

In Search of  
New Value

CIBC MELLON

# *In Search of New Value*

How Canadian Pension Plan Investment Managers  
Are Preparing For A Post-COVID-19 Environment

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Alistair Almeida is Executive Director & Segment Lead, Asset Owners, for CIBC Mellon. Alistair is responsible for working with Canadian asset owners as they grow and evolve, connecting with and supporting multi-national pensions as they engage in Canada, and for growing and expanding CIBC Mellon's presence in the Canadian asset owner space.

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, reshaping the global economy and forcing organizations of all sizes to carry out operations with many employees and stakeholders working remotely.

This is the backdrop against which CIBC Mellon 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.

**HIS ARTICLE ORIGINALLY  
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**50**

**Leading pension  
plans surveyed**

The good news is that Canada's pension plans are well-governed, maintaining diversified portfolios that deliver returns closely aligned to their long-term liabilities. Canadian pensions' far-sighted approach has provided some protection from the disruption caused by COVID-19; most plans have the time and the space they need to work through the immediate impacts of the pandemic on short-term returns. Canadian pension plans, funds and their managers continue to be seen as industry leaders within Canadian financial services markets and across the globe. The "Canadian model" of jointly trustee, shared risk, strongly-governed modern defined benefit plans continues to find rising awareness on the global pension stage.

Canada's pension plans are dealing with familiar challenges, including an aging population, longer life expectancies, finite resources, a sustained low interest environment, and evolving regulatory requirements. For some, these pressures are further magnified amid uneven global economic prospects and rapidly shifting markets. In this difficult environment, pension plan leaders are thinking carefully about what is needed to maintain confidence in their ability to meet their long-term obligations – above all, to fund pension payments to their members.

#### **TO BUILD IN-HOUSE OR TO OUTSOURCE?**

A key trend emerging from our research is that many pension funds are preparing to bring more investment activities 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%. This may indicate a desire to bring costs down, with in-house teams able to deliver significant cost savings:

**Two thirds of plans achieved cost savings by bringing asset management in-house, and the savings were significant for most: the vast majority achieved savings of 10% or more, with more than a third achieving savings between 21% and 30%.**

Indeed, studies have shown that the Canadian industry's strong performance compared to international peers is at least partly explained by greater use of in-house management teams<sup>1</sup>.

Two thirds of our survey participants also noted that clearer alignment of strategies to long-term objectives is a key benefit 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.

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 strategies.

Few organizations can be great at everything, and to achieve target investment results takes substantial investment in technology, talent and time. Indeed, those moving in-house across any class face an array of challenges, including recruiting and retaining high performance investment talent, substantial and ongoing investment into investment technology infrastructure, and rising needs among stakeholders regarding governance and risk mitigation.

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.

<sup>1</sup> ["The World's Best Pension Funds Are Canadian. Sorry." Institutional Investor. Christine Idzelis. 6 Aug. 2020.](#)

## SUCCESSFUL OUTSOURCING: PENSION FUNDS DEMAND MORE

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 portions of their portfolios, only a 34% have an outsourced chief investment officer (OCIO).

## WHICH INVESTMENT MODEL(S) DOES YOUR ORGANIZATION CURRENTLY EMPLOY?



As one pension leader said to me in discussion of these findings, a robust external manager program can deliver strong results, including flexibility and an opportunity to select best-of-breed talent without taking on the key person risk. He also noted that “it is easier to replace underperforming external managers than in-house teams.”

The picture is one of pension funds taking an imaginative and 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 among the diversity of strategies currently in play. 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.

Despite their plans to manage more assets in-house, outsourced asset management remains important for Canadian pension funds. They need to choose managers carefully, with rigorous selection processes and performance and compliance measurement underpinning 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. Canadian pension funds are also 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. Most (80%) of pension funds intend to be more vocal about investment strategies as well. This not only relates to performance, but to broader issues such as governance and – for some – the consideration of nonfinancial or values-driven factors such as environmental, social and governance matters.

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30%

of pension funds pick technology out as a key theme to watch.



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.

Furthermore, 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.

#### **TECHNOLOGY COULD CUT COSTS AND IMPROVE TRANSPARENCY**

Innovation – particularly where it 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 reduced costs they are looking for. Technology is also widely regarded as a route to the greater transparency that investors are now demanding, with 30% of pension funds picking this out as a key theme to watch. New tools that connect investors with detailed information about the way their funds are performing – and how they are managed – offer exciting advances in this regard.

Elsewhere, 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 some pension organizations that have built scale and success as they have grown, and for those multiemployer plans a move to take in outside assets or pension responsibilities may represent the next frontier.



## Questions pension plans may wish to consider.

### 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 to achieve its goals? How does this compare to consolidation or outsourcing of pension or investment activities?
- c. What are your needs and requirements from a vendor for areas you choose to outsource?

### How will your plan achieve efficiency and scale?

- a. While providing a user-friendly experience for plan members across payments and member information – including across complex multi-employer entities and underlying plans?

### 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. How will you keep pace with rising stakeholder expectations – from Boards, Trustees and other stakeholders?
- c. How is your plan supporting the necessary compliance with the regulatory environment of today and the year ahead?



## Conclusion

Based on our research, Canadian pensions have not settled on a single correct pension asset management, operational and member services model. Pension plans, pension asset managers and other providers need to understand and assess where to allocate time, talent and resources. Plans may build robust asset management functions in-house, strategically invest in technology, and focus narrowly on key areas where they can deploy scale, expertise and focus to create stakeholder benefits – while outsourcing functions to leading providers where it makes sense. Others may 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 across mostly outsourced activities. Across the many 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.



## For more information

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Visit [www.cibcmellon.com/isonv](http://www.cibcmellon.com/isonv) to download the full research project.

## About CIBC Mellon

CIBC Mellon is dedicated to helping Canadian institutional investors and international institutional investors into Canada service their financial assets throughout the investment lifecycle. Founded in 1996, CIBC Mellon is 50-50 jointly owned by The Bank of New York Mellon (BNY Mellon) and Canadian Imperial Bank of Commerce (CIBC). CIBC Mellon delivers informed investment services for investment funds, pension plans, insurance companies, banks, foundations, endowments, corporations, and global financial institutions whose clients invest in Canada. As at March 31, 2021, CIBC Mellon had more than C\$2.3 trillion in assets under custody and/or administration. CIBC Mellon is part of the BNY Mellon network, which as at March 31, 2021 had US\$41.7 trillion in assets under custody and/or administration.

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