2021 Investment Innovation Conference

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Event coverage

Canadian Investment Review

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ALL EVENT PHOTOS TAKEN BY MICHELLE QUANCE

Introduction

By: **Gideon Scanlon**
Editor, *Canadian Investment Review*

During the 2021 Investment Innovation Conference in Niagara-on-the-Lake, public intellectuals and industry leaders presented on a smorgasbord of topics relevant to pension plan sponsors.

In his keynote speech, David Frum shared his thoughts on why the ongoing political chaos in the U.S. could have a long-term impact on global economic stability. During the event's case studies, delegates heard about the challenges facing pension plan sponsors seeking to implement new strategies at their organizations and the opportunities these strategies could bring with them. During other sessions, the discussions touched on overlooked investment opportunities available in Canada.

Despite the breadth of the content, many of the presentations kept returning to a similar point: we live in a time of great uncertainty. While it may be impossible to predict the changes that the post-pandemic era will bring, there are plenty of bellwethers that plan sponsors should be paying attention to.

In the articles included in this booklet, we've done our best to capture the essence of each of these informative presentations in a concise manner. While abbreviated, we hope this booklet will serve to remind delegates of the key points raised during the conference. For readers who were unable to attend, it is our hope this booklet will convince you to join in next year.

Considerations for pension plan sponsors in a post-pandemic political climate

By: Gideon Scanlon

However long the social, political and economic fallout of the coronavirus pandemic may last, humanity and its economic systems have weathered the storm exceptionally well, said David Frum, a political commentator and senior editor at *The Atlantic*, in the conference's keynote address.

"We just put the entire world on furlough. 'Work from home using these amazing technologies — some of which are brand new. Maintain your productivity, because the creation of goods and services creates the optimism about the future that will drive capital markets through this pandemic. Some of you are going to have to be paid to stay home. We can afford to take a big bunch of our workforce for two years because we can borrow the money from the future in amounts never before seen. The future will lend it to us at one per cent interest,' we said. We did it, too. That is a stupendous achievement."

Despite the resilience of the world's political and economic institutions, the turbulence of the era could last far longer than the threat posed by the virus itself, cautioned Frum. "There has never been a time like this to be alive and what we demonstrated was the power of resilience and creativity. But the future is a time of opportunity and of apprehension."

This doesn't mean the pandemic's fallout will be easily managed. According to Frum, one of its biggest impacts on institutional investors is how it will affect the world's youngest and oldest workers.

As schools took their classes online, North America's secondary students dropped out of school at rates not seen in decades. Without high school diplomas or tertiary education, Frum is concerned these dropouts will struggle to find well-paid work through the entirety of their careers.

On the other side of the age divide, the work-from-home era brought an early end to many careers, with many people born in the middle of the 20th century choosing to leave their careers behind.

"When COVID-19 came, many baby boomers said, 'You finally sent me home and it's not so terrible. I'm enjoying the walks and the extra freedom so I will not return to work.'"

With actuarial predictions on life expectancy adding two decades to men's and 25 years to women's retirement years, this trend presents a particularly acute challenge for defined benefit pension plan sponsors. Frum suggested the best approach to dealing with this problem is through a profound culture shift. "How do we get people excited about the idea about working into their early to mid-seventies or even longer? How do we change the workforce so that we can extend the working lives of people?"

He also shared his own thoughts on the likely trajectory of politics in the U.S., noting one of the simplest and most effective ways to judge the political tea leaves is to assess whether a president is lucky.

"There are lucky presidents and there are unlucky presidents. Bill Clinton wasn't a tech guy, but during his first term, somebody asked, 'What would happen if I put pictures on the Internet?' This ended up creating the World Wide Web and pushing productivity up by three points. Lucky. Jimmy Carter wins the presidency in '76 because of the severe recession of '74-'75. But in '78, prices began rising and the U.S. was hit by another supply shock. Unlucky."

As a direct result of the uncertainty in the time in which he serves, President Joe Biden falls squarely into the unlucky camp. For that reason, Frum said he suspects the Democratic Party won't hold onto its majority in the House of Representatives during the 2022 mid-term elections.

"It's not Biden's fault that there are these supply constraints. The surge in demand may be a little bit his fault, though most of those decisions that led to it were made before he took office. He's trying to add more demand, but he's only moderately successful."

With former President Donald Trump, who Frum said was "haunting" the Republican Party, looking like a possible contender in the 2024 presidential election, one possible consequence of the pandemic may be a second Trump term if the sitting president is unable to turn his luck around.

David Frum, political commentator and senior editor, *The Atlantic*

"Lurking in the wings is Donald Trump, who wants to return to politics. . . . He talks about prices and border issues. He makes fun of Biden for his relatively few public appearances. But the thing that is on [Trump's] mind, above all, is revenge. He thinks the presidency was taken away from him and he has no respect for the rules and process by which the people actually own the election — the voters, the citizens of the country."

The impact of climate change on asset valuation

Michelle Dunstan
chief responsibility officer
AllianceBernstein

By: Blake Wolfe

Asset managers that incorporate climate change into their investment processes are increasingly looking beyond commitments to net zero and exploring the impact on asset valuation, said Michelle Dunstan, chief responsibility officer at AllianceBernstein, during a session at the event.

"A changing climate can be described both in terms of means and extremes. Averages will change and extreme events will become more frequent and more severe. Today's society is organized around an historic understanding of those means and extremes. Where we live, how we live, what we produce and how we produce it — a changing climate will affect how society's organized and, in turn, affect cash flows and asset prices."

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To do that more effectively, Dunstan said managers need to expand their analysis beyond the first and second order impacts tied to historic norms and patterns. She cited the 2010 global wheat shortage — caused by separate extreme weather events in Australia, Canada, China, Ukraine and Russia — which she argued led to the Arab Spring of 2011 and related fluctuations in oil prices.

"The largest wheat importers are in the Middle East, where food represents a large portion of household spending and much of these food calories come from bread. . . . Climate change didn't cause [the Arab Spring], but it acted as a powerful accelerant. And instability in the Middle East has profound implications for the oil market — there's actual supply constraints and the fear of unrest leading to further constraints driving up prices. It also led to the U.S. and Canadian shale revolutions, which generated economic return and ramped up quickly, lowered the cost [of this oil production method] and became a permanent fixture of the oil market."

In determining the impact of climate change on an asset's value, managers will need to consider the effect on macroeconomic factors — such as interest rates and inflation — while thinking broadly across disciplines, said Dunstan. "[Managers] need to develop knowledge of climate science as well as geography, political science and agriculture. At a macro level, global economic growth will be slower — GDP is labour force times productivity and climate change will slow both. . . . Current productive capital could be stranded or lost [and] inflation and interest rates will also likely be higher."

She also urged investors to analyze risks and opportunities at an issuer level — such as damage and loss from sea level rise and increased costs due to greener technology requirements — by following the carbon, said Dunstan. "[These risks] are easy to understand, but hyper local. Investors need to understand on an issuer basis where all of their assets are, as well as their supply chain and customer base. You need to evaluate physical and transition risk and the opportunities of a particular issuer and the impact on each of the impact statements, the balance sheet and the cash-flow statement. . . . These are risks that are materializing today."

Maximizing the certainty of an outcome – it isn't just death and taxes

Shivin Kwatra

head of U.S. LDI portfolio management

Insight Investment

By: Gideon Scanlon

With many defined benefit pension plan solvency ratios at all-time highs, plan sponsors have an excellent opportunity to rethink their approach to investing, according to Shivin Kwatra, head of liability-driven investing portfolio management at Insight Investments.

"It is important to highlight two approaches to investing: one [is] traditional – a mean variance framework of maximizing returns and minimizing risk. The other is about maximizing the certainty of outcome. When a plan is in the accumulation stage, the traditional framework of mean variance may suffice, as the end goal is far out in the future. However, if your plan is in the decumulation stage, when the outflows exceed inflows and the focus shifts to the end goal as it draws nearer, more precision is needed as you have less flexibility and time to recover from market setbacks with a shorter timeframe. In this case, an outcome-oriented investing approach – trying to maximize the certainty of your desired outcome – is much more important."

When focusing on the end outcome, the objectives and risk-management focus needs to change, said Kwatra. For mature plans, plan fiduciaries should be conscious of three pillars of investing, each helping to address three major sources of risk. The first is that cash flows must be paid by plans when due, helping to minimize forced-selling and reinvestment risk. Second, plans must manage investment risks and reduce liability risks as much as feasible, reducing the volatility of plan solvency ratios. Third, growth above the discount rate of liabilities must be achieved, but in a protected way avoiding potential for large drawdowns.

"Cash flow, liability risk management and growth – these three pillars can be thought of as the broad objectives of defined benefit portfolios," he said. "Managing liquidity and cash-flow matching can help you ensure the certainty of benefits getting paid."

"Cash flow, liability risk management and growth – these three pillars can be thought of as the broad objectives of defined benefit portfolios. Managing liquidity and cash-flow matching can help you ensure the certainty of benefits getting paid."

Also, for mature plans, which are already paying cash benefits, the timing of returns is of greater importance. To manage liquidity risks, Kwatra suggested plan sponsors adopt a cash-flow matching strategy.

"It's quite simple. You take the cash flows from your bonds, the principal payments and the coupon payments and you align them with your liability cash flows. That can be incorporated as part of your broader management plan. So you could have other sources of cash contributions, like those from dividend payments and alternative investments that can be used for other purposes than benefit payments or expenses and other requirements of the plan. All of that can be coordinated so that your cash inflows and cash outflows can be more closely and precisely aligned."

In the current environment, more pension plan sponsors are adopting a dynamic cash-flow matching program comprised of government and corporate bonds, as well as structured credit, private debt and emerging markets debt, he said.

"Dynamic and intelligent protection strategies can be used to try to reduce the cost of protecting your return-seeking portfolio. There's no free lunch, but there are approaches that can help you make the trade-off between reliability and cost and then there may be parts of the distribution that you value differently from the market."

Taken together, noted Kwatra, liquidity management, liability hedging and downside protection strategies can serve as a significant tool in any plan sponsor's arsenal. "Managing liquidity and cash-flow matching can help you ensure the certainty of benefits getting paid. Reducing your risk by hedging your liabilities in an explicit way, with specific liability benchmarks, can help you get to a more certain outcome."

A look at one investment manager's responsible investing journey

Maria Elena Drew
director of research, responsible investing
T. Rowe Price

By: Blake Wolfe

A high-profile fraud case and a devastating oil spill directly inspired Maria Elena Drew to focus on environmental, social and governance factors in her investment career.

During her session, the director of research in responsible investing at T. Rowe Price said she began her ESG journey a decade ago as an equity analyst and portfolio manager at Goldman Sachs Group Inc., where she managed investments in BP and Enron Corp. Both Enron's fraud case and BP's Deepwater Horizon oil spill in the Gulf of Mexico helped shape her views on sustainable investing.

"Enron was an insightful experience. It taught me to come up with more markers than financial ones to make an investment case. With BP, it was a situation where, if you looked at their track record prior, you could see a long history pointing to operational issues at the company."

At the same time, Drew's European investor clients were starting to ask about ESG integration. "I found they were looking for more than we were answering. What I realized was that I was looking in obvious places or when issues were coming up. What I needed was a systematic process to be more proactively looking at ESG."

While she started out using third-party ESG research, Drew soon developed a framework for her team at Goldman Sachs, allowing it to evaluate the ESG profile of every company in which they invested. "One of the initial problems we found was that when we started to talk about an environmental or social problem with a company, we'd struggle to baseline the discussion and come up with a concrete view. If you think of the various ESG issues in the investment process, they're going to be applied differently. For example, you've done some research around plastics and find the growth rate is changing due to sustainability factors – that can impact revenue trajectory you're putting on a chemical company. . . . That's where building a systematic framework that's consistent across issues and proactive can help."

At T. Rowe Price, Drew set up a new framework for her responsible investing team as a way of embedding ESG research across the entire investment platform. The approach can be applied to any portfolio without supplanting fiduciary duty as the team's top priority.

"Many of our peers started off by launching ESG products like impact funds and creating boutiques within a larger asset manager and working backwards towards embedding ESG into platforms. We started the other way around. ESG doesn't represent one single investment style – it's about recognizing each factor within the investment process."

> **"ESG doesn't represent one single investment style – it's about recognizing each factor within the investment process."**

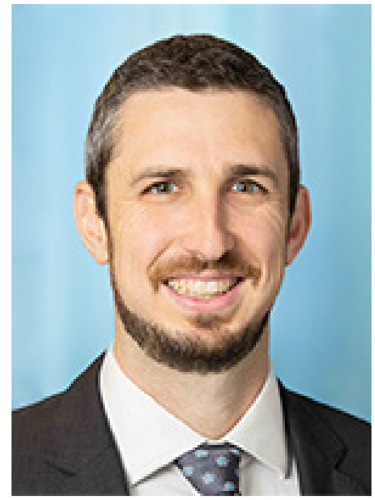
Drew's research also touches on responsible investing strategies that allow investors to express their values through portfolios – usually through a series of exclusions. It also covers the creation of impact investing strategies, the first of which was launched this year.

The integration process includes three steps: identification, analysis and integration. "We've built a proprietary tool – our responsible investing indicator model – to scan large universes of securities to identify where to do more work. These securities are rated in a traffic light system – green, yellow, red. Our ESG specialist can then go in and identify outliers that need more focus.

"This research is then published for portfolio managers and they start on integrating ESG. . . . If you're doing ESG well, you want to root out problems first."

Turning theory into action in impact investing

John G. Levy
director of impact
Franklin Templeton Investments



By: Gideon Scanlon

Investing is undergoing a paradigm shift, which will see investors do well by doing good, according to John Levy, director of impact at Franklin Templeton Investments.

"Traditional investing is agnostic about its role on the planet, local communities and society. At some point, something like what we now call sustainable investing came along. The idea to avoid harm – it was done by avoiding investing in areas deemed to be harmful for the greater society, like sin stocks. This socially responsible investing had benefits for stakeholders."

While socially responsible investing may not have traditionally been seen as a way to improve returns, Levy said investors have come to recognize its potential to fuel capital generation. As institutional investors began to pay more attention to information related to environmental, social and governance issues, the data revealed plenty of opportunities to generate market-beating returns.

"By paying attention to environmental and social information and data and using it to create better financial outcomes, this kind of investing is still a means to a purely financial end. You can reduce your financial risk and increase your financial return. This is the impact investing ecosystem that we work in today."

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Modern impact investing operates on a dual return basis, where social and financial returns are valued equally. While many investors may view this bifocal approach as inherently limiting, Levy argued that the facts indicate otherwise. "Through the dual return strategy, you can actually outperform the market. We have a track record showing that."

As an example, Levy shared the case of a nursing home on a remote Italian island. Prior to his team's acquisition of the hospital, it was operated by a religious order undergoing financial struggles. As one of the island's major medical providers and one if its most significant employers outside of the tourism sector, the operator rejected higher bids from investors planning to repurpose the building into a seaside retreat.

"We were able to come in and buy it at a good price because we were aligned with the interests of the sellers. We would not only keep it operating, but would invest in it to improve it."

Levy also discussed a deal his team reached to acquire 40 derelict buildings in Cambridge, England, which will be redesigned to serve as affordable accommodation. As home to one of the U.K.'s best universities, Cambridge's rental prices have been driven up by students willing to pay exceptional rental rates.

While many of the units will be made available to this group, it won't be the only group to benefit from dedicated affordable housing. High rental rates also present an acute problem for the National Health Service. It's working with Levy and his team to ensure some of the buildings will provide low-cost housing to its nurses and other medical professionals, as well as for its patients with special housing needs.

"Affordable housing is an issue everywhere. It's an issue for families, individuals, for students and for the elderly."

How OPTrust is designing, implementing an effective ESG strategy

Alison Loat
managing director, sustainable investing and innovation
OPTrust

By: Blake Wolfe

The OPSEU Pension Trust is shifting toward responsible investing as environmental, social and governance factors become increasingly more material to returns for institutional investors, said Alison Loat, managing director of sustainable investing and innovation at the pension fund.

"We're seeing a lot of shifting sands around consumer preferences and expectations. There's also a lot of pressures from our stakeholders asking us to explain, with a lot more clarity, how we're managing their money with respect to these issues. . . . We're starting to evolve both our approach and how we communicate that approach, trying to be honest about the challenges and accessible in the way we communicate this to our beneficiaries."

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In addition, she highlighted the growth of regulatory attention and disclosure expectations related to sustainable investments. "[The Ontario government] hasn't made any declarations, but we've been seeing our sister and brother plans in the U.K. are almost all being effectively required to announce net-zero strategies."

In 2007, the OPTrust began including responsible investing in its policy statements and established its statement of responsible investing principles. In 2008, it created two dedicated staff positions for ESG. While the plan hasn't taken much of an exclusionary approach in its responsible investing strategy, Loat noted it divested from tobacco and cluster munitions in 2017.

To make better sustainable investment decisions, the OPTrust also established a responsible investing partner evaluation, which is applied to every externally managed new investment, she said. "One of the things we realized is there's high variability in the way responsible investing is practiced at OPTrust. None of it had a well-defined process, so one of the first things we did was struck a group and spent eight months developing a process . . . . It gives our investment professionals a tool they can easily use and it helps them be more thoughtful about the integration of ESG in their decision-making."

The pension fund also mandated that capital allocation is focused at the overlap of technology and innovation, investment opportunities and sustainability objectives. "There's no benchmarks or asset class restrictions, so it's wide open for us to think about how we apply [capital]."

In early 2020, the OPTrust also opted to focus on earlier stage investments than it would traditionally consider, said Loat, adding this focus was primarily on funds with a climate solution thesis. "That's exposed us to lots of interesting innovations as well as the immaturity in that market, which surprised us."

She also noted climate change will require the OPTrust to look at different ways of assessing its funded status in the future. "In a matter of years, we'll see significant shocks to the financial system and asset repricing, breaching the way we assess our funded status. [We'll need] asset class-specific criteria to identify the highest-risk individual assets or strategies to develop better ways of assessing climate impacts."

Is inflation here to stay?

Ilan Kolet
institutional portfolio manager
Fidelity Investments Inc.

By: Gideon Scanlon

"Inflation is here and it has a meaningful impact on portfolios and financial assets," said Ilan Kolet, an institutional portfolio manager at Fidelity Investments Inc. "I don't think this will be a shock to anyone in the room or online."

Highlighting the most significant considerations for institutional investors during periods of high inflation, Kolet referred to more volatile markets, an increased correlation between stock and bond performance, as well as decreasing returns from both, and an increased risks of interest rate hikes. He noted that not all of these effects were reflected in the current inflationary cycle.

"We know about the potential for central banks to raise interest rates, but the global attitude is very permissive of it. The biggest risk is, to me, the increased correlation between stocks and bonds."

> "We know about the potential for central banks to raise interest rates, but the global attitude is very permissive of it. The biggest risk is, to me, the increased correlation between stocks and bonds."

The effects of inflation can be further categorized as transitory, intermediate and permanent, he added. "A transitory shock is really something that will be out of the data in the first quarter of next year. When you see airfare, car rentals and hotel rates inflating very rapidly, it is transitory. A year ago, those sectors were essentially closed, so the prices are just catching up. Another example is oil prices. Supply chains have caused vehicle prices to accelerate. It isn't transitory and it isn't permanent. It will disappear, but not for another 18 months.

"The third bucket, where we are most concerned, is what's happening to the labour market – wage growth and increasing service prices," said Kolet, highlighted a chart that showed 80 per cent of U.S. businesses expect to raise wages. "We are experiencing an exceptionally tight labour market and we don't think it will recover any time soon."

Referring to a recent survey by the Canadian Federation of Independent Business, he noted an increase in consumer demand and an increase in labour availability in 2021. "This is really a supply problem not a demand problem. Consumers are flush with cash. The job market is very healthy. The constraint is labour. The answer is higher wages."

Most of the effects of this cycle are transitory, said Kolet, adding he expects inflation will rise above the sub-two per cent levels markets have acclimatized to in the 21st century. "What are the asset classes that best protect against unexpected changes to the rate of inflation? Anything commodity-related. I don't think this will come as much of a shock to any of you."

In terms of a portfolio balance that's capable of shrugging off inflationary risks, Kolet suggested a portfolio with a neutral mix of 42 per cent equities, 50 per cent fixed income and eight per cent commodities. In addition, he said the ability to overweight or underweight asset classes based on market opportunity could be well-hedged against the unpredictable effects of inflation.

According to internal research based on comparing this portfolio mix during historical periods, the hedged model could outperform a traditional 60-40 portfolio mix during periods of high inflation by more than 12 per cent, said Kolet. During more normal periods of low volume with either rising or dropping interest rates, a traditional asset mix would outperform the proposed inflation-protected mix by about two per cent.

"This inflation-protected portfolio generally keeps up in most market regimes. The cost of that insurance is not overwhelming."

Unlocking investment innovation in Canada's Indigenous communities

Kevin Thomas
chief executive officer
Shareholder Association for Research and Education

Mark Sevestre
senior advisor and founding member
National Aboriginal Trust Officers Association

By: Blake Wolfe

Institutional investors can play a role in reconciliation efforts by embracing the growth opportunities presented by Canada's Indigenous communities, according to Kevin Thomas, chief executive officer of the Shareholder Association for Research and Education.

Joined by Mark Sevestre, senior advisor and founding member of the National Aboriginal Trust Officers Association, Thomas noted the two organizations partnered in 2016 to create the Reconciliation Responsible Investment Initiative, which works with Canadian investors to help them incorporate reconciliation into their portfolios and assist Indigenous communities to make investments that are consistent with their traditions and cultural values.

"It was a natural partnership when the NATPO approached us," he said. "We started talking to them about the challenges that Indigenous trusts were facing in governance, oversight and trying to play out their responsible investment values through the investment chain. There was a natural partnership there and we can learn from each other."

With reconciliation measures in the spotlight following last summer's discovery of multiple mass graves at former residential school sites, institutional investors can play an important role, said Sevestre. He cited a call to action in the Truth and Reconciliation Committee's 2016 report that urged Canadian businesses to undertake meaningful consultation with Indigenous communities to seek consent for resource-based projects. "We're not anti-business or anti-development, but we're demanding to be part of the process. Another part of it is ensuring equitable access to employment and opportunities within the business."

Thomas said institutional investors also stand to gain by viewing Indigenous communities as opportunities rather than risks. "Indigenous people aren't just a risk to be managed — they have their own roles and responsibilities in this process and they bring a lot of value to the Canadian economy, which isn't being tapped into. The National Indigenous Economic Development Board estimated the loss in terms of value to the Canadian economy from not having full Indigenous participation at roughly $27 billion annually."

> "We started talking to them about the challenges that Indigenous trusts were facing in governance, oversight and trying to play out their responsible investment values through the investment chain."

There are a number of funds and debt products for institutional investors seeking engagement with Indigenous communities, he said, noting these include bonds that operate like municipal debentures and offer an opportunity to invest primarily in First Nations infrastructure, as well as funds allowing for investments into smaller Indigenous-owned businesses.

And while less common, direct investment opportunities also exist, added Thomas, such as the OPTrust's investment in a $1.5 billion natural gas power plant in Alberta, which brought together a group of partners and six First Nations to invest as an Indigenous community syndicate.

Alison Loat, managing director of sustainable investing and innovation at the OPTrust, said the project changed the investment team's approach to power generation projects. "[The investment team] came in with a traditional investing lens and that brought them to work very closely with these six First Nations. It's also impacted them personally as there was trust built between the investors and these communities."

Saving Canada from demographic doom

Darrell Bricker
chief executive officer
Ipsos Public Affairs
senior fellow
Munk School of Global Affairs and Policy

By: Gideon Scanlon

Pension plan sponsors pay too much attention to predictions and not enough to demographic data, according to Darrell Bricker, chief executive officer of Ipsos Public Affairs and a senior fellow at the Munk School of Global Affairs and Policy.

"Demographics . . . is like a glacier. You can see it coming from a long way away and it transforms everything that it contacts. We are over-emphasizing the wildfire that is COVID-19, but the glacier is continuing to grind onward."

While Bricker expects the coronavirus pandemic to cause long-term challenges, he doesn't believe anyone has enough information to predict these changes with any degree of accuracy. "Late night comics, pop psychologists and sociological experts all thought that, with people stuck at home, we were going to have lots of kids. They thought that, when people ran out of things to read or watch, couples would do what they do best."

However, instead of a pandemic baby boom, there was a baby bust. Recent U.S. figures showed 300,000 fewer people were born in 2020 than had been predicted. Predictions about deaths have also fuelled Bricker's skepticism. "[The coronavirus] has killed five million people. That number was supposed to be 200 million."

He has more faith in demographic data because it's drawn from reliable statistics based on human decisions that have already been made. He also highlighted the importance of looking at past behaviour and human decisions to understand future political and economic problems. "The decisions that I'm going to talk about today have already been made: your parents made them; you've already made them, for the most part; and your kids are now making them today. . . . In a way, they're pretty much locked in. That's what makes them projectable."

One of the most incontrovertible conclusions Bricker draws from demographic data is that the human population is likely to peak before the middle of the 21st century. It will then suddenly decline. "In the 2040s, when every single baby boomer will be in the last decade of their life, we are going to experience a mass extinction event. Why? Because that's how long human beings live."

Beyond aging, humanity will also have to wrestle with issues related to fertility and urbanization, he said. "The biggest migration in human history is happening today. It has been happening since 1960, when people began moving from the countryside to the city. This is happening everywhere. . . . The [United Nations] tells us that, by 2050, 68 per cent of the population of the world is going to live in an urban environment. Back in 1960, it was only 34 per cent. . . . Today, it's 57 per cent."

In Canada, which saw its urban population outsize its rural population in the 1920s, there's also a considerable flow of people from smaller urban centres to metropolises. Today, about 40 per cent of the country's population lives in or around its four largest cities — Vancouver, Calgary, Toronto and Montreal.

"When I'm thinking about investments, I think about urban infrastructure. How are we going to accommodate all these people? How are we going to deal with all of this? Because this trend isn't reversing. . . . Ninety per cent of Canada's population growth over the space of the last 20 years has been in car-commuting suburbs, which is why we shouldn't be getting excited about bike lanes. . . . We've got to come up with some sort of solution. It's probably rail or something else."

The issues caused by suburban expansion may be exacerbated by declining fertility rates around the world. "Back in 1960, the global fertility rate was 5.2. In Canada, it peaked in 1959, when the average person had four children. Today, it's down to 2.4 around the world, according to the U.N.'s numbers. . . . Canada's fertility rate last year was 1.4, the lowest in our history."

With the population of suburban areas expanding, Bricker is concerned about the usefulness of large, single-family homes. In Canada, more homes are occupied by individuals than couples with children, he noted, adding one reason is that women tend to outlive their husbands.

"Who thinks about housing for older women? Who thinks about transportation for older women? There's more and more and more of them every day. And old folks are hoarders. They're savers. . . . We completely ignore them and they have all the money and all the best real estate."

CBC Pension Plan monitoring, refining LDI strategy

Duncan Burrill
managing director and chief executive officer
Canadian Broadcasting Corp. Pension Plan

By: Blake Wolfe

With interest rates trending downward over several decades, liability-driven investing has proven to be a successful strategy for the Canadian Broadcasting Corp. Pension Plan.

The maturity of the plan — which currently sits at $8 billion and has an active membership of 38 per cent — drove many of the decisions around adopting the LDI strategy, said Duncan Burrill, managing director and chief executive officer of the plan. "We view ourselves as a pension plan delivering on a promise, rather than an asset manager within a pension fund."

One key to this strategy is the constant refinement of the asset mix, which can drive 80 to 90 per cent of returns, he said. Currently, the asset mix is 42 per cent equities, 14.5 per cent real assets and 43.5 per cent fixed income with a 34 per cent bond overlay strategy, with provincial bonds and liabilities hedging much of the interest rate risk.

"Our version of LDI is an investment strategy that looks at both assets and liabilities. It's more of a philosophy than a hedge ratio. Some people say they hedge 80 per cent or 60 per cent, but our mission is to deliver the pension promise over 80 years. Solvency and going-concern funded status objectives are our key checkpoints to ensure we're providing benefits security."

Another key component of the LDI approach is carry from the plan's bond overlay strategy, said Burrill, noting it enhances long-term expected returns and has accounted for a third of the plan's gains since the strategy was implemented in 2007.

While LDI helped the pension plan stay afloat amid the 2008/09 financial crisis, he said it's taken a decade to recover. The plan's going-concern funded ratio and solvency funded ratio currently stand at 161.4 per cent and 104.6 per cent, respectively.

And with the possibility of a post-pandemic rise in interest rates, Burrill said the plan sponsor is evaluating the effectiveness of this strategy moving forward. Indeed, an interest rate hike earlier this year cost the plan roughly $400 million in hedging losses.

"The assumption is that rates are going to rise and LDI will be a bad strategy [to maintain]. Our take is that it isn't quite that simple. . . . We've had a 40-year downward trend on interest rates, but at some point there's going to be a regime change and when that happens, LDI won't be as effective. It's not a set-and-forget strategy, it's something you need to adjust over time. . . . We need to look at how much risk we can take and what the plan is if things go against us."

"It's not a set-and-forget strategy, it's something you need to adjust over time. . . . We need to look at how much risk we can take and what the plan is if things go against us."

An LDI strategy also does poorly amid stagflation, said Burrill. "You have leveraged exposure to fixed income so if rates rise, you lose money on the hedge [and] if you get in a situation where rates go up because of inflation and the equities market goes down, you get a double whammy.

"We need to be looking forward, not backward. What worked in the past won't necessarily work in the future. . . . You have to be changing your goalposts and think about funded status instead of how big the pile of assets is. There are also times where you'll underperform peers quite dramatically. You need to have a board that's understanding and not panicked by that."

Are pension plan sponsors rethinking real estate investments in work-from-home era?

Gary Timlick
chair of the investment committee
Winnipeg Civic Employee Benefits Program

Les Marton
managing director of client consulting
Bfinance Canada

Tom Keenleyside
associate director of investments
Western University

By: Gideon Scanlon

The coronavirus pandemic will leave an indelible mark on the way businesses operate, said Gary Timlick, chair of the investment committee at the Winnipeg Civic Employees' Benefits Program, during a panel session at the event on the potential long-term impact of the pandemic on commercial real estate.

"There will be opportunities for staff to determine where they want to work – and some will want to work at home and some will want to work in the office. There's going to be a bit of a challenge in meeting in the middle on that. I think most companies as a minimum would like to see staff in their office for a few days every week."

"I think most companies as a minimum would like to see staff in their office for a few days every week."
– Gary Timlick

This conclusion was supported by an impromptu audience poll that asked whether delegates' organizations were likely to adopt a permanent hybrid workplace model. All but four people raised their hands.

"Part of the reason we're all actually considering this is that it works," said Les Marton, managing partner at BFinance Canada. "Back in March 2020, we were all forced to work from home. Sure, there were hiccups. In general, though, things went smoothly."

The movement toward hybrid workplace models will have a chilling effect on the commercial real estate sector, he said, noting he expects this dip in demand to be balanced out by an increase in the need for offices designed to accommodate businesses adopting a hybrid model.

"I think there's going to be less need for office space. Having said that, I don't think this will be across the board. The newer offices in the well thought out downtown – the class A-type building that has put a lot of effort into sustainability – have really put a lot of thought into making themselves friendly to a hybrid model as well."

"I think there's going to be less need for office space. Having said that, I don't think this will be across the board."
– Les Marton

While this may make it easy for the owners of modern, top-tier buildings to secure tenants, Marton noted the average age of second- and third-tier offices, at 60 in the U.S., would make adapting more

difficult. "What will really drive change is the labour shortage. If you want to convince people to come into the office, you'd better make sure it's a nice one. We're going to see office spaces offering more amenities and larger spaces. Those [class B and C] spaces that can't be easily improved or turned into condominiums will have a problem. Most will, probably, be knocked down."

Tom Keenleyside, associate director of investments at Western University, agreed that labour shortages are likely to help push up demand for attractive, top-tier offices to some extent. However, he still expects overall demand for premium space to fall.

"My estimate is that there will be [a] 20 per cent dip in demand for class-A office space over the next five years. The vacancy rates aren't there yet, but that is because the leases on many long-term tenants haven't come up for negotiation yet."

> "My estimate is that there will be a 20 per cent dip in demand for class-A office space over the next five years."
> — Tom Keenleyside

From an investment perspective, the panellists said they don't believe pension plan sponsors should be moving away from making investments in premium office spaces. They also don't expect interest in the broader real assets category to wane because of an increase in hybrid workplaces.

"The largest plans have allocations between 20 and 25 per cent and that's typical for the top plans," said Marton. "This has trickled down to the smaller and medium-sized plans. That's not going away."

Timlick suggested investors look more broadly at investments in real assets. He also cautioned plan sponsors against having a domestic bias in allocations toward the asset class. "Plans should be looking for a great deal of diversity within [real asset] holdings. Perhaps that could be based more geographically. There's much more opportunity in the U.S. than in Canada."

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