INSIGHTS
FOR INSTITUTIONAL INVESTORS

FALL 2014

WHAT ARE THE LEADERS OF CANADA'S LARGEST PENSION FUNDS SAYING?

Few people in our industry have a better window on the retirement world than defined benefit (DB) plan sponsors. These are the organizations directly impacted by market movements, regulation and policy changes, and shifts in government retirement programs.

That's why Sun Life Investment Management recently surveyed leaders at Canada's largest pension funds, seeking their opinions on some of the most topical issues today:

1. **The health of DB pension funds:** We asked plan sponsors about the state of DB pension funds across Canada, including their own.

2. **Investment strategies today and tomorrow:** We asked plan sponsors what investment vehicles they are using to meet their obligations to plan members today and how that might change in the future.

3. **Canada's retirement income system – a policy "wish list":** We asked plan sponsors about their long-term views on Canada's retirement income system and in what areas they would like to see policymakers take action.

The key findings featured in this paper provide you with insight about how leading DB plan sponsors feel about the state of their plan – what is causing optimism; what is causing concern – and how they are planning for the challenges of the future. Their views on policy – from changes to the Canada Pension Plan, to support for existing DB plans, to the issue of pension coverage – are a welcome addition to the retirement income debate.

ABOUT THE SUN LIFE INVESTMENT MANAGEMENT DEFINED BENEFIT PLAN REPORT

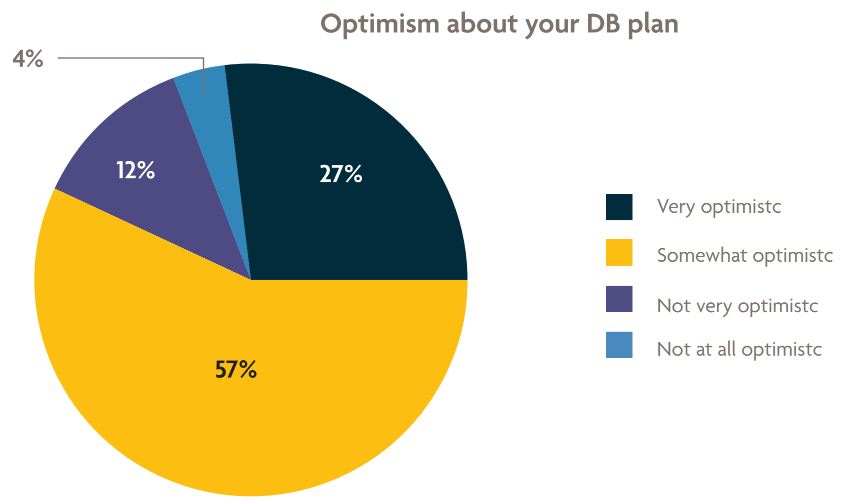
- We surveyed 100 DB plan sponsors across Canada who manage plans between $50 million to $10 billion in pension assets; 51 of the respondents manage assets of $1 billion or more.
- The survey was conducted online and by telephone by Rogers Connect Market Research in the spring of 2014. Names were selected from the Canadian Institutional Investment Network database.

Sun Life
INVESTMENT MANAGEMENT

THE STATE OF DEFINED BENEFIT PLAN SPONSORSHIP

An optimistic outlook on their own plans

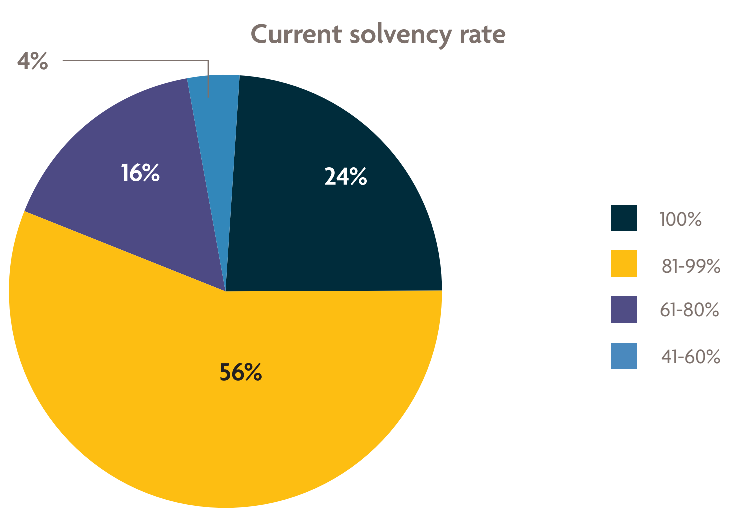
A strong majority of respondents – 84 per cent – is optimistic about the future of their own plan, and for good reasons. However, less than half of respondents (43 per cent) are optimistic about the future of DB pension funds in general, and we'll take a look at their concerns later.



Q2 – Are you optimistic about the future of your defined benefit plan?
Base: all respondents answering n=100

2013 solvency status improved ...

With 91 per cent of DB plans improving their solvency status in 2013 and the average funding level for plans on a solvency basis at almost 88 per cent, it's not hard to see why the majority of plan sponsors surveyed are generally feeling optimistic about the future.



Q5 – What is your current solvency funding rate?
Base: all respondents answering n=98

OTHER KEY FINDINGS ABOUT SOLVENCY RATES*

17% report an increase of 20% or better

43% report an increase of 10% to 19.9%

30% report an increase of less than 10%

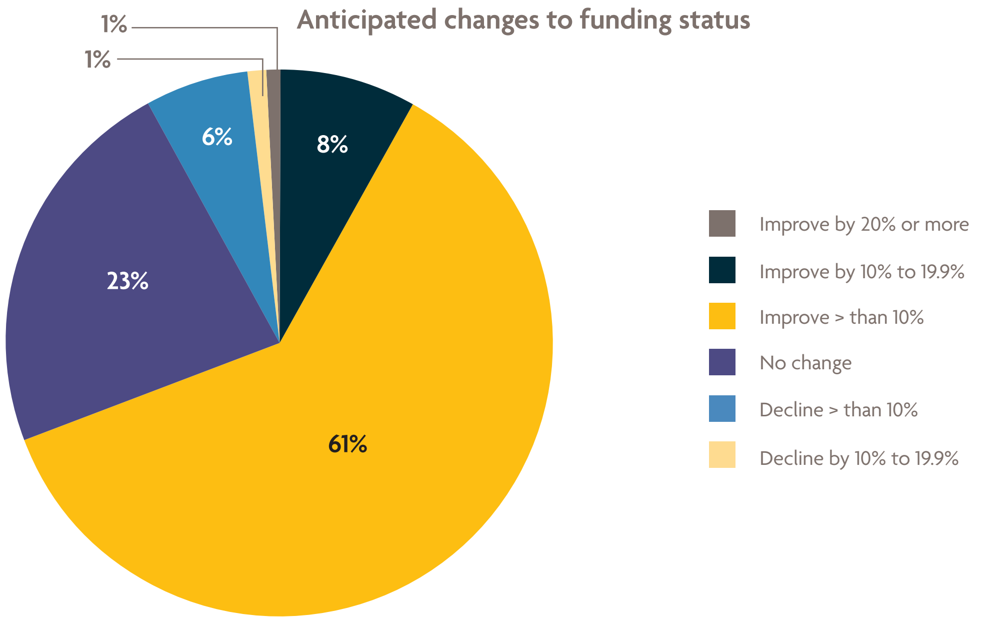
7% report no change

Only **2%** of respondents experienced a drop in their solvency rate

***Q6** – How has your plan's solvency funding status changed in the past year(2013)?
Base: all answering n=99

... and the future looks bright

The future looks similarly bright, as a solid majority of respondents (70 per cent) believe their funding status will improve this year. Just seven per cent expect a decline.



Q7 – How do you anticipate your plan's funding status will change one year from today in 2015?

Base: all respondents answering n=97

This optimism is reflected in the fact that most funds represented in the study (70 per cent) are open to new employees. Just 29 per cent are closed to new employees and one per cent has frozen benefits for all plan members.

KEY FINDING: PLAN STATUS

70% open to new employees

29% closed to new employees

1% frozen benefits for all plan members

KEY FINDING: PERFORMANCE MEASUREMENTS

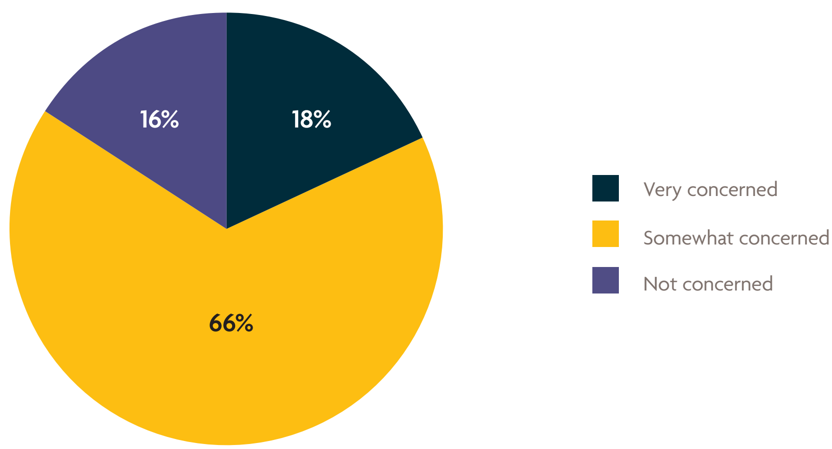
78% measure their fund performance against an investment benchmark

22% measure their performance against the fund's liabilities

Causes for concern

While there is general optimism about their plans, DB plan sponsors also expressed some concerns about the future – 84 per cent are worried about the effects of their plan members living longer.

Concerns about longevity risk



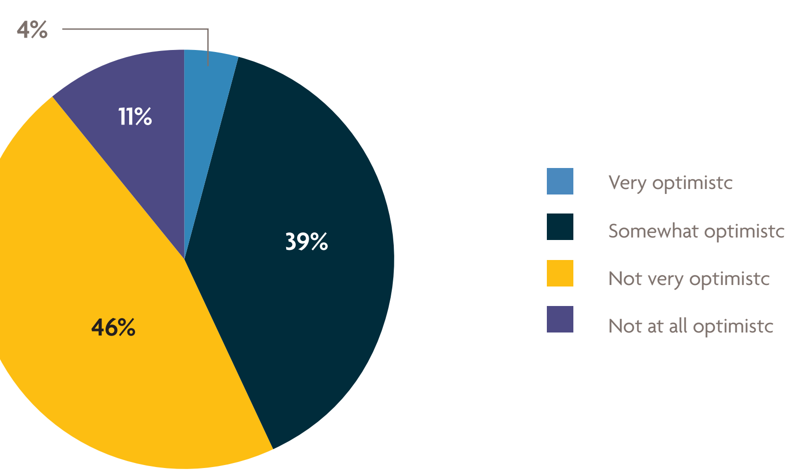
Q4 – To what extent is your organization concerned about longevity risk?

Base: all respondents answering n=100

Other concerns cited were regulatory pressures (17 per cent), demographics working against DB plans (17 per cent), risks not evenly shared between employers and employees (13 per cent), and finally, the perception that DB plans were out of favour (10 per cent).

It's for these reasons that DB plan sponsors were less optimistic when we asked how they felt about the future of DB plans in general. In contrast to 84 per cent of plan sponsors being optimistic about their own plans, only 43 per cent were optimistic about DB sponsorship in Canada.

Optimism about DB sponsorship in Canada



Q1 – Are you optimistic about the future of defined benefit plan sponsorship in Canada?

Base: all respondents answering n=100

INVESTMENT STRATEGIES AND CAPITAL MARKETS

DB plan investing – the shift in thinking begins

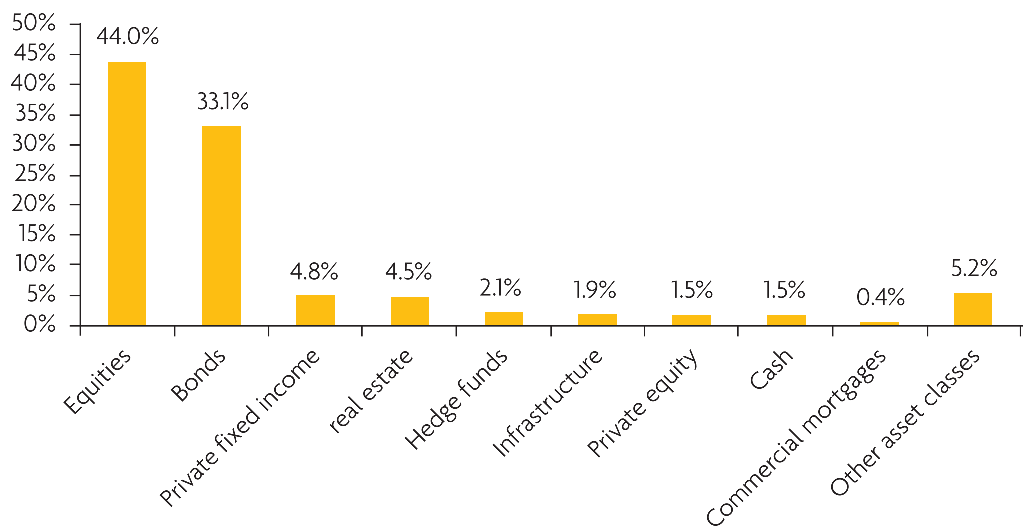
With the potential effects of rising long-term interest rates and plan member longevity, it's no surprise that many DB plan sponsors are considering changes to their investment strategy.

Thirty-eight percent are considering changes to their investment strategy, with 31 per cent thinking about introducing or increasing liability-driven investing allocations. Based on the survey results, these are the two most common changes currently under consideration. Over one-third (37 per cent) say that they won't change their investment strategy.

Asset mix

We asked respondents to share their fund's asset mix as of Dec. 31, 2013. On average, they are holding 44 per cent in equities, 33 per cent in bonds and 22 per cent in cash and other assets.[1]

Average asset mix, as of Dec. 31, 2013



[1] Reported asset mix is based on average responses among 100 respondents. These averages do not add up to 100%.

Going forward, many of these DB plan sponsors expect to decrease their allocation to equities and maintain their bond holdings. Two asset classes in which many expect to increase their holdings are real estate and infrastructure.

Plans for Exposure by Asset Class

	Average Allocation	Increase	Decrease	Maintain
Equities	44.0%	7%	53%	36%
Bonds	33.1%	33%	16%	42%
Private fixed income	4.8%	21%	2%	20%
Real estate	4.5%	45%	4%	29%
Hedge funds	2.1%	10%	5%	28%
Infrastructure	1.9%	44%	2%	27%
Private equity	1.5%	21%	8%	24%
Cash	1.5%	3%	11%	71%
Commercial mortgages	0.4%	7%	0%	20%
Other asset classes	5.2%	11%	9%	19%

KEY FINDINGS: EQUITY HOLDINGS

41% – Canadian stocks, but geographically diversified

21% – U.S. stocks

8% – emerging markets stocks

KEY FINDINGS: FIXED INCOME HOLDINGS

54% of bond portfolios actively managed

25% – index funds

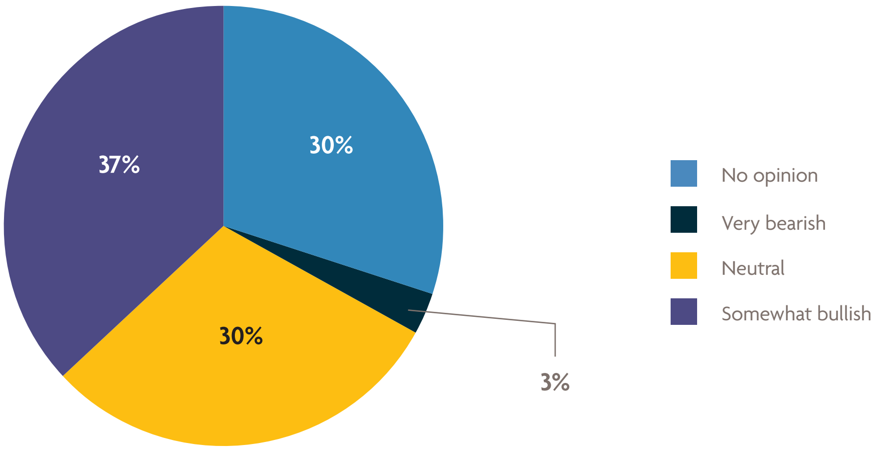
16% – customized funds

Fifty-six per cent of respondents use the DEX Universe Bond Index as a benchmark and 57 per cent use the DEX Long Term Bond Index. Seven per cent use a global benchmark bond index and 29 per cent use a customized bond index. Shifting to a customized benchmark may suggest an enhanced focus on underlying fund liabilities and derisking.

Alternative investments

Finally, we asked respondents to share their DB pension fund's view on the outlook for alternative investments. More than one-third (37 per cent) are somewhat bullish, while 30 per cent are neutral and three per cent are bearish. Three-in-ten have no opinion or are unsure.

Outlook on alternative investments



Q20 – How would you describe your organization's view on the outlook for alternative investments (infrastructure, commercial mortgages, real estate) in 2014?

Base: all respondents answering n=96

CANADA'S RETIREMENT INCOME SYSTEM

Looking for improvements

Defined benefit plan sponsors bring valuable perspective to the debate over Canada's retirement income system. The role these pension fund leaders play as industry participants provides them a unique perspective on of the system's pros and cons.

There is no shortage of ideas to consider. Enhancements to the Canada Pension Plan, introduction of the Pooled Registered Pension Plan, even the proposed addition of a new provincial government plan in Ontario – all are on the agenda for discussion.

The predominant view among these thought leaders is that the Canadian retirement income system needs to improve, and that workplace plans have a central role to play in future success. We presented respondents with four general statements about the Canadian system, and asked them to rank which options they believe policy makers should consider undertaking:

"Policy makers should work on measures that support existing defined benefit plan sponsors" *53% ranked this statement first; 68% ranked it first or second*
"Policy makers should work on enhancing workplace pension coverage across the country" *20% ranked this statement first; 64% ranked this first or second*
"Policy makers should work on enhancing the Canada Pension Plan" *24 % ranked this statement first; 44% ranked this first or second*
"Canada's retirement income system does not require significant change" *4% ranked this statement first; 9% ranked it first or second*

Among those who ranked support for existing DB plan sponsors first, 29 per cent said it would make their plan more sustainable in the long term. Twenty-four per cent said it would enhance benefits/value for participants and retirees. Another 24 per cent said it would reduce the cost of their plan; and another 24 per cent said it would improve their company's ability to deal with solvency issues.

As the Canadian retirement income system continues to evolve, the views of DB plan sponsors – who currently manage the vast majority of retirement savings assets in Canada – are sure to play an important role.

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Carl Bang is President, Sun Life Investment Management Inc., a Sun Life Financial business that offers investment solutions to defined benefit pension plan clients and other institutional investors. Carl is responsible for the business in Canada.

The 2013 Sun Life Defined Benefits Plan Sponsor Executives study was conducted by Rogers Connect Market Research, a division of Rogers Publishing Ltd., Feb. 7 to Mar. 22, 2014. Rogers Connect Market Research Group has been collecting consumer and B2B decision-maker insight via interviewing and engaging elite audiences, such as those responsible for Canada's largest pension plans, and has developed and honed techniques and best practices for dealing with this type of respondent for the past 10 years.

The 100 self-selected respondents come from Rogers' Canadian Institutional Investment Network database and include persons serving in executive or management roles at the pension plans. There are 1,823 available contacts among the database's top 400 DB funds (defined as having at least $50.0M in assets under management).

Fielding and preliminary analysis were also completed by Rogers Connect Market Research. All sample surveys and polls may be subject to other sources of error, including, but not limited to methodological change, coverage error and measurement error. The information obtained by Rogers Connect Market Research during the survey was taken "as is" and was not validated or confirmed by Sun Life Investment Management Inc.