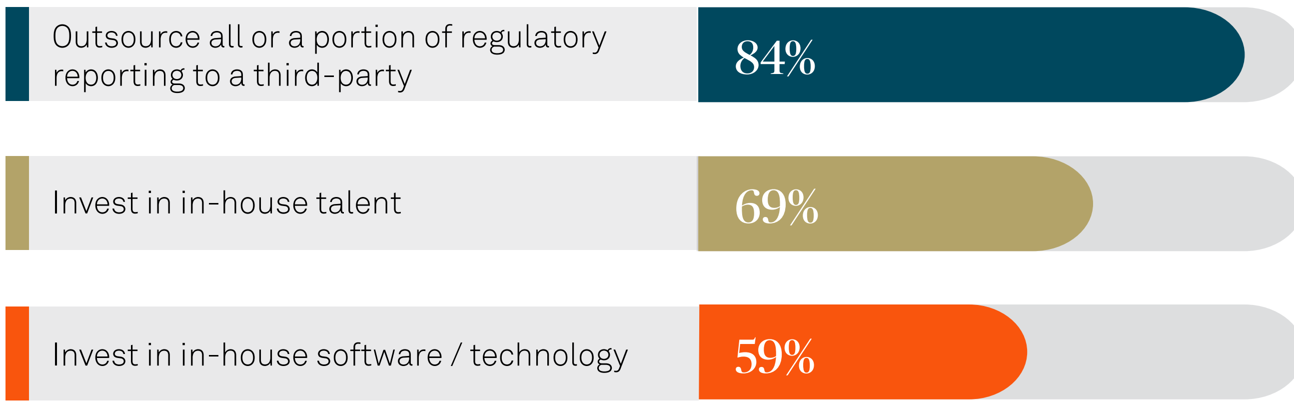
How satisfied are you with your external managers in the following areas?



> Only 60% of pension funds say they are satisfied or very satisfied with their managers' performance. As pension plans reposition their investments, this may create opportunities for leading external managers to capture new mandates based on outperformance, cost containment or their ability to demonstrate closer strategic alignment to pension funds' goals."

Finally, it is important to recognize that pension plan sponsors and pension fund managers are looking across the board at the in-house versus outsourcing debate - from operations to technology to investment management. While 84% of funds say they will outsource at least some of their regulatory reporting work over the next 12 months, it is notable that this is also an area prioritized for in-house investment. Some 69% and 59% of pension funds respectively report they will invest in talent and technology in this regard.

How do you expect your organization to meet its legal and regulatory requirements over the next 12 months? (Select all that apply)



84%
of funds say they will outsource at least some of their regulatory reporting work over the next 12 months.

"Pension plan administrators are under tremendous and rising pressure to exercise good governance - from regulators, boards, trustees, governments and individual members. Governance audits or reviews should be regularly undertaken to review compliance, best practices and areas for potential improvement."

Shilpa Savla
Assistant Vice President,
Pension Benefit Services

Canadian pension plan sponsors and fund managers remain relentless in their pursuit of stronger outcomes for stakeholders. Boards and Trustees demand sustainable returns, dependable operations and attentive service to plan members - all while reinforcing sharp focus on compliance and sound governance. Even the largest plans increasingly recognize they lack the scale and resources to be the very best at everything for which they are ultimately accountable. As a result, they continue turning to strong and specialized providers for support as they focus their time and resources on the areas where they can drive greatest value for plan members."

Ian Fulton
Assistant Vice President,
Institutional and Pension
Accounting

“As we have seen, Canadian pension funds are pursuing investment strategies founded on portfolios with diverse assets, including significant holdings of alternative assets. Securing sufficient expertise in such a broad range of areas is naturally difficult.”

Alistair Almeida
Segment Lead
Asset Owners

Chapter 2: 10 Minute Video Recap Discussion

In-house capabilities are on the rise, but outsourcing remains vital

Our second chapter explores how pension plans are expanding in-house capabilities while also becoming more strategic in their use of outsourcing. Considerations include alignment to organizational objectives, potential cost savings, opportunities to capture stronger returns, and a core strategic question on whether to invest into in-house or outsourced technology. In our chapter 2 video, Alistair Almeida connects with Darcie James Maxwell and Ian Fulton to explore these trends and questions.

This video is available at **www.cibcmellon.com/isonv**

Download all our chapters at **www.cibcmellon.com/insearchofnewvalue** or contact your relationship manager to discuss our findings.

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CHAPTER 3

In Search of New Value

RISE OF THE CONSOLIDATORS: CANADIAN ASSET OWNERS PURSUE SCALE AND OPPORTUNITY

Chapter 3 of our research, explores how Canadian pension plans are seeking scale via consolidation, and in some cases transforming into asset managers who compete for external mandates.

> "Maintaining in-house technology capabilities and in-house expertise are challenging. Addressing skill gaps is difficult at a time when the economic situation is changing and most companies are looking to adapt. Increasing technology capabilities is challenging because of the significant downtime that is involved."

Pension Fund Chief Financial Officer

Investment strategy

3

Rise of the consolidators: asset owners as asset managers

72% of Canadian pension funds are **currently focused on consolidation options** that seek to offer greater certainty that the fund will be able to meet its liabilities.

50% of pension funds considering merging other funds' assets into the plan believe this will require them to **cope with greater scrutiny;** however, **economies of scale** and regulatory effectiveness offer significant potential benefits.

50% of pension funds **plan on implementing their consolidation plans over the next three to five years.**

Across markets, segments and business lines, for Canadian asset owners, asset managers, insurance companies, and indeed across many other industry verticals, the hunt for scale has been a key driver of stronger outcomes. For asset owners and asset managers alike, the collection and consolidation of larger asset pools is at the heart of driving scale.

Scale can enable efficiencies, stronger pricing power and the development of more specialist capabilities to achieve key organizational goals. Greater scale can confer the ability to amortize research, technology, operational efforts across a broader cost base. Others see scale as enabling greater access to desirable investment opportunities (or indeed, desirable investment talent). Consolidation can take many forms; while many in the industry are familiar with annuitization or risk transfer of assets and liabilities to a larger provider, Canadian organizations have also launched other structures to enable asset management consolidation.

Various government entities across Canada have established independent pension asset management entities designed to deliver professional and advanced asset management to underlying sponsors. Some private pension entities are competing with asset managers to manage outside capital on behalf of other plans, or even embarking on campaigns to merge in and take on the pension assets and liabilities of other plans. The use of an Outsourced Chief Investment Officer (OCIO) is another route to access scale and efficiency while maintaining control over overall strategy. Still other structures may yet emerge. In each case, the consolidators offer a compelling proposition to smaller plan sponsors, who see opportunities to simplify their cost structures or even exit the business of pension management to refocus on their own core businesses.

The "Canadian pension model" has become known around the world[1] for delivering out-sized results for stakeholders built around key factors such as independent governance, joint sponsorship by employers and employees, greater portions of in-house asset management, significant investment in talent, a long time horizon, and most recently higher portions of investment into private market assets. Competition for outside assets may very well represent the next stage of evolution for Canada's innovative industry.

One consequence of COVID-19 is likely to be that many pension funds and their sponsors will take time to review their strategies, operations and investment strategies. For some, this may involve reducing risk appetites and lowering allocations to higher-risk asset classes – particularly for funds that already enjoy strong funding levels – but many will pursue other de-risking options or consider consolidation.

According to our survey, pension funds say there are a range of options already being considered if not actively implemented. The push to reduce uncertainty is nearly universal: 72% say they are already reducing the uncertainties around their liabilities through some sort of risk transfer, with an additional 26% considering doing so through some form or another. This may mean the purchase of an annuity or another type of third-party guarantee, shifting to an investment approach where assets are matched more closely to liabilities, joining forces with other organizations to manage assets or asset classes at scale, or – for some – seeking to take in and manage assets on behalf of other asset owners.

Other solutions being implemented include the use of pension or government entities (52%) and greater use of an Outsourced Chief Investment Officer (OCIO) in certain circumstances (48%). Almost a fifth (18%) say they are considering consolidation by incorporating or merging other pension assets, liabilities or operations into their plans. The same number say they are thinking about whether to begin managing assets on behalf of other pension plans.

Collaborative strategies can work well, according to the director of investments at one pension fund: "Investments together with external funds have helped us remain sustainable over the past few months. Since performance has been dropping to some extent, we have been intent on improving capabilities and managing pooled assets has allowed us to delay exits where required."

"The ongoing evolution of Canadian pension plans as asset managers will no doubt bear close observation by industry participants and by global pension industry watchers - particularly given the significant disruption to markets in 2020 and into 2021."

Alistair Almeida
Segment Lead
Asset Owners

Ash Tahbazian
Chief Client Officer

"Asset owners and asset managers alike face rising pressure from stakeholders, increasing market complexity and growing competition for opportunities. The pursuit of scale and its ability to support greater focus and expertise - whether by growing assets or by tapping into specialized providers - will likely continue to accelerate."

72%

of pension plans and sponsors are currently undertaking consolidation or risk transfer options that seek to offer greater certainty that the plan will be able to meet its liabilities.

50%

of pension funds considering merging other funds' assets into the plan believe this will require them to cope with greater scrutiny; however, economies of scale and regulatory effectiveness offer significant potential benefits.

50%

of pension funds plan on implementing their consolidation plans over the next three to five years.

Darcie James Maxwell
Lead Architect,
Client Data Solutions

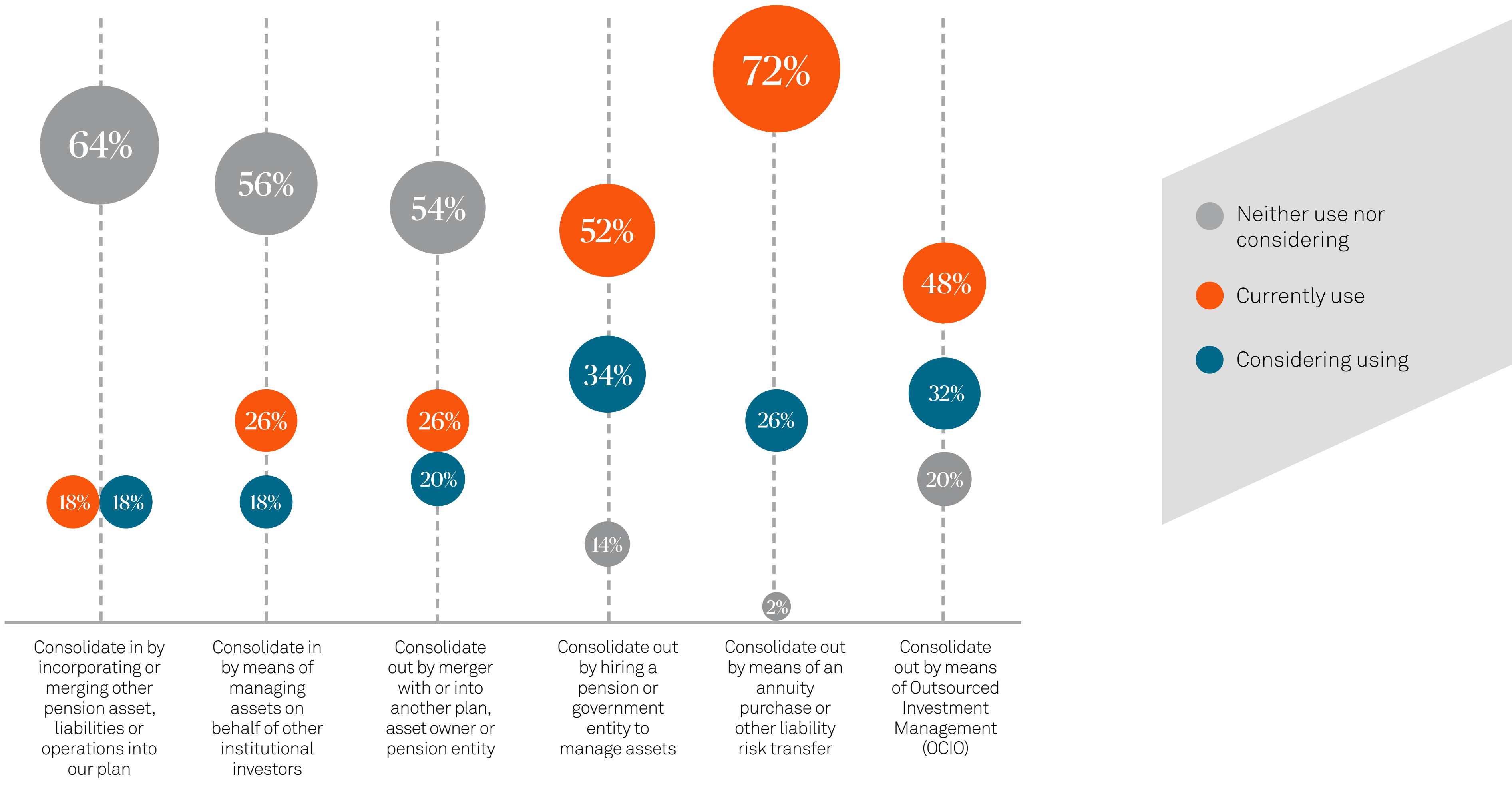
"As Canada's pension funds pursue innovative and sophisticated investment and organizational strategies, some are turning to advanced technology and data tools to streamline operations, access new market opportunities and gain competitive advantage. Target outcomes include greater agility, enhanced resiliency, and a desire to better future-proof technology operations against the emerging needs of tomorrow. Some players are looking to close gaps in technology investment and modernize legacy tools using established best practice, others seek to keep pace in the asset management technology arms race, and a few are looking to leapfrog global competitors and capture opportunity by breaking new ground.

Regardless of motivation or target stance, there is increasing recognition among Canadian pension funds that the status quo is insufficient to meet future needs."

The decision to consolidate, and if so, the selection of the model or models to employ, will not be a straightforward set of decisions. As with many other aspects of pension plan and asset management, one size does not fit all. While consolidation offers pension funds certain advantages, there will also be obstacles to overcome. Pension funds intend to take their time making such decisions and introducing any new approaches.

Just 4 per cent anticipate completing such work within the next 12 months, though 40% are working to a timescale of between one and three years, with a further 50% expecting to take three to five years.

Do you use or are considering using the following approaches to consolidation?



Currently, 24% of pension funds report that they manage assets on behalf of external organizations, while a further 16% plan to do so in the future or are at least considering such a move. This portion may seem high, until one recognizes that the "Canadian model" of pension management has seen many pension plans move asset management and at times also plan member service delivery functions from government entities and employer plan sponsors out to separate entities reporting to independent Boards of Trustees and working in service of their employer / sponsor and plan member clients.

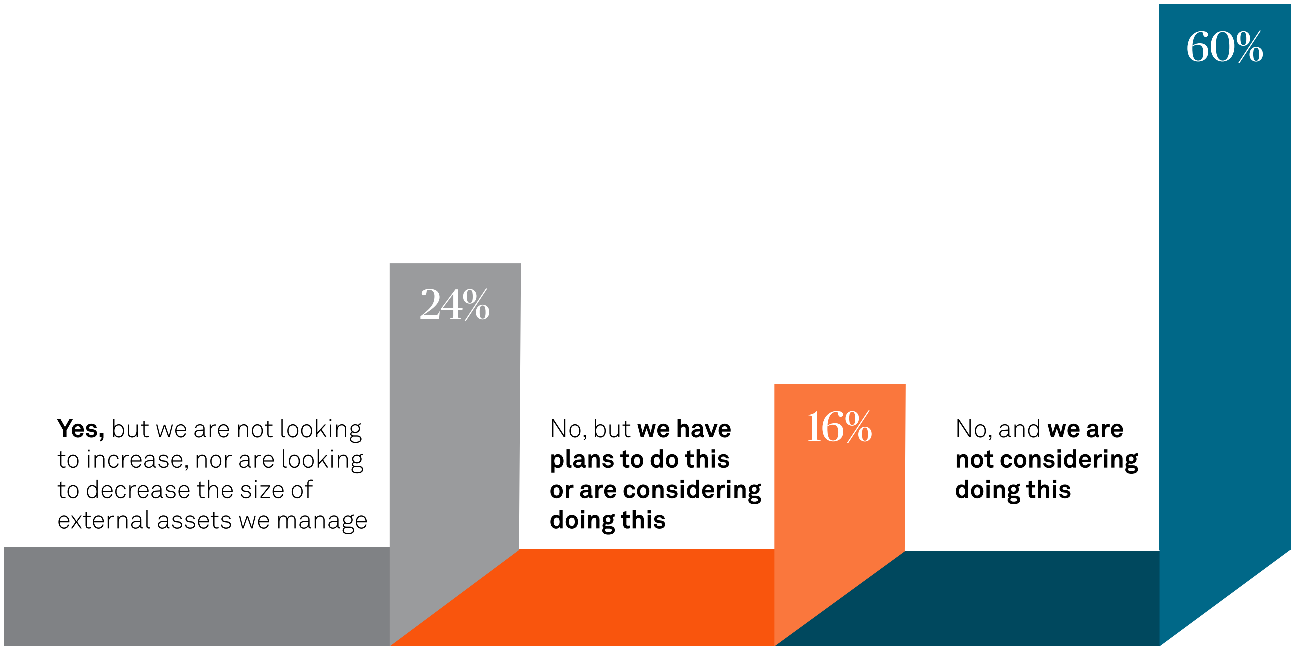
Funds that do manage assets in this way are most likely to do so on behalf of other pension plan members (cited by 92%), but third-party endowments and foundations (92%), charities (67%) and related organizational clients such as the corporate treasury function (67%) are also key - and for some, key prospects.

"

Scale confers considerable advantages on a pension organization. It enables more activities on both the investment and administrative side to be brought in house, reducing costs and improving long-term alignment of interests. Scale also enables organizations to make meaningful investments in technology, helping improve both pension administration and investment operations, that smaller organizations would not be able to make. Governance can also benefit from scale, because larger, more sophisticated funds often have an advantage in attracting board members and in ensuring their boards are well supported."

The Evolution of the Canadian Pension Model Practical Lessons for Building World-class Pension Organizations, World Bank Group Report

Does your organization manage assets from external pension funds?

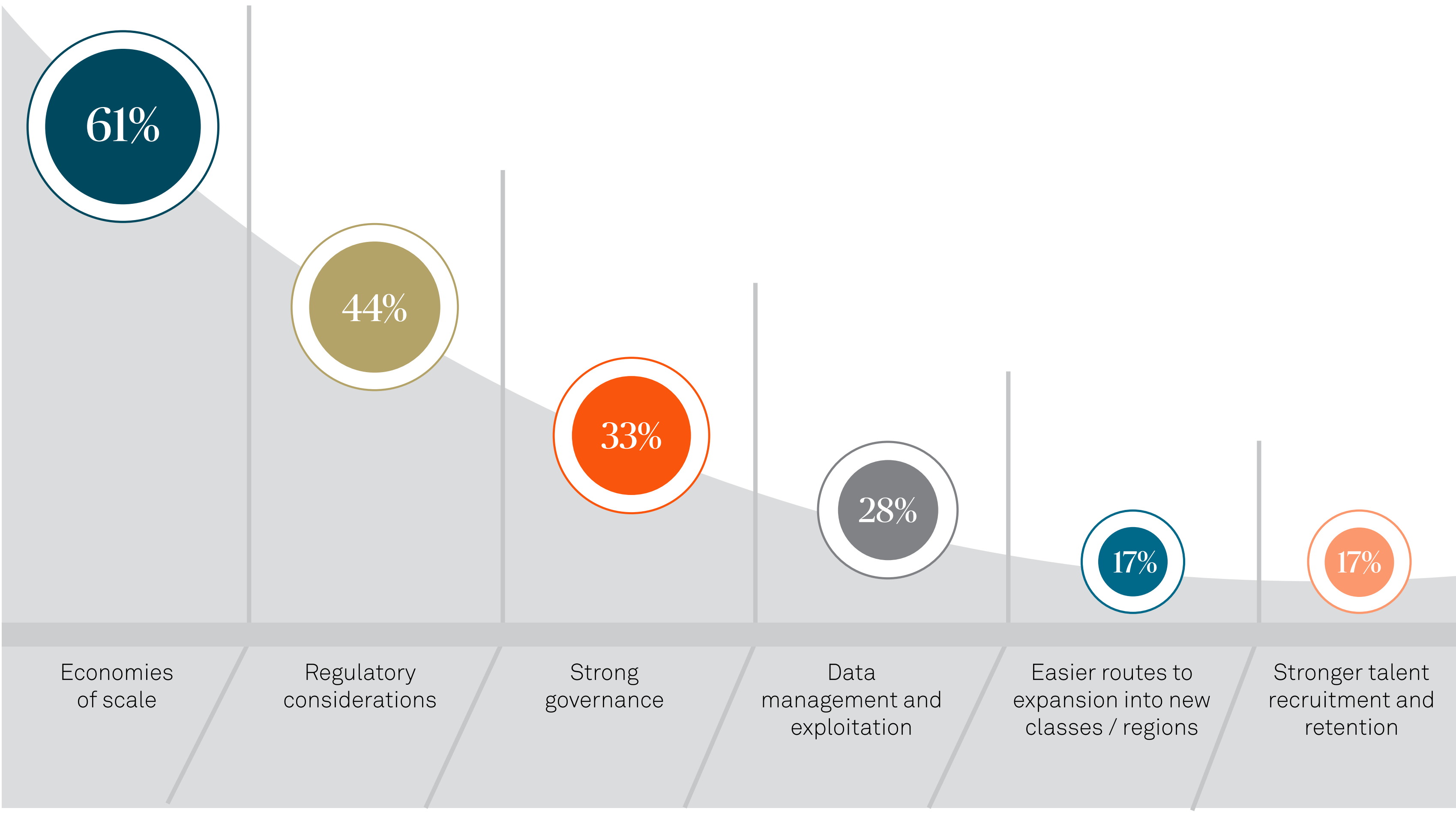


Consolidation brings benefits as well as concerns

Clearly, there are good reasons to consider consolidation options given the current market backdrop. Many analysts now expect moves such as mergers of pension plans or consolidation into larger multi-employer pension plans or pension asset management organizations to accelerate. Funds themselves realize the potential benefits of such mergers. More than half (61%) point to the possibility of securing economies of scale in a merged entity. Some 44% suggest that larger funds may also be able to manage their regulatory responsibilities more effectively.

There may also be scope to tackle some of the problems highlighted elsewhere in this research. For example, 28% of pension funds believe consolidation via a merger might be an opportunity to improve the way they make use of data. Some 17% think this could make it easier to plan expansion into new asset classes and regions.

What are the main drivers for plans considering consolidation via merger? (Select top two)



“Investments together with external funds have helped us remain sustainable over the past few months. Since performance has been dropping to some extent, we have been intent on improving capabilities and managing pooled assets has allowed us to delay exits where required.”

Pension Fund Director of Investments

DBplus was created to provide what employers and employees both want. Employers want predictable costs while attracting, retaining and de-stressing employees by providing a defined benefit pension plan. Employees want the same things: predictable contributions and a pension that will last their lifetime. Through DBplus, CAAT is making a modern defined benefit pensions available to more Canadian workplaces.

DBplus provides secure, predictable retirement income for life. CAAT's low administration costs and not-for-profit structure provides employees a better return on their pension contributions and helps employers focus less on administration, and more on achieving their organizational goals."

Derek W. Dobson
Chief Executive Officer,
CAAT Pension Plan

PODCAST

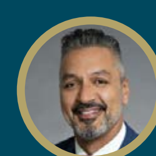
Scale, Expertise and Focus

United Way Greater Toronto joins the CAAT Pension Plan

Listen to United Way Greater Toronto Chief Operations and Financial Officer Michael Cheong, CAAT Pension Plan CEO Derek Dobson and CIBC Mellon's Ash Tahbazian discuss scale expertise and focus, including UWGT's decision to consolidate into the CAAT Pension Plan - as well as the power of scale, expertise and focus.

Michael Cheong
Chief Financial and
Operating Officer,
United Way Greater Toronto

Derek W. Dobson
Chief Executive Officer,
CAAT Pension Plan



Ash Tahbazian
Chief Client Officer,
CIBC Mellon

Watch the video:
https://vimeo.com/cibcmellon/expertise

Listen to the podcast:
https://anchor.fm/cibcmellonperspectives/episodes/The-Power-of-Expertise--Scale-and-Focus-eqhua3

Consolidating into another pension entity: United Way Greater Toronto.

Michael Cheong
Chief Financial and
Operating Officer,
United Way Greater Toronto

"Our intention has always been to continue providing a pension plan to our valued employees, but we found managing a pension plan took focus away from our core mission of tackling local poverty and unignorable issues linked to and impacted by poverty.

We were delighted to join the CAAT Pension Plan's DBplus plan at the end of 2020, which gave our employees access to a jointly-sponsored pension program run by those with expertise in pension and investment management.

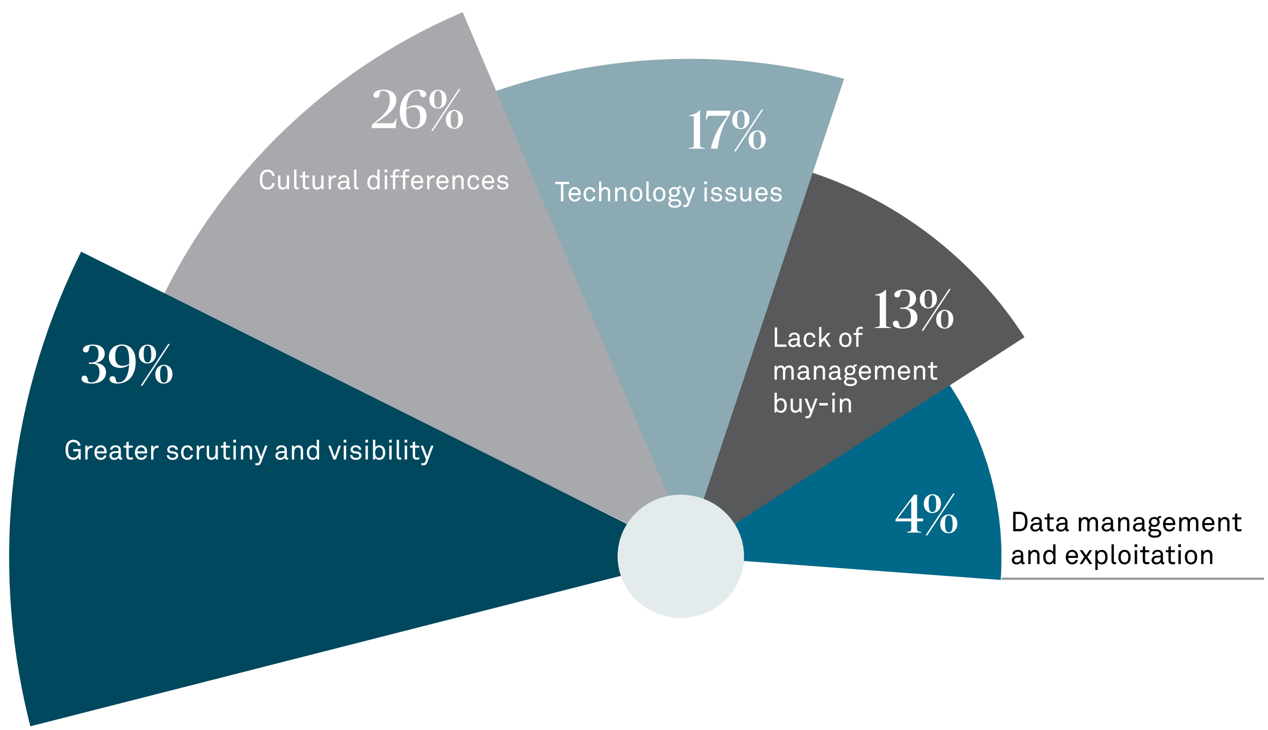
This merger allowed us to improve the pension plan we offer to our employees, helping ensure long-term, sustainable and secure retirement savings. An overwhelming majority - 99% - of members voted for the merger. The decision to join had many pros for our organization and employees. It was an easier and simpler plan to understand, with no member investment decisions to make. There were enhancements in areas like indexing, early retirement and survivor benefits. We were able to achieve more stable costs, reduce annual service costs, and stay aligned on the incorporation of ESG factors. We were also able to significantly reduce the governance and oversight requirements for our Board's Finance, Audit and Risk Committee."

Pension plan mergers present their own challenges, with hurdles to overcome even as plan stakeholders seek to deliver benefits to plan sponsors and members. Among those funds considering incorporating or merging other pension assets, liabilities or operations into their plan, 50% point to the need to cope with greater scrutiny and increased demands for visibility. Regulators and pension plan members will want to ensure that plan members' interests are protected.

There are the practical integration aspects of any merger: more than a quarter of pension funds (28%) point to technology issues, such as bringing legacy systems together which could jeopardize the route to economies of scale. Cultural differences are also an issue, highlighted by 11% of pension funds.

The same problems, moreover, confront pension funds considering incorporating or merging their assets into another pension fund or entity – as our findings show, pension plan mergers are challenging for both parties.

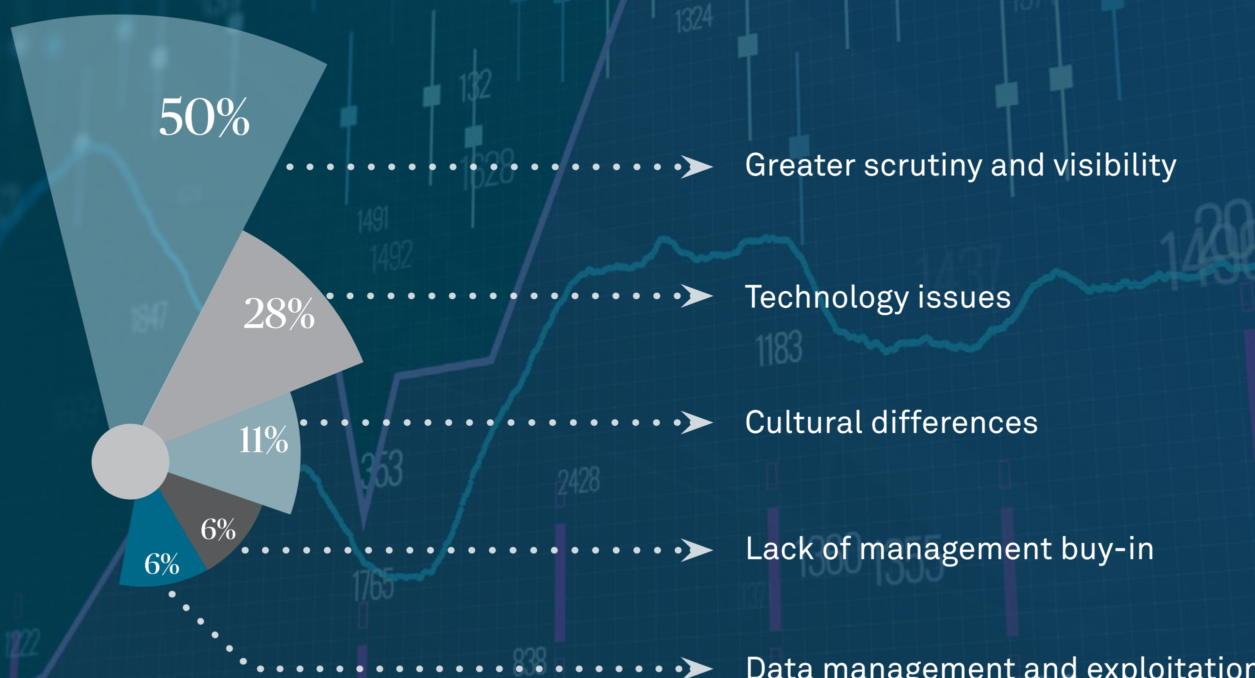
What do you consider to be the main challenge for consolidation via merger with or into another plan, asset owner or pension entity?



"In order to manage assets from external funds, we need more talent and technology capabilities; the governance, policies and legal terms will also need to be discussed before we move ahead to protect interests."

Pension Fund Director of Investments

What do you consider to be the main challenge of incorporating or merging other pension assets, liabilities or operations into your plan?



Rise of the consolidators: new challenges face asset owners as they seek greater scale through consolidation.

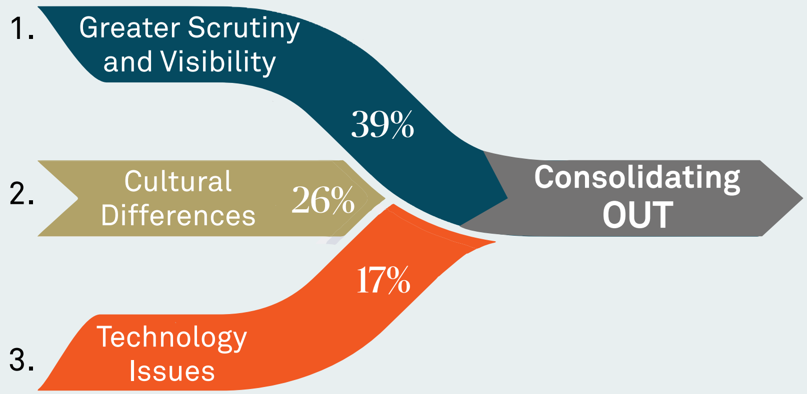
For asset owners seeking scale by moving investment, pension or operations activities out to a larger provider, and similarly for those looking to grow by consolidating in assets from outside pension entities, similar questions and challenges are in focus. Canadian pension plan sponsors take their fiduciary responsibilities seriously, and this is likely to colour their considerations of whether and how it makes sense to come together with other entities.

Greater scrutiny and visibility was top of mind across the board, along with concerns related to potential cultural differences between organizations as well as technology issues. Those looking to transfer responsibility, asset management or operations outside of their organization also expressed concern about cultural differences between organizations as well as the technology outlook.

Top three challenges:

Consolidating OUT

Pension funds via merger into another entity



Consolidating IN

by merging outside assets, liabilities or operations into the plan

Areas for consideration

Potential focus areas as pension stakeholders consider their future operational stance

Governance

- How will consolidation impact our governance requirements?
- What are our stakeholders' needs for transparency, oversight and compliance?

People and organization

- Do we have the necessary internal expertise to move our organization forward?
- How will our talent needs evolve?
- What is the right organizational design to set us up for the future?

Investments

- Do we have the scale and expertise to succeed? If not, how can we access it?
- How are we evolving our asset allocation strategy?
- What asset classes or strategies should we manage in-house?
- Where will we rely on external managers?

Administration

- How do we deliver high quality service to plan members or stakeholders?
- What is our technology strategy?
- What is our data strategy?

Plan design and funding

- Is our organization appropriately aligned to its core mission?
- How have our assumptions been confirmed or challenged by market turmoil in 2020?
- How are we measuring, monitoring, mitigating and sharing risk?

Regulation and public policy

- How is our organization maintaining the trust of our stakeholders?
- How are we navigating the regulatory and legislative environment?
- How will we continue to operate at the highest standards?

"Pension plan sponsors, pension asset managers, OCIO providers, insurers and other Canadian pension industry participants are leveraging their leading talent, advanced governance models, and investment expertise as they compete in a challenging market, seek to more efficiently access scale, and above all, work to deliver better results for their stakeholders.

Darlene Claes McKinnon
Executive Director,
Relationship Management

In addition to in-house expertise, many participants are engaging third-party experts for insights, advice, independent oversight and even hands-on participation in such aspects as governance, transformational project management, complex investment and operational strategies, and plan member services. We are seeing rising use of consultants and external advisors in areas beyond investment and pension design, as industry players work to act quickly but conscientiously in response to opportunities and risks.

For major organizational transformations, such as consolidation of assets or liabilities, thoughtful consideration is critical to successful outcomes, as the benefits and risks of consolidation must be carefully identified, measured and balanced. The need for support doesn't stop with the decision to change, either - we see a rising number of sustained engagements, with external advisors supporting smooth transitions as well as stronger sustained outcomes in complex multi-party relationships."

Consolidation Implications: Questions worth exploring

Canadian Pension Plans have built a global reputation on a foundation of strong governance, sound leadership, advanced investment strategy, innovative organizational design and more. The emergence of Canadian pension consolidators and the move by some Canadian leaders to take on outside assets represents a new industry chapter that is likely to generate considerable discussion within and beyond Canada.

For pension plan sponsors seeking scale by engaging larger players to manage assets, take on liabilities or assume key operational functions, just as for organizations looking to grow by taking on mandates from smaller pensions, significant and thoughtful diligence will be required. As with any major organizational transition, robust review, collaborative engagement with stakeholders, and a sharp focus on governance are likely to help drive successful outcomes. "Structures, processes, and leadership that build and maintain trust among relevant pension stakeholders"including accounting for the needs of members, employers, unions, as well as government, regulatory and market stakeholders have been hallmarks of the "Canadian pension model."[2]

Many questions will arise as organizations contemplate new mandates – whether approaching them as counterparties, clients, colleagues, asset managers, service providers – establishing a shared framework will help both parties gain confidence around their shared concerns around scrutiny, visibility, technology and cultural alignment.

"Canadian pension plan sponsors take their fiduciary responsibilities seriously, and this is likely to colour their considerations of whether and how it makes sense to come together with other entities. From consolidation restructures, annuity buy-outs, innovative longevity risk mitigation strategies, and the strategic use of external asset managers to access scale, our clients continue to explore both old and new approaches to optimize their management of pension assets, liabilities and operating models."

Hilary Grimmett
Relationship Executive

More questions worth asking

A wide array of framing questions may help those on both sides of the consolidation equation assess the potential fit of any major transition.

	Consolidating OUT to another pension management entity	**Consolidating IN** external assets, liabilities or operations from a pension plan or sponsor
	What are the benefits and risks of consolidation to our stakeholders?	
Governance	• How will Trustees approach the strategy? • What other stakeholders do we need to engage, and how – unions, employers, members, consultants? • How will we provide confidence to stakeholders that transitioning key responsibilities to an outside organization is consistent with fiduciary, regulatory and member service obligations? • What governance is needed over the outside operations – through the selection process and in terms of ongoing performance? • What are the implications of consolidation to our investment policies and procedures?	• How will taking in outside assets or liabilities impact our organization's governance and risk framework? • How will we provide confidence to underlying clients and their plan members regarding sound governance? • How will we sustain the confidence of the plans and members we serve? • What are our responsibilities in terms of supporting governance over our organization by our new stakeholders?
	• How will consolidation change our governance and regulatory obligations?	
People / Organization	• How will the change impact the organization's people strategy? • What are the implications of consolidation to in-house teams? • What talent and organization should be retained in-house? • What people or resources can we free up by transitioning out? Can we reallocate them to better achieve our goals?	• How will our talent needs change as we grow? • How should we structure our organization to maximize success for stakeholders? • What is our target client, stakeholder or member service model? • What new skills, people or capabilities do we need as we expand our services to outside organizations?
Investments	• How does the current asset/liability mix align with the consolidator entity? • What are the implications to our investment policies and procedures? • Do we have strategic alignment? (e.g. risk tolerance, stance on ESG)	• How will we continue to achieve the investment performance our stakeholders expect? • What will be managed in-house? • What will be outsourced? • How will the organization continue to balance risk and liabilities? • How should we adapt our investment and allocation strategy as we grow?
Administration	• What technology, administration functions, member services or other administrative activities must be retained?	• What is our long term technology and data strategy? • How will the organization evolve its business functions over time (e.g. client service, marketing, member support, risk management)?
Plan Design and Funding	• How will consolidating out impact plan design or funding assumptions? • What cost efficiencies can we achieve through consolidation? • How will engaging an external provider change our liability, solvency or funding obligations?	• How will inbound assets, mandates, clients, liabilities or operations impact risk or funding? • What new opportunities will open up as we gain scale? What new risks? • How can we gain cost efficiencies as we scale up? How do we share those with our stakeholders?
	• Are the financial advantages of consolidation sufficient to justify the transition effort and costs? • What are new obligations or impacts to current members/stakeholders could result from the changes? • How will a new consolidation mandate benefit current stakeholders? • How can we demonstrate that the transition serves the interests of our current stakeholders?	
Regulation and Public Policy	• What are the regulatory and policy implications of the change? • How will members perceive the change? • What current or emerging legislation from various government levels will impact our organization? • Are there any additional considerations or consequences we need to consider?	

Chapter 3 of our research: Video Recap Discussion

In this third chapter, we explore how Canadian pension plans are seeking scale via consolidation, and in some cases transforming into asset managers who compete for external mandates. In our chapter 3 video, Alistair Almeida connects with Hilary Grimmett and Cynthia Shaw-Pereira from our global enterprise to explore these trends.

This video is available at **www.cibcmellon.com/isonv**

Download all our chapters at **www.cibcmellon.com/insearchofnewvalue** or contact your relationship manager to discuss our findings.

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In Search of New Value

CHAPTER 4

LIQUIDITY, LESSONS LEARNED AND THE LONG-TERM IMPACTS OF COVID-19 ON ASSET OWNERS

Chapter 4 of our research, explores the push to lower fees, the fallout from liquidity limitations, and the future outlook as Canada's innovative pension funds reposition themselves for the future.

CIBC MELLON

Looking ahead

Canada's pension plans enjoy a well-deserved global reputation for strong management and resilient performance, but they are not immune to shocks in the markets in which they operate. The COVID-19 pandemic has tested pension plans and their asset managers, prompting significant volatility in financial markets and reshaping the global economy. This is the backdrop against which we surveyed 50 of Canada's leading pension plans, seeking insights into how they have coped with the crisis, the challenges and opportunities that now lie ahead, and how they are positioning themselves. In 2021, we engaged collaboratively with clients across industry forums, peer discussions and individual meetings to further explore our findings, and capture additional insights regarding how Canadian pension plans continue to navigate the pandemic environment.

In this final chapter, we review some of the longer term implications across research dimensions such as asset management outlooks, outsourcing strategy, industry consolidation and technology. We also explore questions around liquidity, assess lessons learned from the pandemic dislocation, and look to the long term implications as Canadian asset owners look to the future.

Investment strategy

4

From lower fees to liquidity limitations:

What does the future hold?

58% of pension fund managers believe the push for lower investment fees will be a crucial theme for their sector over the next two years. 30% cite the increasing role of new technologies.

80% have made operational changes including succession plan changes and shifts in investment policy, with 29% making changes to asset allocation, all as a direct result the COVID-19 crisis.

64% of pension funds say they have had concerns about liquidity during the crisis and almost all say their future investment decisions will be influenced by this experience.

46% of the pension funds surveyed say COVID-19 has prompted a review of their outsourcing plans.

One defining theme that emerged from our initial research, across client discussions and industry workshops in 2021 is that there is no one size fits all approach. Canadian pension plans are sophisticated and recognize that differences across organizational structures, talent, geography, scale, and even political context can critically influence which strategies are most likely to deliver optimal outcomes. As a result, plans are thoughtful and willing to deploy a diversity of approaches. Canadian plans necessarily worked through the market and industry disruption of 2020, but are seeking to incorporate the lessons learned through the pandemic period to drive success over the months and years ahead.

“Over a period of time, the assets managed in-house will increase considerably,” predicts one pension fund managing director. “Once there is relief from the pandemic risk, organizations are bound to consider better opportunities for sustenance and to develop measures for long-term growth. The cost savings attached to bringing operations in-house is higher and will drive changes in the Canadian pension fund investing space.”

Concerns about fee levels looks set to dominate the debate. Some 58% of funds suggest that lower fees for asset managers will be one of the two most significant trends in the Canadian pension fund market over the next 12 to 24 months.

With the fallout from COVID-19 likely to keep monetary policy around the world at historically loose levels, the search for return will go on. Pension funds intend to double down on their efforts to minimize anything that eats into returns.

According to our survey, pension funds say there are a range of options already being considered if not actively implemented. For example, 72% say they are reducing the uncertainties around their liabilities through some sort of consolidation or risk transfer. This may mean the purchase of an annuity or another type of third-party guarantee, shifting to an investment approach where assets are matched more closely to liabilities, joining forces with other organizations to manage assets or asset classes at scale, or – for some – seeking to take in and manage assets on behalf of other asset owners.

Other solutions being implemented include the use of pension or government entities (52%) and greater use of outsourced investment managers in certain circumstances (48%). Almost a fifth (18%) say they are considering consolidation by incorporating or merging other pension assets, liabilities or operations into their plans. The same number say they are thinking about whether to begin managing assets on behalf of other pension plans.

Such strategies can work well, according to the director of investments at one pension fund:

“

Investments together with external funds have helped us remain sustainable over the past few months. Since performance has been dropping to some extent, we have been intent on improving capabilities and managing pooled assets has allowed us to delay exits where required.”

Director of Investments, Pension Fund

58%

of pension funds believe the push for lower investment fees will be a crucial theme for their sector over the next two years, while 30% cite the increasing role of new technologies.

80%

have made operational changes including succession plan changes and shifts in investment policy, with 29% making changes to asset allocation, as a direct result of the COVID-19 crisis.

64%

of pension funds say they have had concerns about liquidity during the crisis and almost all say their future investment decisions will be influenced by this experience.

46%

of the pension funds surveyed say COVID-19 has prompted a review of their outsourcing plans.

Technology and data in focus

Technology and data are rising in focus as pension plan leaders look to achieve their strategic goals and navigate a rapidly shifting risk and opportunity landscape. Almost a third of pension funds (30%) see innovation that delivers lower investment charges as a key theme of the next couple of years. New models of service delivery, underpinned by advances in technology in areas such as data science and automation, could provide funds with the cost efficiencies they are seeking.

Technology is also widely regarded as a route to the greater transparency that stakeholders - including Boards, unions, plan members, sponsoring employers, counterparties, regulators and others - are now demanding: 30% of Canadian pensions picked this out as a theme to watch. New tools that connect pension plan asset managers, allocators and investment finance teams with detailed information about the way their funds are performing – and how they are managed – offer exciting advances in this regard.

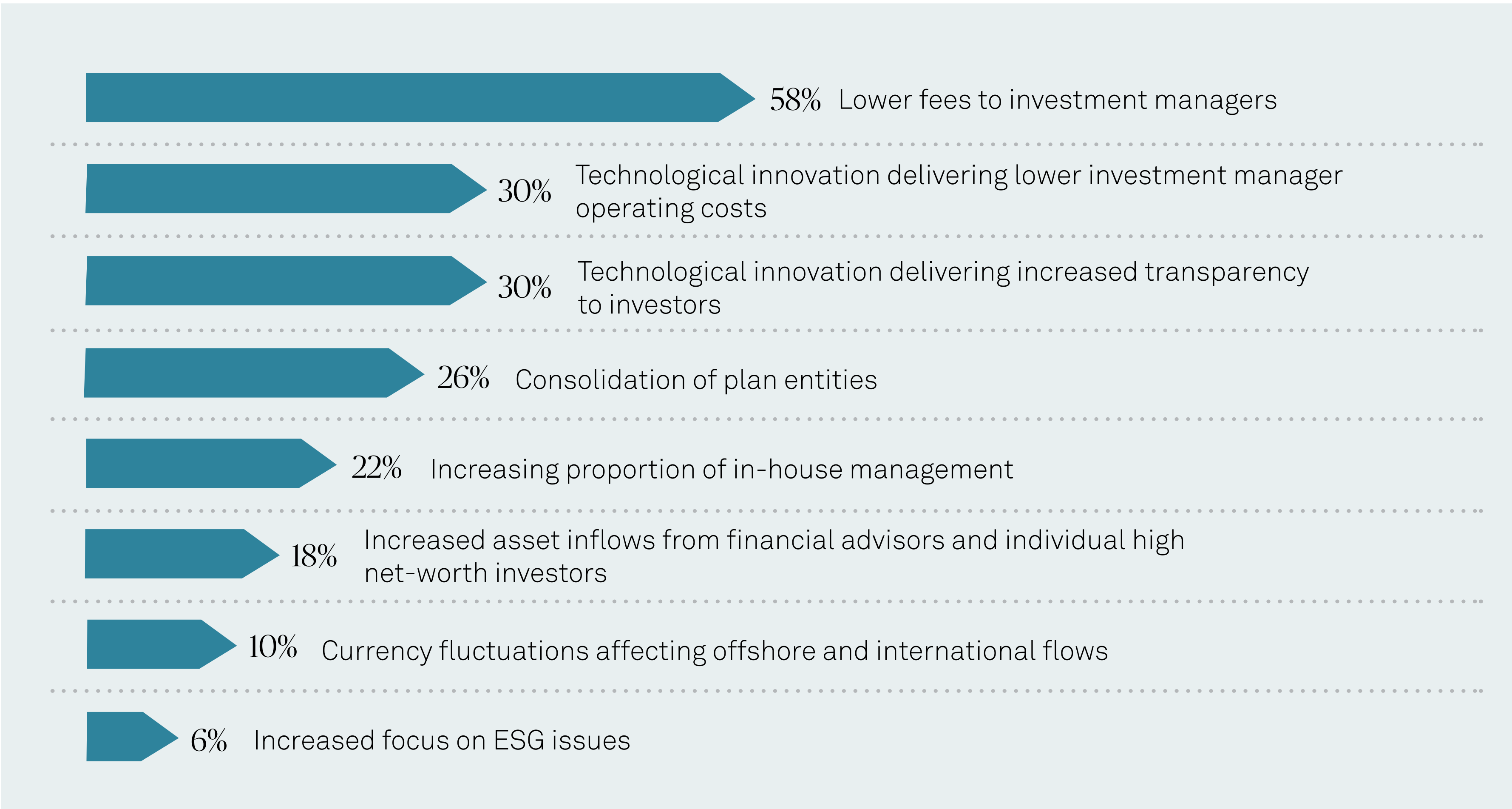
Timely access to investment information - across asset classes, geographies, managers and markets - can position plans to better manage risk and access opportunity. Beyond the significant advantages that data can bring to investment performance, the transparency and reporting enabled by sophisticated oversight tools can also position plan sponsors with evidence in support of their compliance with governance, regulatory and policy requirements. Pension plan leaders are seeing their investment activities come under scrutiny internally, among direct stakeholders, and at times even in more public forums. This places an even higher premium on tools that can help arm leaders, investment and oversight teams with the data to identify, execute and subsequently evidence sound decisions.

Pension plan industry leaders, along with a growing array of vendors, consultants, managers and consolidator organizations, are bringing an array of solutions to market. Again, one size rarely fits all strategies, and as such while plans recognize they face challenges related to their technology and data operations, many are concerned about how to best future proof their technology and data strategies to drive success and also future-proof operations against the relentless advance and innovation in markets and technology.

"Pension plans - like other asset owners and asset managers - are looking to data for competitive advantage. Timely and accessible data can help inform asset allocation, improve investment performance, support governance and achieve many other imperatives. Better data tools can also help address the rapidly growing demand for increased transparency, in particular around private asset classes and multi-asset portfolios. Gone are the days of a single monolithic solution for all, however; plan managers need to strike the right balance of in-sourced, co-sourced and out-sourced solutions to meet their unique organizational needs."

Darcie James Maxwell
Lead Architect, Client Data Solutions

What do you predict will be the most significant trends in the Canadian pension fund investing space over the next 12 to 24 months? (Select top two)



"The Canadian pension fund investing space will be transformed with the inclusion of technology. We will see how management practices and workplaces are influenced as new digital capabilities are introduced, such as enhanced data management skills and options for accurate predictive analysis."

Managing Director, Pension Fund

Many pension funds are also reviewing their approach to investment strategy in light of the pandemic. The lesson of previous crises, including the global financial crisis of 2008-09, is that investor behaviour changes in the medium-to-longer term, even when the immediate short-term threat has receded. As one pension industry leader noted in discussion, this may be to some extent connected to the expectation that domestic and global regulatory changes enacted as a result of a crisis can take many years across review, consultation, proposal, approval, implementation and enforcement.

Nonetheless, almost a third of Canadian pension funds (29%) say they have changed asset allocations due to the pandemic. They report increased demand for fixed-income assets, with some citing the volatility in equity markets as a driver. Alternative and private market assets, offering diversification and a different type of return profile, are also attracting significant interest from pension funds. Given Canadian pension funds' strong and longstanding appetite for private market investments, increased allocations to these asset classes are likely to continue to increase well beyond the turmoil of the pandemic, according to many plan leaders.

A range of allocation and investment strategies came into play in a turbulent market environment. Deploying reserve capital for opportunistic acquisition, repositioning holdings in alignment to broader economic trends (for example, a rise in interest in logistical infrastructure to support a rise in e-commerce), growing interest in areas such as private credit/debt, or even questions related to the nature and degree of support that should be afforded to portfolio companies suddenly struggling amid the pandemic environment.

The focus on consolidation of plan entities (picked out by 26% of funds) reflects their ongoing desire to secure economies of scale and greater effectiveness, as well as offering a possible means to de-risk. For 22% of pension funds, a shift towards the greater use of in-house asset managers will be a defining characteristic of the next two years.

For many plans, the available choices, risks and opportunities were also deeply intertwined with questions related to liquidity and with investment finance.

Ric Marrero
Chief Executive Officer
The Association of Canadian
Pension Management (ACPM)

“

Over the last several years, the pension industry stakeholders in Canada - sponsors, members, employers, governments and more - recognize that workers increasingly value a good pension.

Secure, lifetime income in retirement affords many benefits to those for whom it is available but pension availability has not expanded to any significant degree for years.

It has only been in recent times that industry stakeholders have started to cope with the implications of limited pension availability and the challenges associated with pension investments in volatile times. However, there has been an extended life for pension plans via the development of a new “Canadian Pension Model” where jointly trusteed structures share risks, costs and gains between employers and employees. This has been complemented by new pension regimes such as target benefit plans which have been introduced in several provinces across the country.

New ideas, offerings and opportunities are coming to market and more work is needed in these areas to meet increasing demand for funded lifetime income opportunities for workers in a way that is sustainable for employers. On behalf of our members, we look forward to engaging with a diverse array of retirement industry stakeholders as we strive to achieve shared successes that will ensure a sustainable and equitable retirement for Canadians.”

Consolidation, Cost and Containment of Risk: Canadian Pension Plan Innovations

As we explored in Chapter 3 of our research, the focus on consolidation of plan entities (picked out by 26% of funds) reflects their ongoing desire to secure economies of scale and greater effectiveness, as well as offering a possible means to de-risk. The crisis had a significant impact on pension plans; many felt compelled in turn to respond with fundamental changes [to their operations/strategies.]

Plan sponsors have a growing array of offerings available to them, including widely known options available, such as an outsourced chief investment officer (OCIO), liability risk transfers, and annuitization. Canada also has a strong tradition of jointly-trusteed, independent entities that manage pensions on behalf of multiple employers. More recently, Canada has drawn global attention as innovative offerings have come to market, including multi-employer plans opening their offering to other employers to merge in, government-sponsored nonprofit entities offering high-scale asset management consolidation, plans merging as equals to create new multi-employer pension plans, and even asset managers offering defined-benefit style fixed payouts to the retail market through mutual fund distribution channels.

For global pension industry watchers who have forecast the decline and even eventual demise of defined benefit pension offerings, the innovative movements in Canada in recent years offer an array of lessons as market leaders are seeking to enhance or expand access to retirement savings options that answer both cost pressure from employers as well as benefit appetite from employees, for whom the upside of a "Canada-model" plan can be remarkable - delivering as much as four times the retirement income per dollar as the typical individual approach.

Alistair Almeida
Segment Lead
Asset Owners

"Given the significant disruption to markets in 2020 and into 2021, the ongoing evolution of Canadian pension plans as asset managers will bear close observation by industry participants and by global pension industry watchers."

Reinforcing Resiliency and Continuity under COVID-19

In the early days of the COVID-19 pandemic, Canadian pension funds responded rapidly to the immediate challenges. 2020 saw a rapid increase in focus on the operational issues faced by funds – for example, 80% say they have taken action to improve communication with staff, while 78% point to efforts to protect employees by permitting or requiring them to work from home. Other actions have been more strategic: 80% of pension funds say, for example, that the crisis has prompted them to think about succession planning in a business continuity context.

From improving vaccination rates in 2021, divergent reopening plans around the world, and ongoing focus on various variants of COVID-19, uncertainties persist. More broadly, however, the actions that pension funds have taken in areas such as succession planning, remote work capabilities, cyber risk management and operational oversight should boost their resilience on a permanent basis.

For some, the pandemic provided an inflection point that force them to question longstanding operational practices, for example considering outsourcing various non-core or even critical functions to providers able to offer enhancements to resiliency, efficiency or member experience.

"As the Canadian investment industry works through the market turbulence, early indications are that investors may see this as an inflection point to secure increased transparency. From gathering information to assist in various risk and performance scenarios, to launching separately-managed accounts with trusted asset managers, initial feedback is that investors are keen to further the gains they have made in enhancing control in recent years."

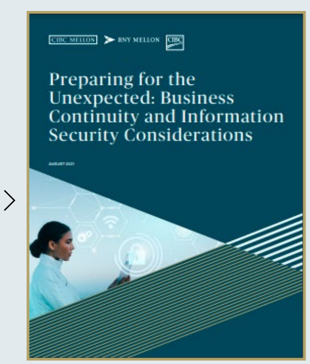
Ash Tahbazian
Chief Client Officer

Business Continuity Questions Worth Asking

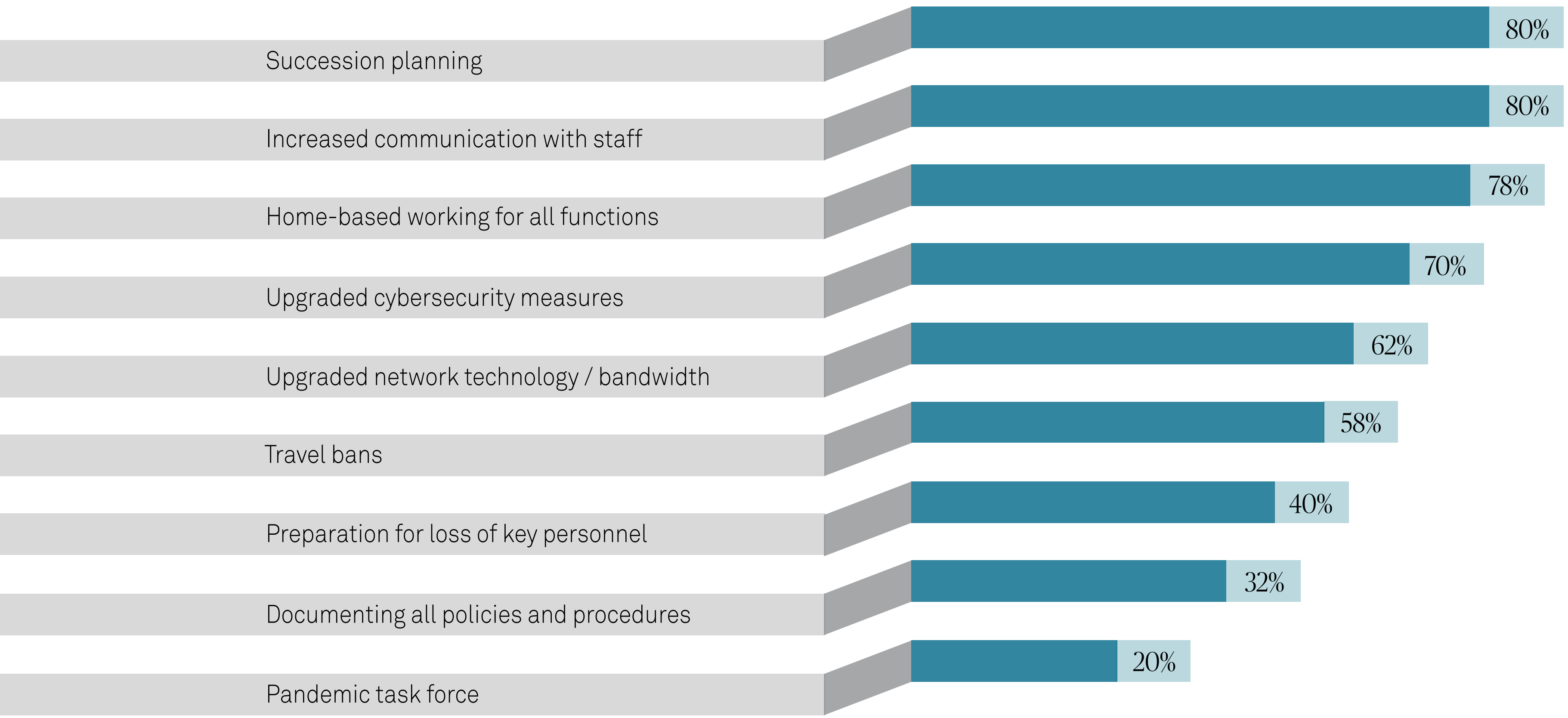
These are a few of the questions which may assist your organization in business continuity and resiliency planning efforts.

1. What are our organization's most critical functions? Clearly documenting these can assist in understanding dependencies as well as prioritizing resiliency and recovery efforts.
2. What risks are the organization most likely to encounter based on your geographical location?
3. What is the likely impact of a disruption (e.g. a pandemic)?
4. What are the consequences to the organization?
5. Do we have backup for crucial job functions and incident response tasks?
6. Do we have backups of all important data? Would this be accessible to critical employees in a business continuity situation?
7. Can we avoid disruption of service when key locations are closed?
8. What problems could derail a business continuity strategy?
9. Who are our major suppliers, customers, third parties - and what role would they play in a continuity scenario?
10. Do my critical vendors' business continuity planning preparations meet my business needs?
11. How will my stakeholders be notified in case of vendor impact?

For more considerations related to pandemic risk management and other topics, visit CIBC Mellon's website ->



What plans have you put in place to maintain business continuity during the COVID-19 crisis? (Select all that apply)



Top three trends in the Canadian pension fund investing space:

58%

Lower fees to investment managers

30%

Technological innovation delivering increased transparency to investors

30%

Technological innovation delivering lower investment manager operating costs

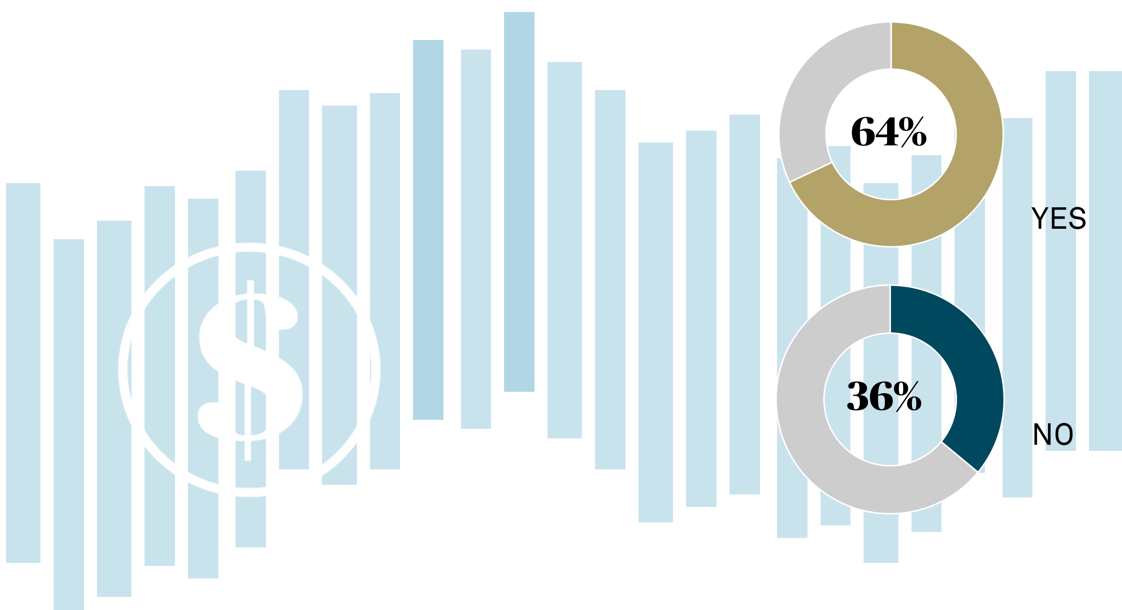
Liquidity concerns may shift pension funds away from illiquid asset classes

The crisis had a significant impact on pension plans; many felt compelled in turn to respond with fundamental changes to their operations and investment strategies. While Canadian pension funds are renowned for their financial strength, almost two-thirds of respondents (64%) concede that they have had concerns about liquidity during the crisis.

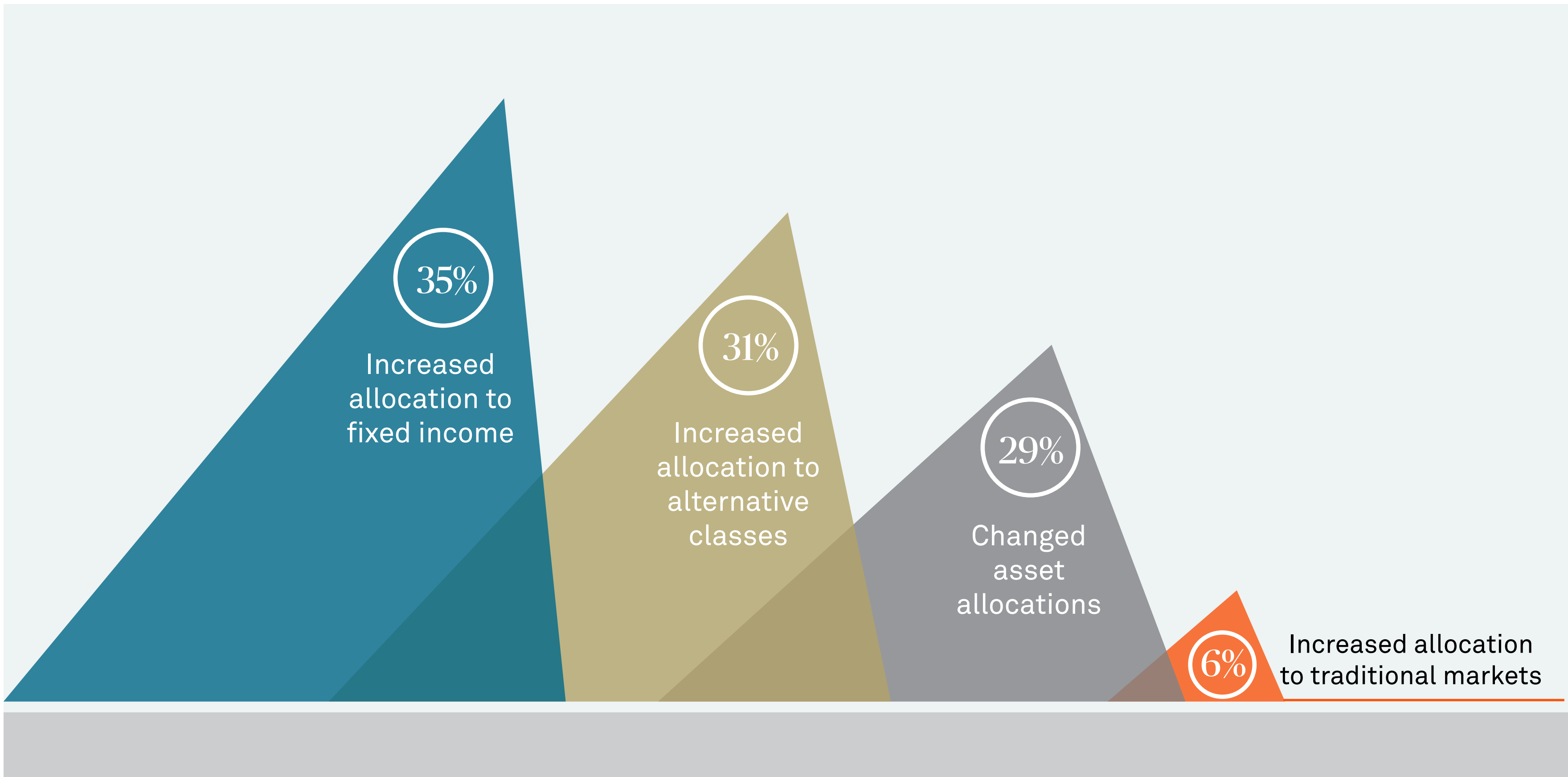
Under the circumstances, investments by pension funds in illiquid asset classes including real estate and infrastructure, acquired for diversification purposes, may well prove problematic. This may be why, for example, so many pension funds say they now intend to reduce their exposure to infrastructure. Among pension funds reporting liquidity concerns, 97% say the experience will have an impact on the investment decisions they make in the future.

A retreat from less liquid assets, despite the undoubted attraction of many of these investments, may be one consequence of the pandemic. At the same time, large numbers of pension funds indicate that they intend to pay closer attention to liability-driven investment strategies, matching assets against liabilities. For those funds with liabilities falling due over the very long term, a continued focus on illiquid investments may remain entirely appropriate.

Did your organization have any liquidity concerns, during this period?



Has your organization significantly changed its investment approach as a result of the COVID-19 pandemic?



“Across the diversity of available choices, Canadian pension plans continue to take their obligations seriously, to work to continuously refine their investment, technology and operations models, and to work relentlessly to deliver the right outcomes for their underlying plan members and stakeholders. The years ahead will present many challenges, but Canada’s pension plans are thoughtfully preparing to drive outsized success in the year ahead.”

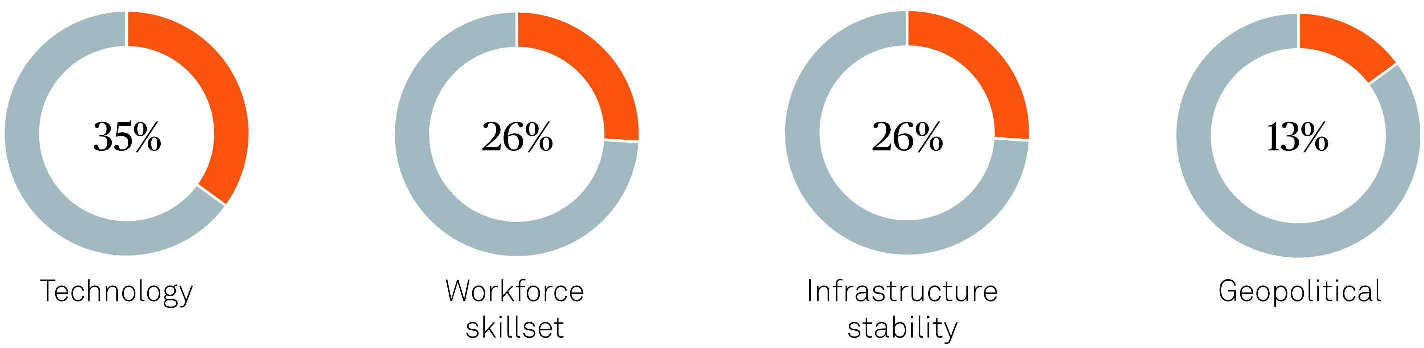
Alistair Almeida
Segment Lead
Asset Owners

Based on our findings and according to our ongoing client discussions, many pensions are putting careful thought into how they split asset management responsibilities between in-house teams and external providers. According to our findings, 46% of pension funds say the crisis has prompted them to review their outsourcing plan. Where this was the case, technology was the most likely trigger for review, followed by workforce skillset and infrastructure stability.

It may be that some pension funds have felt ill-equipped to cope in-house, lacking the necessary technological capabilities and data-driven investment operations models, the depth of talent or the operational resiliency – particularly in a majority-remote environment. In which case, making improvements in these areas will clearly be paramount. In the longer term, the advantages many funds have identified for in-house management will remain valid.

Equally, where pension funds decide to continue using outsourced providers – or to increase their use – the case for pushing for a new relationship with these asset managers will remain intact. Competitive fees, transparency and a collaborative approach to investment strategy look more important than ever in the post-COVID-19 environment.

Most important considerations driving pension funds' decisions to outsource to external managers.



While nobody is certain what a post-COVID-19 future might look like at this point, our findings confirm that Canadian pension funds are working hard to ensure continuity while keeping a close eye on costs and considering their consolidation options. As ever, despite being put to the ultimate test by COVID-19, their reputation for reliable, long-term resilience remains intact.

Navigating the Evolving Challenges of Today’s Capital Markets

Jim Ginis
Executive Director,
Financial Solutions Group,
CIBC

“Through the market and industry disruption of the past year, we have seen pension plan sponsors and asset managers seek a holistic view of the challenges and opportunities specific to their plans. We are seeing rising appetite for analysis, market intelligence and bespoke solutions to support asset review and allocation.

During this period some clear trends have emerged or strengthened. A growing number of pension plans are bringing their asset management in-house. There is strong interest around insourcing high quality liquid assets (HQLA) and expanding the use of overlays. Passive outsourced allocations are being reviewed and non-funded solutions considered for liquidity or outperformance. Pension Boards are increasingly deepening their understanding of leverage and opportunities outside of traditional asset classes. These trends are bringing many benefits, but also present some challenges related to talent development, technology and risk management framework to support these sophisticated activities.

Clients are demanding innovative solutions, from hedging against potential rising inflation risks to achieving strong returns while still keeping ESG considerations at the forefront of asset allocation. In short, it is an exciting time to be partnering with Canadian pension plans, understanding our clients unique needs, providing industry-leading intelligence and helping our clients navigate the evolving challenges of today’s markets.”

“Fundamentally, there is no one right operating or investment model. Pension plans and their asset managers need to understand and assess where to allocate their time, talent and resources. Plans may build robust asset management functions in house, reliant on outsourced technology, focus on a few key areas of advantage while outsourcing many function, or may similarly determine that the necessary talent, technology and risk requirements outstrip their ability to build in-house, and instead focus on building an efficient, lean governance organization designed to maximize the impact of outsourced investment managers.”

Ash Tahbazian
Chief Client Officer

Insights into the future of work, returning to the physical office, and lessons learned from working remotely through the pandemic.

The return to the office post-pandemic is a critical strategic inflection point. Across geographies, organizational structures, market segments and plan types, it is extremely rare that so many different types of organizations facing the same challenge. For pension plans and their vendors, the rapid shift to and sustained operation amid a remote environment has driven lessons learned, challenges, and opportunities.

The core question ahead of many relates to the future of work, in particular around the degree to which organizations will permit remote working in a post-pandemic environment - and if so, how much flexibility employees will be afforded.

Pension and asset management organizations cite significant concern about collaboration, culture, and connection as leaders contemplate remote, flexible and in-office models. Some see the physical office as central to the collaboration that drives value, while others are seeking ways to retain culture and employees' sense of belonging in a remote or hybrid workforce.

Across diverse organizations and varying plans to return to the physical office, leaders have heard very clearly that employees want flexibility, and are aware of strong demand from employees to continue remote / hybrid work post-pandemic. The demand is particularly strong among younger employees who are more likely to have the comfort of digital natives with remote working technology.

> “Rather than dictating that people must come back into the office just because we have office space, we are looking at whether we can create collaborative spaces that make people want to come in to work together.”
>
> Pension CHRO

Nonetheless, among pension and pension asset management organizations, significant disparity is emerging in how much employee choice organizations plan to allow. Models include:

- Requiring a full return to the office post-pandemic, after which policies for hybrid work may be considered.
- Deploying a hybrid approach which scheduled days for in-office or remote working.
- Leveraging role-based or persona-based approaches that define varying degrees of remote working according to job function. (for example, requiring trading or portfolio management staff to be in the office, while enabling operational transaction teams to work remotely.)
- Flexible approaches that enable a high degree of remote working based on employee choice.

> "We have reduced our space by ~30% and focused on the office as a place for collaboration rather than a place to work."
>
> Pension Asset Management Organization COO

Canadian investment organizations are largely considering either in-office or structured hybrid approaches. Some are considering employee or client-led client flexible approaches. Executive leaders are keen to keep things "fair" across different teams, roles, and groups. Some worry about disparity should choice be left to individual managers. Divergent views on how much in-office time will be required, and how much employee choice will be permitted.

Many Canadian pension plans - particularly those located outside major urban centres with higher real estate costs and commuting times - are indicating an expectation to return to the physical office - particularly those whose local health environments have permitted brief returns to the office.

However, there are many remaining unknowns. What will life look like after COVID-19? Organizations are looking to prepare and plan while preserving flexibility. They want to "reserve the right to get smarter" and evolve their thinking, as plans may change substantially over the months and years ahead.

CIBC Mellon will continue to engage with clients on this topic, and we look forward to client engagement.

In Search of New Value: Implications and Outlook

Considerations for pension plans and their asset managers

Across the spectrum of pension investment stakeholders, perhaps the most dependable constant will be rising expectations – for performance, efficiency, outcomes, compliance, timeliness, risk mitigation and a multitude of other factors. Pension plans and their asset managers face a demand for change that has only been accelerated by market turmoil, disruption and volatility – as well as by exciting opportunities, rapid developments in technology, and fresh strategic opportunities.

The need for more comprehensive data – presented in a convenient and digestible way – will increasingly be at the heart of pension, investment and operations processes. Pension and asset management professionals expect to be able to access, analyze and manipulate detailed, accurate and timely data. Likewise, as new generation of people moves into senior roles in the retirement industry (and indeed, into retirement) demands around data and reporting will continue to intensify.

As data science in investment management grows as a field, specialist expertise is increasing in demand and cost. Some of this expertise is only needed for key challenges or points in time. We are seeing clients working with specialist consultants as well as looking to our global enterprise for skillsets that they don't intend to hire or grow in-house.

There is a need for data to support the changing investment strategy. The demand for analytics only increases in a volatile market as industry participants aim to insulate their assets from risk or try and figure out ways to capitalize on the volatility and further grow their assets. Investors are looking into their exposure across a broad universe of assets under management (AUM). In an ideal world, AUM decomposition data can be aggregated and analyzed by simply adding a couple of portfolios together. For example, leveraging the ability to mix alternative assets and public assets that may be managed on different platforms or services so that the organizations can see the assets holistically.

In the wake of COVID-19, pension-related regulatory and public policy developments relevant to large Canadian public pension funds and other institutional investors will unfold – likely over years. In particular focus are changes that allow for the growth of existing public pension organizations, across multiple organizations, between provincial borders and beyond. This has included rules to facilitate the merger or consolidation of plans as well as opportunities for public pension organizations to provide services, such as third-party asset management, to others beyond the plan's existing membership.

For some pension plan asset managers, the evolution to take on and manage external assets is a logical outcome from the years spent growing some of the most sophisticated and successful asset management operations in the world. Twenty-six percent of funds in our study cited consolidation as one of the most important trends ahead. For others, the growth by consolidation and merger is an opportunity to build necessary scale to retain or gain competitive advantage and cost efficiency. Again, one size does not fit all: in various workshops, a number of leading pension plans cited their proven track records, large scale or highly efficient external manager programs as demonstrable evidence that mergers or outsourcing might in fact erode the advantages they had carefully built for plan stakeholders over many years.

Many pension funds are also reviewing their approach to investment strategy and investment operation models. Past crises can inform future strategies, if the investment industry can take away anything from the global financial crisis of 2008-09, is that investor behaviour changes in the medium-to-longer term, even when the immediate short-term threat has receded. COVID-19 has emphasized the importance of keeping a diverse portfolio, as well as the vulnerabilities of illiquid assets such as infrastructure.

Even amid a rising trend toward in-house management, external managers continue to see strong demand and a recognition that their long investments into industry-leading talent, powerful tools, advanced asset management offerings confer significant advantage (and associated investment return). Competitive fees, transparency and a collaborative approach to investment strategy look more important than ever in the post-COVID-19 environment. While consolidation offers pension funds certain advantages, there will also be obstacles to overcome. Pension funds intend to take their time making such decisions and introducing any new approaches, and the consensus remains that external managers have much to offer.

Considerations and questions for pension plans and asset owners

1. **What will you do in-house and what will you outsource?**
   a. What is the likely cost profile of your operational model?
   b. Does your plan have the necessary level of capability and sophistication, and how does this compare to a lift-out outsourcing of investment operations?
   c. What are your needs and requirements from a vendor for areas you choose to outsource?

2. **How will your plan achieve efficiency and scale** while providing a user-friendly experience for plan members across payments and member information – including across complex multi-employer entities and underlying plans?

3. **How is your plan engaging with alternatives,** and how will your approaches evolve over time?
   a. What talent do you need in-house and what talent can you source from suppliers and partners?
   b. What technology and tools do you need to achieve the necessary transparency, governance and investment data outcomes?

4. **How will you keep pace with rising stakeholder expectations?**
   a. Boards, Trustees and other stakeholders are demanding enhancements to reporting, oversight. How is your plan supporting the necessary compliance with the regulatory environment of today and the year ahead?

“

Canadian asset owners are at the forefront of a trend to shift asset management functions in-house - along with associated requirements for investment operations and systems. Whether building an in-house team or running an external manager program, organizations need to be clear about how they will allocate their resources to generate value. Where will your organization invest in building, and what will it outsource?”

Ash Tahbazian
Chief Client Officer

Alistair Almeida
Segment Lead
Asset Owners

"For plans looking to transfer assets, liabilities or activities to another market participant, as well as for those looking to grow by merging in or managing assets on behalf of others, the top area of concern is greater scrutiny and visibility, followed by cultural differences and technology issues. To this end, pension funds on either side of the equation should consider how to address these concerns together - whether as prospective counter-parties, clients or colleagues. The Canadian pension model and indeed the Canadian market in general is known for its high focus on governance: it is no surprise that concern over scrutiny and visibility weighs heavily on participants."

Methodology

In 2020, CIBC Mellon's research provider interviewed senior executives, including directors of investment, CEOs and managing directors, from 50 pension funds headquartered in Canada to assess their asset management trends, including their response to the impact of COVID-19. The funds being managed were split evenly between those with AUM of C$600million - C$1.2 billion to those with AUM over C$1.2 billion. The average AUM of funds in the study was $C31 billion. Respondents were located across Canada; 26% of respondents were private plans, and 74% public.

In 2021, we engaged with a wide array of Canadian pension plans to discuss and further inform these findings.

To learn more, please visit www.cibcmellon.com or contact your Relationship Manager.

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Watch for future research from CIBC Mellon as we explore topics in collaboration with Canadian asset owners, asset managers, insurance companies and global investors into Canada. To discuss our research efforts, learn more about the themes we are exploring, contact your CIBC Mellon relationship manager.

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