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GOVERNANCE

# ‘What Is Pension Governments?’

By: Gord Lewis

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# 'What Is Pension Governments?'

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In 1991, Silence of the Lambs was playing in theatres, Bryan Adams was at the top of the charts, and hair was still fairly big. The news was saturated with images from the first Gulf War, the break up of the Soviet Union was becoming passé, and the TSE 300 was at 3,272 points. All of this and a new magazine for the pension industry – *Benefits and Pensions Monitor* – was just getting started.

**'... INTRODUCTION OF MORE CHOICE DID LITTLE MORE THAN CONFUSE PLAN MEMBERS.'**

Fast forward 20 years and while the music has definitely changed and hair has been somewhat tamed, there still remains national and political upheaval around the world. Given the volatility we've seen in the markets recently, there may be some people that believe the TSX Composite may end up back at 3,272.

Not surprisingly, the pension industry has evolved along with the rest of our world.

## Key Element

Governance is now a key element for all pension fiduciaries and their plans. Twenty years ago, the term 'governance' was not something well understood by many involved in managing their company pension plan. In fact, I often tell the story that when I started with Proteus in 1997 and mentioned 'pension governance' to prospective clients, they would on occasion

reply with 'what is pension governments?'

Managing pension investments and fund choices is an important part of governance and by the early 1990s most Defined Contribution plans had evolved to a point where they had available to them a wide range of investment options. While this continuing increase in DC plan options was often touted as a good way to promote diversification and help create portfolios that matched a member's risk tolerance, some might argue that the introduction of more choice did little more than confuse plan members.

Fund choices and investment strategies have continued to develop and evolve, as evidenced by the introduction of new strategies and fund families. The range of funds and asset classes continues to increase making the plan fiduciary's job of identifying the 'appropriate' choices that much more difficult. Should small cap, emerging markets, or hedge fund strategies be included?

Another aspect of the investment decision that has changed over the years is the access to foreign markets. Recognizing Canada's limited size on the world's financial stage, the ability to invest pension assets outside of Canada had been of keen interest – especially when it wasn't allowed.

Prior to 1994, only 10 per cent of assets could be invested outside Canada. That rose to 20 per cent in 1994, 30 per cent in 2001, and the restriction was finally removed in 2005 – pretty much co-incident with the Canadian market initiating its period of relative outperformance compared to foreign markets, which continues today.

The years have also seen a fairly gradual yet consistent shift in the type of pension plan members participate in. In Canada, the number of private sector employees covered by DC plans increased by 400,000 between 1991 and 2006. In contrast, there were 270,000 fewer employees covered by DB plans during the same period.<sup>1</sup> While the trend is evident, it is worth noting that DB plans continue to make up the greater portion of the pension industry with approximately 30 per cent of all Canadian workers covered by DB plans (down from 41 per cent in 1991) and only six per cent in DC plans (up from four per cent in 1991).<sup>1</sup>

This shift from the DB structure is even being experienced within the largest companies. In 1980, 90 of the Fortune 100 companies had a DB plan. By 2009, that number had dropped to 45. Within that same group, the number of companies offering a DC plan moved from 10 to 55 by 2009.<sup>1</sup>

## Interest Rates

Interestingly, interest rates have had a significant impact on pension plans over the past 20 years. As the bulk of pension assets continue to reside within DB plans, the affect of declining interest rates over the past 20 years has resulted in improving fixed income returns, but, in most cases (disproportionately), increasing the liabilities of those same plans. With rates at historic lows, DB plans are feeling the pain like never before and some may conclude that this in part accounts for the declining trend in DB plans.

We have seen a lot of attention paid to pension reform over the past several years – much of which has been in reaction to the challenges – actually, problems – that DB plans have faced. One could argue that changing some of the regulatory rules to make it easier on plan sponsors is simply putting more of the risk onto the members. However, the regulators appear to have balanced that thought with the consideration that if the pension obligation ultimately puts the plan sponsor out of business, that doesn't help the employee or their pension.

One element that has not changed over the years is our desire to be comfortable in retirement. What has changed is the amount of awareness employees have regarding what may or may not be involved in helping them reach that comfort level. Reliance on CPP and other government sponsored programs continues to make up an important element of Canadians' retirement incomes. In 2003, the government took the bold step to help stabilize and strengthen the CPP by increasing the contribution amounts. This move helped to ensure the benefit will be around when all of us need it.

What has changed the most? There is no doubt the amount of information and resources available to help interested plan members better understand their plans and the associated investment options has dramatically increased. One need only ask the individuals respon-

sible for developing these tools at the various record-keepers and consulting firms and add up the millions of dollars spent on this front. While everyone seems pleased and impressed with the actual tools and resources available, I don't hear too many expressing satisfaction regarding the level of usage

by the plan membership. In a nutshell, while the pension industry has been evolving and improving over the past 20 years, the ones that have the most to benefit from those developments seem to be the slowest to embrace the changes and take full advantage of them.

Maybe they will by 2031. **BPM**

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1. CBC.ca May 26, 2009