Investor & Treasury Services

Pathways to Sustainability

Canadian Defined Benefit Pension Survey 2021

RBC Investor & Treasury Services' fourth annual survey of Canadian defined benefit pension plans, conducted in November of 2020, reflects the perspectives of 122 pension plans from across the country.

4.0~	50%	Low interest rates	73%	3.5~
Declining confidence in meeting liabilities	Proportion of fully-funded pensions—down from last year	Top near-term challenge again this year	Proportion of pensions that hold alternatives—up from last year	Growing importance of SRI

~Based on a 5-point scale where 5=extremely confident/important and 1=not at all confident/important

Key takeaways

- Confronted with persistently low **interest rates** and deteriorating **funded status**, pension plans are less **confident** in meeting future liabilities but the outlook continues to be upbeat
- Re-assessment of **asset management strategies** and **higher contributions** are the most likely responses to COVID-19
- Pension plans will be reviewing their **asset mix** to enhance ongoing sustainability
- **Liability-driven investments** (LDIs) remain the top de-risking strategy but their importance continues to decline as the use of **alternative investments** gains momentum
- Pensions are increasingly embracing **alternatives** and, while **real estate** and **infrastructure** remain the most popular alternative investments, demand for real estate appears to have softened
- The **indirect alternative investment model** continues to be the top approach overall but the **direct model** is preferred by large and private-public plans that are closely managing these investments
- Interest in **socially responsible investing** (SRI) is increasing but remains less than enthusiastic as the gap between pension plans and asset managers narrows

Did you know?

22%	38%	$82T	73%
of Canadians will be seniors by 2030—up from 17% in 2018[1]	of pension assets are alternatives—more than tripling since 2004[2]	of infrastructure investment will be required by 2040 globally[3]	of responsible investment assets are held by pensions[4]

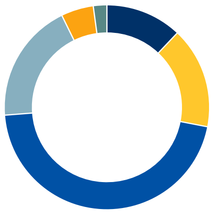
[1]Statistics Canada and RBC Economics, September 17, 2019
[2]Pension Investment Association of Canada, defined benefit pension plans as at December 31, 2019
[3]The Economist, In the Works, January 2, 2021, USD
[4]Responsible Investment Association, Canadian RI Trends Report 2020

About the respondents

This year's survey includes the aggregate responses of 122 Canadian defined benefit pension plans, compared to 119 in the previous year.

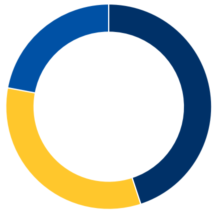
Location

British Columbia	12%
Prairies	16%
Ontario	46%
Quebec	19%
Atlantic	5%
US	2%



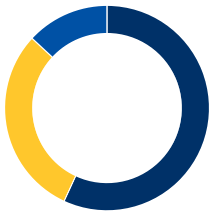
Asset size

Less than $1 billion (small)	45%
$1 billion to $5 billion (mid-sized)	33%
More than $5 billion (large)	22%



Type

Private	57%
Public	30%
Private-public	13%

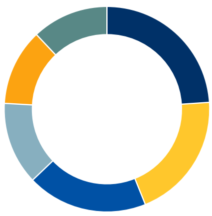


Status

Open to new members	66%
Closed to new members	34%

Role

Finance & administration	24%
Trustee/board member	20%
Executive	19%
Human resources	13%
Investment	12%
Other*	12%



*Including board secretary; consultant; outsourced chief investment officer; plan administrator; and "not disclosed"

Outlook

Confidence in meeting liabilities declines but remains bullish

Faced with persistently low interest rates, deteriorating funded status and a global pandemic, the confidence of Canadian pension plans worsened year-over-year (4.4 to 4.0*) but remained higher than 2017 (3.7) and 2018 (3.8). The decline occurred regardless of respondent size, type or status. Confidence is highest among large plans (4.3) and lowest among public plans (3.8).

Year-over-year confidence is lower across all plan categories

Large plans are most confident

Confidence in meeting ongoing pension liabilities

2019	2020	
4.4	4.0	**Overall**

2019	2020	**Size**
4.3	4.0	Less than $1 billion
4.4	3.9	$1 billion to $5 billion
4.5	4.3	More than $5 billion

2019	2020	**Type**
4.4	4.2	Private
4.3	3.8	Public
NEW	3.9	Private-public

2019	2020	**Status**
4.4	4.0	Open to new members
4.2	4.0	Closed to new members

How confident are you in your plan's ability to meet its ongoing liabilities?

2019	2020	
49%	30%	5 - Extremely confident
42%	46%	4
7%	21%	3
0%	1%	2
2%	2%	1 - Not at all confident

A challenging year

Public plans are least confident

*Based on a 5-point scale where 5=extremely confident and 1=not at all confident

Funded status

Fewer pension plans are fully funded

Half of respondents reported that their pension plans are fully funded on a going-concern basis, down significantly from 66% in 2019. Nearly two-thirds (62%) of large plans are fully funded, compared to 55% of small plans and less than a third (31%) of mid-sized plans. This year's median going-concern funded status of 99% sits two percent below last year's 101%.

Bouncing back?

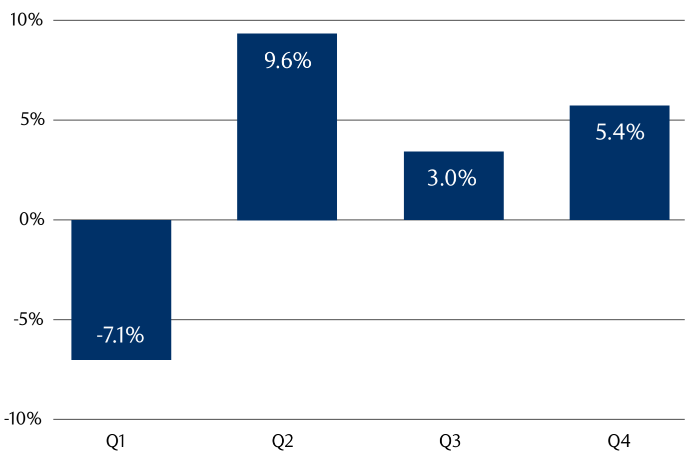
Following a dismal first quarter of 2020, including negative median returns of more than 7%, Canadian defined benefit pension plans bounced back in the remainder of the year with positive quarterly returns of approximately 10%, 3% and 5% respectively, and an annual return of more than 9%. The returns are based on RBC Investor & Treasury Services' All Plan Universe Survey, which tracks the performance of a cross-section of Canadian defined benefit pension plans.[1]

Despite favourable net returns in 2020, there was a significant year-over-year decline in the proportion of pension respondents that reported fully-funded plans (66% last year to 50% this year). This may indicate that favourable net returns were offset by the higher current value of pension liabilities, driven up by lower Canadian 10-year benchmark bond yields.

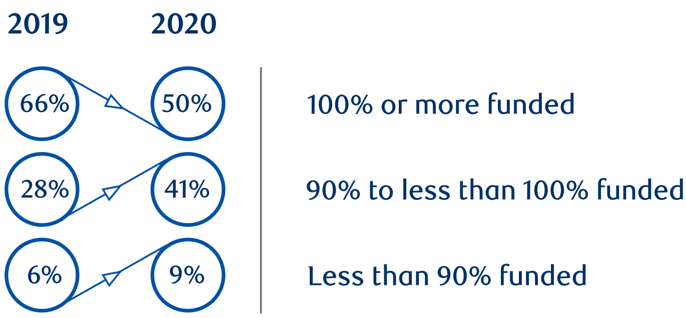
Half of all pension plans
are fully funded

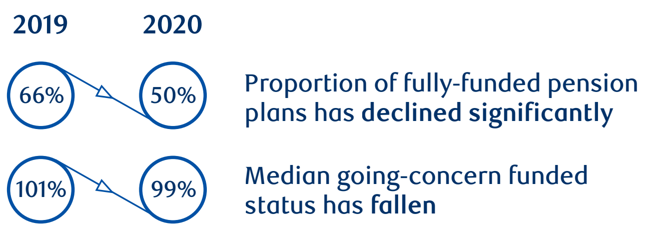
Less than a third of mid-sized plans
are fully funded

Canadian Defined Benefit Pension Plans
2020 Quarterly Median Returns[1]



What is the current going-concern funded status of your pension plan?





[1]RBC Investor & Treasury Services, All Plan Universe Survey, December 31, 2020

Challenges

Low interest rate environment is the overriding concern

The persistently "low interest rate environment" further advanced its position as the top near-term challenge overall (20% to 26% year-over-year) and across all respondent categories. This was followed by increasingly popular "economic and geopolitical uncertainty," which is in a distant second-place tie with "market volatility" (13%).

"Aligning future liabilities with assets" continued its three-year descent from first to fourth spot among the various challenges overall (21% in 2018 to 12% this year), although plans closed to new members rated this as their second-highest concern (14%). "Meeting solvency requirements" emerged as a related challenge (7%) and, combined with the alignment factor, likely reflects ongoing concern about plan sustainability. Other potential concerns are generally deemed relatively unimportant, at least in the near term.

Focusing on the economy—and politics

What are the top three challenges your pension plan faces over the next 12 months?

2019	2020	
20%	26%	Low interest rate environment
7%	13%	Economic and geopolitical uncertainty
13%	13%	Market volatility
13%	12%	Aligning future liabilities with assets
NEW	7%	Meeting solvency requirements
NEW	5%	Governance
6%	4%	Incorporating new instruments/ alternative investments
7%	3%	Adapting to new regulation
7%	3%	Demographic changes
5%	3%	Realizing operational efficiencies
5%	3%	Aligning benefits with future member needs
17%	8%	Other*

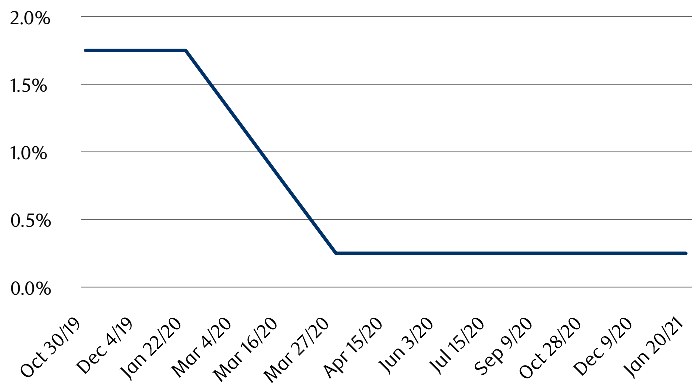
Aligning liabilities with assets

reflects concern about plan sustainability

Almost nothing

Just when it was thought that interest rates couldn't fall any lower, COVID-19 emerged and the Bank of Canada reduced its Policy Interest Rate in March 2020 from 1.75% to 0.25% as part of three successive reductions, which remain in effect.[1]

Bank of Canada Policy Interest Rates



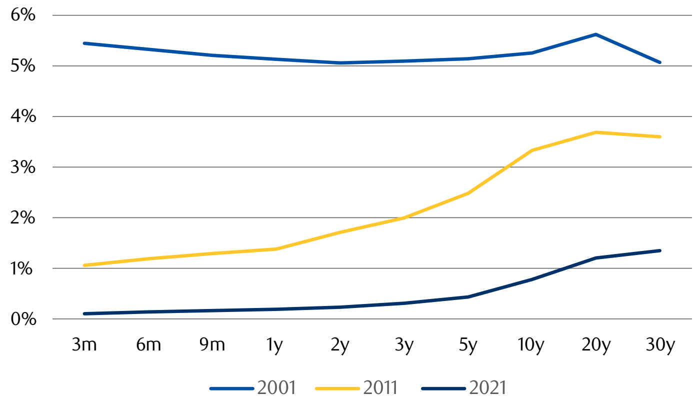
Furthermore, Canada's long-term interest rates have been persistently low since the financial challenges of 2008, as demonstrated by the contrasting yield curves for zero-coupon bonds over the past 20 years.[2]

*Including annuitizing closed plans; cyber/privacy issues; ensuring safety of employees; and expanding digitization/data strategy

Increasing polarization

There is no shortage of political turmoil in today's increasingly polarized world, ranging from trade wars and climate change to a renewed focus on racial injustice and the rise of populist movements. This is reflected in respondents' higher year-over-year ranking of economic and geopolitical uncertainty as a top challenge, increasing from 7% to 13% in a second-place tie with market volatility.

Yield Curves for Zero-Coupon Bonds[2]



Awaiting sustainable growth

Concern about market volatility continues (tied for #2 challenge). While the CBOE Market Volatility Index (VIX) is down materially from the pandemic-induced spike in the spring of 2020, it remains higher than pre-pandemic levels.[3] According to RBC's Deputy Chief Economist, Dawn Desjardins: "News that vaccines are being distributed has brightened the outlook. However, given the resurgence in infections, volatility remains higher than before the crisis. In the near term, the impact of rising COVID caseloads will weigh on the economy with stronger growth momentum only expected to emerge once vaccinations are more widely distributed. This uncertainty is expected to keep volatility measures higher than normal and it is only likely to ease once there is confidence that the economy is on a sustainable growth path."

CBOE Market Volatility Index[3]

> "Volatility is only likely to ease once there is confidence that the economy is on a sustainable growth path."
>
> —Dawn Desjardins, Deputy Chief Economist, RBC

Addressing demographic shifts

Preoccupied with COVID-19, pension plans appear to have relegated concern about demographic changes to the back burner (7% to 3% year-over-year). This is likely to change as the advancing age of baby boomers puts pressure on Canada's pension system in the coming years.

Andrew Agopsowicz, Senior Economist at RBC Economics, highlights what is projected to be a rather startling demographic shift: "Life expectancy at 65 is seeing people live slightly longer than a generation ago. However, by far the main source of demographic pressure comes simply from the size of the baby boomer cohort, which is expected to increase the share of the senior population from 17% in 2018 to approximately 22% in 2030—triple what we saw from 2000 to 2009 and nearly quadruple that experienced in the 1990s."

2018 | 2030
17% → 22%
Share of Canada's senior population[4]

"The past five years has seen a dramatic rise in the number of new immigrants but this has not been enough to offset the increasing size of the retired population."

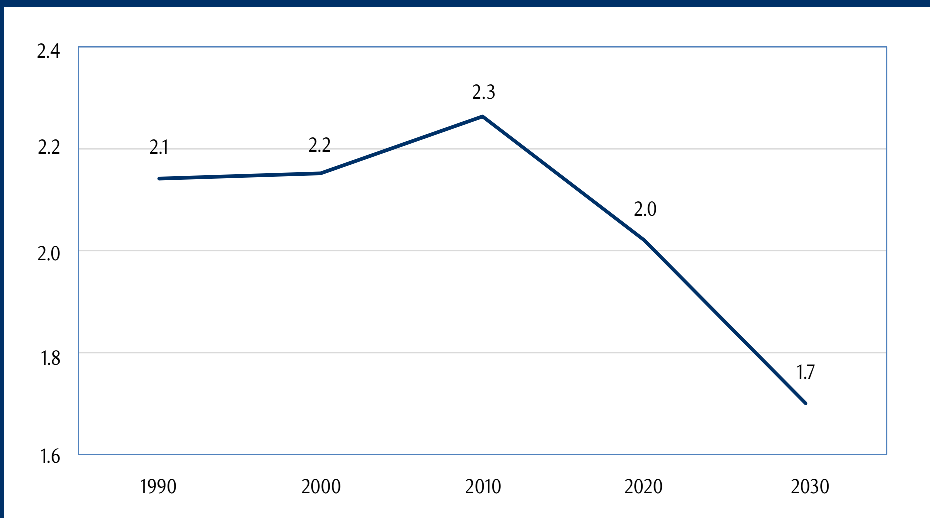
—Andrew Agopsowicz, Senior Economist, RBC

According to Agopsowicz, "The primary reason for such a dramatic aging of the population is that, following the baby boom, Canada's fertility rate plunged and has remained persistently low ever since—a record low today. The past five years has seen a rise in the number of immigrants, but this has not been enough to offset the increasing size of the retired population."

Feeling the squeeze

Working-age Canadians may feel the financial squeeze as a shrinking workforce supports an aging population. In 2010, there were 2.3 working-age Canadians for every youth and senior but this is expected to drop to 1.7 by 2030.[5]

Working-Age Canadians for Every Youth & Senior



[1] Bank of Canada Policy Interest Rates as at January 20, 2021
[2] Yield curves at the start of each calendar year for zero-coupon bonds based on pricing data for Government of Canada bonds and treasury bills with terms to maturity ranging from three months (3m) to 30 years (30y) as published by Bank of Canada
[3] Wall Street Journal/Haver Analytics as at January 1, 2021
[4] Statistics Canada and RBC Economics, September 17, 2019
[5] Statistics Canada and RBC Economics, January 2020

COVID-19 responses

The pandemic will necessitate re-assessment of asset management strategies

Pension plans identified "re-assessment of asset management strategy" and "higher member and/or employer contributions" as their top responses to COVID-19 (29% and 26%). This applies across all respondents except for large plans, which chose "increased focus on responsible investment" (19%) as a distant second-place choice to strategy re-assessment (41%). Private-public plans picked "increased focus on alternative investments" as their #1 response, tied with strategy re-assessment (31%).

What do you expect to be the most significant change for your pension plan due to the economic impact of COVID-19?

2020	
29%	Re-assessment of asset management strategy
26%	Higher member and/or employer contributions
16%	Increased focus on alternative investments
13%	Increased focus on responsible investment
16%	Other*

*Including closure or wind-up of plan; increased focus on risk management; minimal impact; re-assessment of fixed income strategy; reduced member benefits; and shift to defined contribution plan

Changing it up

Higher pension contributions
loom on the horizon

Preparing for the next norm

While the full economic impact of COVID-19 has yet to play out, it seems appropriate for pensions to re-assess their asset management strategies at this juncture. What is the appropriate asset mix to achieve desired returns? What is the appropriate investment style to achieve desired risk preferences and growth/value orientations?

Over the past number of years, Canadian pension plans have been reweighting their asset mix and exploring various types of alternative investments to provide higher risk-adjusted returns over the longer term and to enhance the sustainability of their plans. This is likely to continue as managers re-examine their asset management policies (see Sustainability, De-Risking and Alternative Investment sections).

However, strategy refinement appears to be only a first step in dealing with the aftermath of COVID-19. Additional member and/or employer contributions are high on the list of options and responsible investment is also at the forefront, driven by passionate discussions around climate change and racial inequality. Finally, geopolitical uncertainty is unlikely to disappear anytime soon, while looming demographic changes and the aging of Canada's population—a key focus of pensions prior to the pandemic—will require attention.

There is much to consider in preparing for the next norm.

Pension sustainability

Ongoing sustainability may require changes in asset mix

The vast majority of respondents (83%) are considering options to enhance the sustainability of their pension plans and, of those planning to do so, "changing asset mix" is by far the most popular strategy—more than three times higher than its nearest rivals.

83%
of respondents are looking to enhance their plans' sustainability

Making the right choices

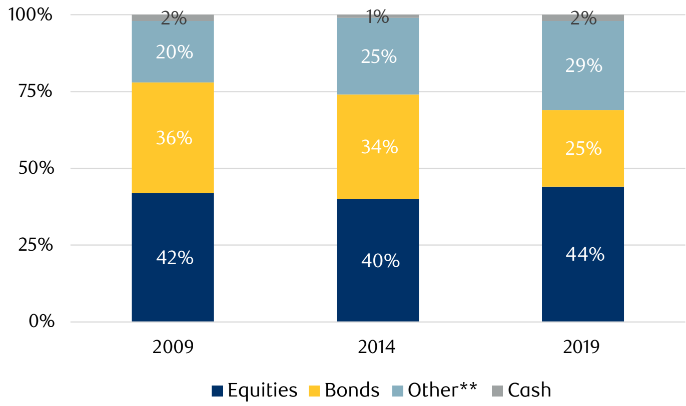
Consistent with respondents' intent to alter the asset mix of their plans, a survey of Canadian institutional investors conducted by global communications firm Edelman reports that 89% of investors expect to re-weight their portfolios toward alternative investments going forward.[1] This would continue a 10-year trend that has seen Canadian pension plans shift their assets to alternatives.[2]

Which of the following options are you considering to enhance the sustainability of your pension plan?*

2020

32%	Changing asset mix
10%	Increasing risk tolerance
10%	Increasing employee contributions
10%	Increasing plan sponsor contributions
7%	Merging with another plan
7%	Increasing plan members' retirement age
6%	Reducing benefits
5%	Closing your plan to new members and offering a defined contribution plan
5%	Expanding membership to include new employers and members
4%	Converting to a target benefit plan
4%	Other***

Canadian Pension Asset Allocations[2]



2009 20% → **2019** 29%

Canadian pension allocations to alternatives

*May include multiple responses
**Including real estate and other alternatives
***Including annuitize liabilities; change jurisdictions to qualify for solvency funding exemption rules; convert to a jointly-sponsored pension plan; increase the retirement age; join another plan; reduce expected return assumptions; remove indexation provisions; and "sit tight"
[1]Edelman Trust Barometer Special Report: Institutional Investors, November 2020
[2]Willis Towers Watson Global Pension Assets Study 2020

De-risking

LDIs and alternatives are the top de-risking strategies

For the fourth consecutive year, “liability-driven investments” (LDIs) remained the most effective de-risking strategy but continued their decline from a high of 39% in 2017 to 26% this year. New option “use of alternative investments” emerged as the second-most popular tool (23%), significantly ahead of “buy-out annuities,” which declined in importance year-over-year (18% to 12%), particularly among mid-sized plans (17% to 5%).

“Use of alternatives” was identified as the most popular de-risking strategy among mid-sized, public and private-public plans (33%, 28% and 31%), as well as those accepting new members (28%). “Target benefit plans” declined in popularity overall (17% to 11%). However, this option is particularly popular among public plans (tied for first place with alternatives as the most effective de-risking option at 28%), compared to significantly lower levels of popularity among private-public and private plans (6% and 4%).

What do you consider the most effective de-risking strategy?

2019	2020	
30%	26%	Liability-driven investments
NEW	23%	Use of alternative investments
18%	12%	Buy-out annuities
17%	11%	Target benefit plans
8%	9%	Benefit amendments
7%	6%	Buy-in annuities
8%	6%	Increased allocation to fixed income
12%	7%	Other*

*Including active management; asset-liability management; changing jurisdictions to qualify for solvency funding exemption rules; converting to a jointly-sponsored pension plan; merging with another plan; and moving to a defined contribution plan

A holistic approach

LDIs
continue to be the top de-risking strategy but their importance is declining

Use of alternatives
emerges as a key de-risking strategy, overtaking buy-out annuities for second place

The potential for higher returns

LDIs continued to be the top de-risking strategy overall; however, their year-over-year popularity was lower across all categories except mid-sized plans, which increased from 38% to 47%. The decline in 2020 builds on previous years’ downward trends, which followed the easing of pension funding rules in Quebec, Ontario and British Columbia, and the ability to smooth contributions over longer time periods in various other provinces. These changes made it more attractive for pensions to take on potentially riskier and higher-return investments such as alternatives to help alleviate funding pressure from a growing base of pensioners with a higher life expectancy. Accordingly, use of alternatives has emerged as the second-most popular de-risking strategy and a recurring theme throughout this report.

A cautionary note

While the prominence of alternative investments has been rising in today’s low-yield environment, Serge Lapierre, Senior Managing Director and Global Head of Liability-Driven Investments at Manulife Investment Management, offers a word of caution on the use of alternatives for de-risking. “It’s important to take a holistic approach and, when there are multiple symptoms, don’t just treat the one that is most obvious,” he says. “Be sure to find the right balance between the possibility of earning higher returns through investments such as alternatives and the need to have a proper hedge against your liabilities. You can’t make decisions in silos.”

Alternatives-adoption

Pensions are increasingly embracing alternative investments

A significant majority of pensions (73%) currently hold alternatives in their plans or expect to augment their portfolios during the next 12 months—slightly above last year's 71%.

73% of respondents
already hold alternatives or plan to add them

Similar to 2019, alternative investments are most popular among large plans (96%) and new category private-public plans also has a high rate of adoption (94%). Alternatives continue to be least popular among small plans (51%) and those closed to new members (62%). While year-over-year popularity of alternatives increased for large plans (90% to 96%) and those closed to new members (57% to 62%), demand for alternatives declined among mid-sized and public plans (93% to 88% and 92% to 83%).

The popularity of alternatives is:
- Highest among large and private-public plans
- Lowest among small plans and those closed to new members

The quest for returns

A common theme

As discussed in the De-Risking section, the easing of pension funding rules appears to have triggered increased interest in alternatives—a common theme throughout this report as pensions look for opportunities to meet increasing obligations from an aging membership:

- Nearly three-quarters of plans currently hold alternatives or intend to add them (see above)
- Pensions identified "increased focus on alternative investments" as one of the top responses to COVID-19 (third spot at 16%)
- "Changing asset mix" is the top strategy to ensure plan sustainability (32%), pointing to the potential for additional alternative investments
- "Use of alternatives" is the second-most popular de-risking strategy (23%)

Pension plans that currently hold alternatives or expect to add them

2019	2020	
71%	73%	**Overall**

2019	2020	**Size**
51%	51%	Less than $1 billion
93%	88%	$1 billion to $5 billion
90%	96%	More than $5 billion

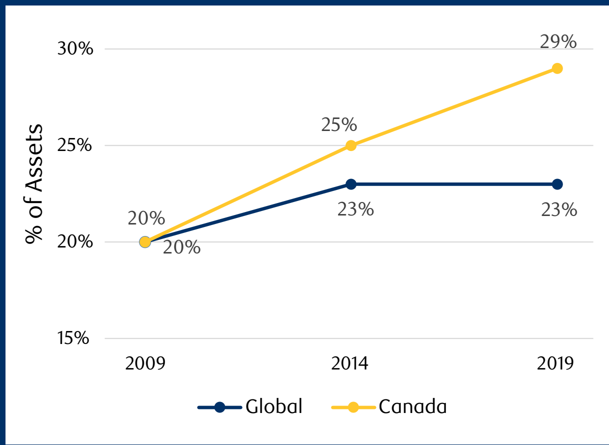
2019	2020	**Type**
60%	63%	Private
92%	83%	Public
NEW	94%	Private-public

2019	2020	**Status**
79%	79%	Open to new members
57%	62%	Closed to new members

Leading the global pack

Canadian pension plans have embraced alternative investments at a higher rate than those in other parts of the world. At the end of 2019, Canada allocated 29% of pension assets to alternatives, noticeably higher than the global allocation of 23%.[1]

Pension Allocations to Alternatives



[1]Willis Towers Watson, Global Pension Assets Study 2020

Alternatives-asset classes

Real estate and infrastructure are the most popular alternatives

Pension plans with alternative investments are most likely to include real estate and infrastructure in their portfolios (96% and 85%), and least likely to hold hedge funds and natural resources (56% and 48%). This is consistent with last year's results.

Hedge funds and natural resources are the least popular alternatives

Considering the alternatives

Adjusting the mix

Nearly 80% of respondents that incorporate alternatives into their plans are looking to make increased allocations to one or more of their alternative investments in the near term—up from 72% last year.

Similar to last year, approximately 60% of pension plans that hold alternatives intend to increase their allocations to infrastructure in the near term and only a few are forecasting reduced demand. However, the demand for real estate is expected to decline year-over-year as relatively fewer plans augment their holdings (53% to 45%) and a higher proportion of respondents look to decrease their allocations to this asset class (0% to 7%).

On the other hand, demand appears to be strengthening for private equity and private debt as a higher proportion of respondents are planning increased allocations year-over-year (38% to 47% and 38% to 46%). Consistent with last year, a relatively small number of respondents plan to change their allocations to the less popular hedge funds and natural resources.

Change in alternative investment allocations

Increased allocations 2019	Increased allocations 2020	Decreased allocations 2019	Decreased allocations 2020	
53%	45%	0%	7%	Real estate
60%	61%	1%	1%	Infrastructure
38%	47%	3%	2%	Private equity
38%	46%	1%	2%	Private debt
11%	9%	7%	5%	Hedge funds
13%	9%	2%	3%	Natural resources

80% of respondents intend to increase at least one of their alternative investment allocations

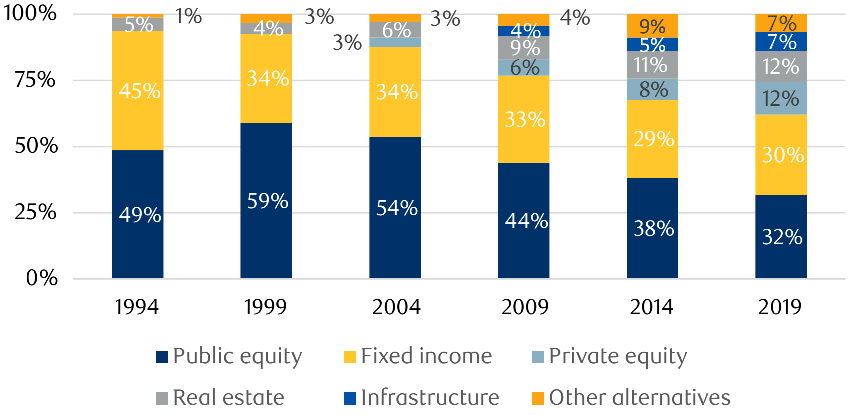
Real estate is experiencing lower demand*

Private debt and private equity are experiencing higher demand*

Continuing the upward trend

Increased alternative investment allocations in the coming year are the continuation of a trend that has resulted in the more than tripling of Canadian defined benefit pension plan alternative allocations over the past 15 years from 12% in 2004 to 38% in 2019.[4]

Canadian Defined Benefit Pension Plans Asset Mix[4]



Higher remote working = reduced office footprints

Real estate continues to be the most popular alternative investment but its popularity appears to be declining somewhat as fewer respondents are planning increased real estate allocations year-over-year and more are looking to reduce their exposure. This may be in anticipation of a potential reduction in office footprints and resultant lower demand for commercial real estate generated by the move to remote teams during COVID-19, a trend that could continue as firms and employees consider adopting more flexible approaches in the future.

The promise of an infrastructure boom

Respondents remain particularly upbeat on infrastructure as over 60% plan to increase their allocations to this asset class in the near term—the highest of any alternative class. This occurs at a time when governments throughout the world are promising an infrastructure boom as part of efforts to restart economies in the post-pandemic period by repairing aging assets in developed countries, providing electricity and clean water in the emerging world, and meeting demands for renewable energy and connectivity globally. The need is substantial and the G20's Global Infrastructure Hub estimates that the world will require $82 trillion of infrastructure investment by 2040.[1]

Meanwhile, CEO of the Canada Pension Plan Investment Board (CPPIB), the country's largest pension manager, believes that "a wall of money" is headed towards real assets, including infrastructure, "because of structurally low interest rates." The CEO recently urged governments to consider privatizing assets to help reduce record deficits that are expected as a fallout of the COVID-19 pandemic. He said CPPIB is in the market for infrastructure and real estate investments, despite the pandemic's dampening effects on office space and commuter-driven infrastructure such as toll roads. "We still like real assets, we still like toll roads," he said. "In fact, we're very close on another toll road (investment)." CPPIB owns a stake in the Greater Toronto Area's 407 commuter toll road.[2]

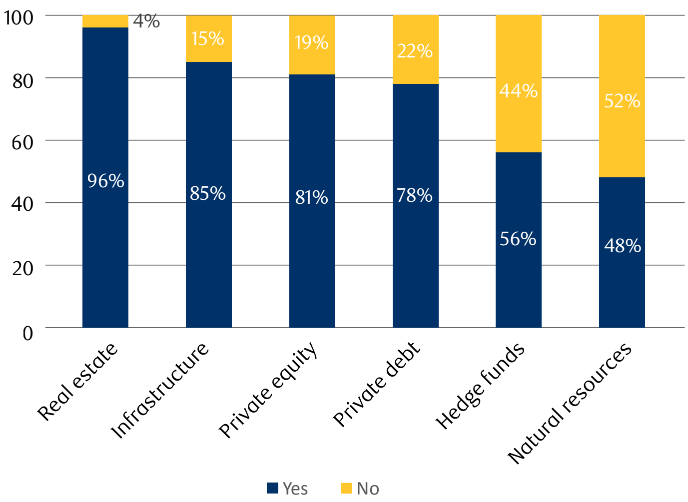
Also of note, the $330 billion Caisse de dépôt et placement du Québec (CDPQ) has reiterated the pension plan's intention to double its infrastructure portfolio over the next five years to approximately $60 billion. The announcement came after CDPQ revealed a -1% return for its infrastructure portfolio in the first half of 2020, compared to a -11.7% return from real estate assets. According to the pension manager's Head of Infrastructure: "We still have plenty of deals to do. It's about finding long-term yield and value, and having a diversified portfolio. Diversifying the risk is as important as getting top dollars." Among its infrastructure investments, CDPQ holds a 13% stake in London's Heathrow Airport and has taken on Montreal's Réseau Express Métropolitain, a $6.3 billion light rail Greenfield development.[3]

Private equity and private debt on the rise

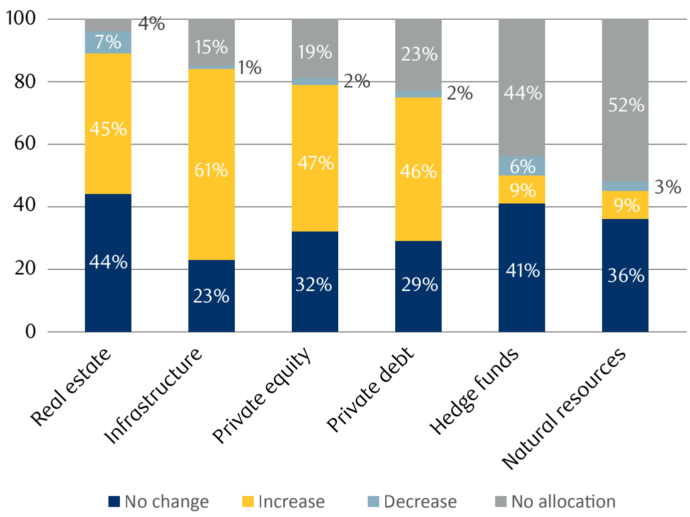
A greater proportion of respondents are planning to augment their private equity investments in the coming year (38% to 47% year-over-year), continuing a 10-year trend of doubling allocations to this asset class in the search for higher returns (6% to 12% of assets).[4] Potential benefits of private equity include the prospect of an "illiquidity premium" for not being in the public markets, while others suggest that stronger returns from private equity investments may be tied to complexity or higher governance costs rather than their illiquid nature.[5]

An increasing proportion of pensions are also accelerating their exposure to private debt (38% to 46% year-over-year), which is generally issued by closely-held companies and offers a premium over corporate bonds due to fewer disclosures and less liquidity. However, investors are reportedly facing a shrinking universe of higher-quality private debt investments to lift returns as the coronavirus pandemic has "crushed" many companies that issue such debt.[6]

Are you planning to include the following alternative investments in your plan's portfolio during the next 12 months?



How do you expect to change your alternative investment allocations during the next 12 months?



*Based on the proportion of respondents that expect to increase or decrease their alternative allocations year-over-year

[1]The Economist, In the Works, January 2, 2021, USD in 2015 prices

[2]Financial Post, CPPIB Chief Sees "Wall of Money" Headed to Infrastructure Investments, December 15, 2020

[3]Infrastructure Investor, CDPQ Plans to Double Infra Portfolio, October 15, 2020

[4]Pension Investment Association of Canada, Asset Mix Report 2019 as reported at calendar year end, excluding cash and leverage

[5]Benefits Canada, Why are Institutional Investors Ramping up Allocations to Private Equity, December 20, 2019

[6]The Globe & Mail, Canadian Pension Funds, Insurers Seeking Private Debt, November 29, 2020

Alternatives-investment models

The indirect alternative investment approach is most popular

The indirect model continues to be the top approach for adding alternatives to pension plans overall (47%). However, the direct model achieved #1 spot among large and private-public plans with the necessary resources for hands-on management of their growing alternative portfolios (46% and 47%).

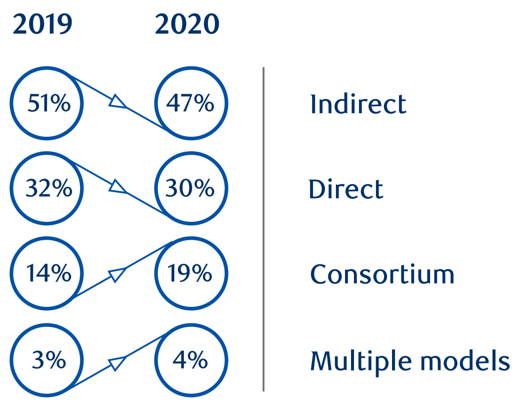
The indirect investment model continued its decline in popularity year-over-year (51% to 47%), offset by increased interest in the consortium model (14% to 19%). Large plans demonstrated a significantly higher interest in the direct model (30% to 46%), which is now their preferred approach. Meanwhile, small and mid-sized plans, as well as public and private plans, indicated a growing preference for the consortium model, which remains well below popularity of the indirect approach among these plans.

The right fit

Direct model
is preferred by large and private-public plans

Consortium model
is increasingly important but continues to lag

What is your preferred private equity and real estate investment model?



Preferred alternative models

	Indirect	Direct	Consortium	Multiple models
Overall	47%	30%	19%	4%
Size				
Less than $1 billion	57%	14%	25%	4%
$1 billion to $5 billion	51%	32%	17%	0%
More than $5 billion	31%	46%	15%	8%
Type				
Private	55%	18%	23%	4%
Public	43%	40%	17%	0%
Private-public	33%	47%	13%	7%
Status				
Open to new members	43%	30%	22%	5%
Closed to new members	58%	31%	11%	0%

Socially responsible investing

The importance of SRI increases but interest remains lukewarm

More than half of respondents (53%) perceive SRI to be important to their overall strategy (rating of 4 or 5 on a 5-point scale)—an average overall score of 3.5.* SRI is most popular among large plans (3.9) and least popular among those closed to new members (3.3).

The current rating of 3.5 represents a considerable increase over last year when 43% of pension plans found SRI to be important with an average score of 3.1. This upward trend occurred across all categories and, while the average SRI score continues to be somewhat lukewarm, a significantly higher proportion of respondents rated SRI as "extremely important" in this year's survey (8% to 20%), particularly large and public plans.

Importance of SRI

2019	2020	
3.1	3.5	**Overall**
2019	**2020**	**Size**
2.9	3.4	Less than $1 billion
3.3	3.5	$1 billion to $5 billion
3.4	3.9	More than $5 billion
2019	**2020**	**Type**
2.9	3.5	Private
3.5	3.7	Public
NEW	3.4	Private-public
2019	**2020**	**Status**
3.1	3.6	Open to new members
3.3	3.3	Closed to new members

Taking responsibility

2019	2020	
43%	53%	SRI is increasingly important to pension plans

SRI is:

- Most important to large pension plans
- Least important to plans closed to new members

Investing more responsibly

The Responsible Investment Association reports a total of $3.2 trillion in responsible investment (RI) assets under management in Canada at the end of 2019, including SRI. This represents a 48% growth rate over the past two years. Pension plans are estimated to account for half of Canadian RI assets, totalling $1.6 trillion at the end of 2019 and up from $1.4 trillion in 2017.[1]

The narrowing gap

RBC Investor & Treasury Services' recent survey of Canadian asset and wealth managers reported that 54% of respondents view SRI to be important with an average score of 3.6—only slightly higher than Canadian pension plans (53% and 3.5). Asset and wealth managers have historically ranked SRI at a significantly higher level of importance than pension plans, but the gap has narrowed of late to the point that SRI is currently more important to large pension plans than large managers (3.9 versus 3.8).[2]

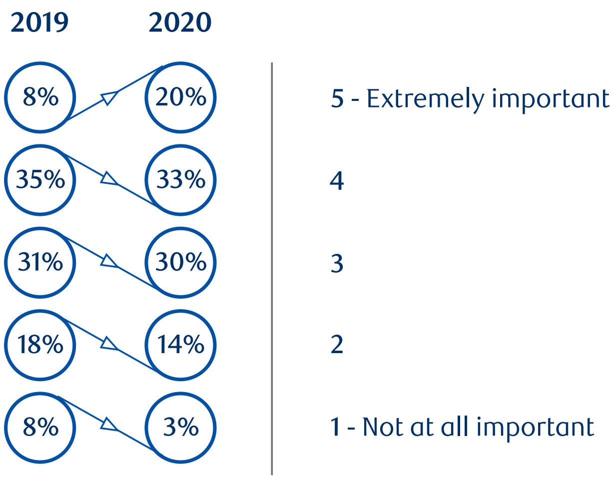
50%
of Canadian RI assets are held by pensions

Seizing the opportunity

The narrowing "SRI gap" between pension plans and asset managers may reflect a heightened focus on sustainable investing within the pension community, particularly among large plans. For example, in a recent precedent-setting move, the CEOs from eight of Canada's leading pension managers jointly called on companies and investors to provide consistent and complete environmental, social, and governance (ESG) information in order to strengthen investment decision-making and better manage collective ESG risk exposures. The joint statement also recognizes the ongoing impact of COVID-19 and recent events that have highlighted long-standing social inequity, including systemic racism, environmental threats and board effectiveness. The signatories implore companies to "seize the tremendous opportunity available at this historic moment to actively take steps to drive lasting change."[3]

> "How companies identify and address issues such as diversity and inclusion, human capital, and climate change can significantly contribute to value creation or erosion."
>
> —Joint statement by CEOs of eight leading Canadian pension managers

How important is SRI to your plan's overall strategy?



What is socially responsible investing?

SRI is a responsible investment strategy that screens companies from the investment universe (positive and negative screening) based on ESG factors in order to generate measurable impact and a market rate of return.

*Based on a 5-point scale where 5=extremely important and 1=not at all important
[1]Responsible Investment Association, Canadian Responsible Investment Trends Report, November 2020
[2]RBC Investor & Treasury Services, Canadian Asset and Wealth Manager Survey, October 2020
[3]BCI, Leading Canadian Pension Plan Investment Managers Issue Joint Statement on ESG, November 25, 2020

About RBC Investor & Treasury Services

RBC Investor & Treasury Services is a specialist provider of asset services, custody, payments and treasury services for financial and other institutional investors worldwide, with over 4,500 employees in 16 countries across North America, Europe and Asia. We deliver services to safeguard client assets, underpinned by client-centric digital solutions that continue to be enhanced and evolved in line with our clients' changing needs. Trusted with $4.5 trillion of client assets under administration,[1] RBC Investor & Treasury Services is a financially strong partner with among the highest credit ratings globally.[2]

[1] Royal Bank of Canada quarterly results as at October 31, 2020
[2] Standard & Poor's (AA-) and Moody's (Aa2) legacy senior long-term debt ratings of Royal Bank of Canada as at December 1, 2020

Contact us

David Linds
Managing Director and Head
Asset Servicing, Global Client Coverage
Canada
david.linds@rbc.com

Sylvain Gervais
Managing Director and Co-Head
Global Client Coverage
Eastern Canada
sylvain.gervais@rbc.com

Paul Folk
Managing Director and Head
Asset Managers and Private Clients
Global Client Coverage, Canada
paul.folk@rbc.com

Niki Zaphiratos
Managing Director and Head
Asset Owners, Global Client Coverage Canada
niki.zaphiratos@rbc.com

Throughout this report, currencies are in Canadian dollars and percentages show proportion of choices unless otherwise indicated.