



## Border Crossings

NEW RESEARCH SUGGESTS THAT DB PLAN SPONSORS ARE FINALLY READY TO GO GLOBAL. BY PETER CHIAPPINELLI

With the demise of the Foreign Property Rule in 2005 came predictions of a quick exodus from Canadian assets, as investors—particularly defined benefit (DB) plan sponsors—would be more inclined to diversify their investments globally. But the migration has been slower than anticipated. Plan sponsors, as a group, move with great care and fiduciary deliberateness. The stellar performance of Canadian equity markets over the past few years has also lessened some of the urgency.

However, that's all about to change. The 2007 survey *Exploring New Ground: Key Global Pension Strategies for Today's Investment Landscape*, conducted by Pyramis Global Advisors and the Canadian Pension Fund Directory, gauges the health and status of 157 public and corporate DB pension plans across Canada, and looks at trends for the future. The results show that many Canadian plan sponsors are gearing up to shift a portion of their Canadian equities into global markets.

### Changing Direction

Before we see where the money is flowing, let's look at where Canadian pension plans stand today. The survey results indicate that DB funds are on solid ground, with an average funding ratio of 101% and an average solvency ratio of 99%. On the investment side, they've been sticking close to home, keeping most of their assets in Canadian equities.

The average DB fund has nearly one-quarter of its assets allocated to Canadian equity, compared to just 12% apiece for U.S. and international equity, and 7% for global equity. Considering the small size of the Canadian market on a global scale—representing just 4% of the market capitalization of the MSCI World Index—this is a disproportionate allocation. And while the Canadian market has been posting outstanding returns over the past few years, it's a very concentrated market, with energy, materials and financial stocks making up almost three-quarters of its composition.

With the removal of regulatory constraints on non-Canadian investments, you'd expect

that Canadian plan sponsors would start moving assets away from Canada, hoping that the increased diversification would help them maintain their current positive funding and solvency levels. And the survey results suggest that's exactly what's about to happen.

Fully 72% of DB plan sponsors indicate that they've either implemented a shift out of Canadian equities or are seriously considering doing so in the next one to two years. While most are projecting a reduction in Canadian equity allocations of 10% or less, some corporate and mid-size plans are considering even larger shifts.

### New Destinations

A sizable portion of the future shift can be viewed as equity diversification, with 56% of plan sponsors planning a move into international equities. U.S. equity will also absorb some assets, as 40% of plan sponsors intend to increase their allocations in this area. Global equity is also set for a big increase, with nearly one-third of plan sponsors (30%) planning to increase their exposure to this asset class.

As plan sponsors weigh their global options, some burgeoning market sectors may receive more attention. For example, emerging market equities are set to gain, with nearly one-third of plan sponsors preparing to boost their allocations. Non-Canadian small cap is another key growth area, with 21% of plan sponsors planning to increase their allocations in this area.

The survey also reveals a trend toward moving out of equities altogether in favour of alternative investments, such as infrastructure, hedge funds and venture capital. A large number of plan sponsors (74%) intend to migrate to these non-traditional asset classes.

The performance of the Canadian markets in recent years, along with strong investment management, has helped DB plans achieve solid funding and solvency levels. Now, Canadian DB pension plans are crossing borders in search of new areas for future investment. Globalization is finally on the horizon. **BC**

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