TAKING CONTROL:
Canadian Asset Owners Transform to Face Uncertainty

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CHAPTER 1

CIBC MELLON

"Canada's pension plans are simultaneously dealing with familiar and novel challenges in 2022, including longer life expectancies in the aging population, rising interest rates, and evolving regulatory requirements. For some, these pressures are further magnified amid uneven global economic prospects, rapidly shifting markets and a host of new investment opportunities driven by both disruption and technology. Across the many available choices, Canadian pension plans continue to take their obligations seriously, to work to continuously refine their investment, technology and operating models, and to work relentlessly to deliver the right outcomes for their underlying plan members and stakeholders.

We thank the many clients, industry stakeholders and enterprise leaders who contributed their expertise, insights and experiences to this report – and we look forward to further discussions."

Alistair Almeida
Segment Lead
Asset Owners

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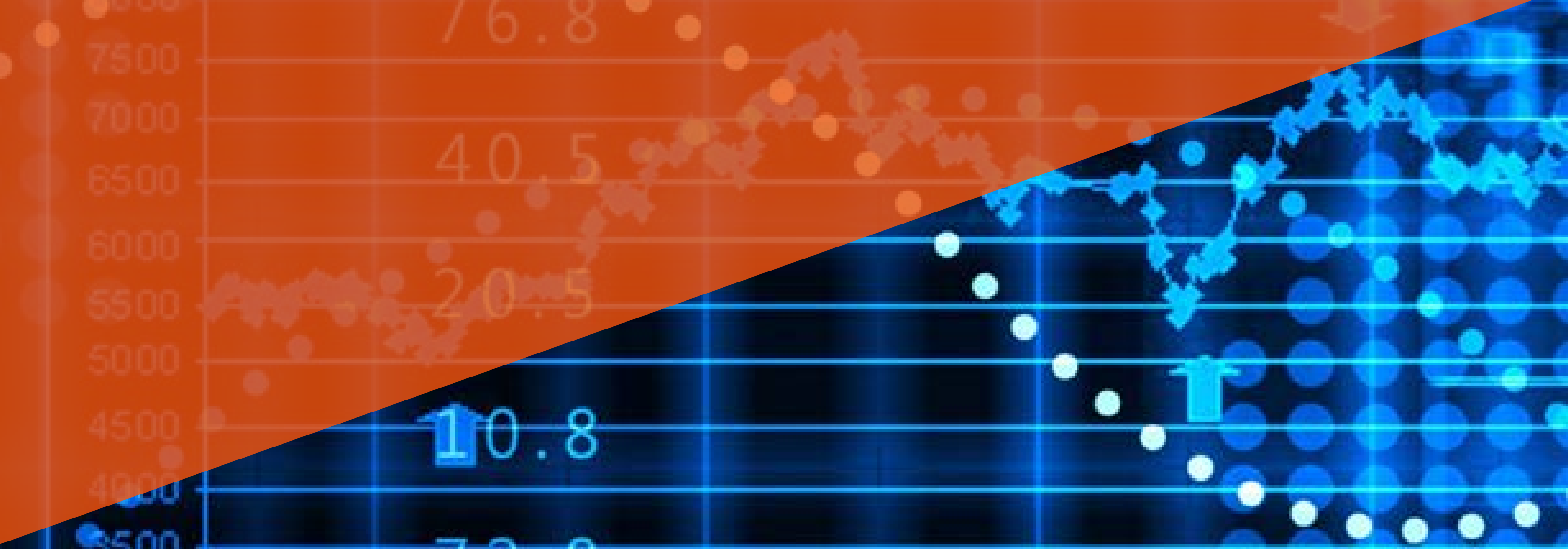


Foreword

Canadian asset owners face an array of daunting challenges and remarkable opportunities amid today's evolving market and business landscape. Rising expectations, longstanding challenges and still-emerging unknowns continue to increase the demands on asset owners, even as innovative solutions and new strategies have the potential to better equip asset owners to rise to meet the current moment as well as better address the long term future outcomes for which they are ultimately accountable.

Like many organizations, Canadian asset owners are being stretched between the need to address the pressing challenges of today while also making critical choices about where to invest for the future. Asset owners must navigate — or in some cases spearhead — a path through the lingering disruption of the Covid-19 pandemic and ongoing global economic volatility. As they do so, they also face strategic and operational choices with long term implications. Roles, objectives, investment strategies and operating models are all changing, and asset owners are now reimagining their roadmaps. Innovation has redefined its role in this space insofar as it demands the support of cutting-edge technology.

Questions that once were looming on the horizon are now increasingly at the forefront of the minds of Canadian asset owners: How should they balance in-house and outsourced asset management? What do modern and future asset allocations look like, and how should asset owners plan to sustain, oversee and manage these choices? How do they meet rising ESG imperatives, which are simultaneously urgent and ambiguous? Where and how should they invest in innovative technology solutions? What is the right talent strategy today, and what types of talent will organizations need to recruit, retain and motivate in the future? Some are even redefining these business and stakeholder scopes to transform into direct client service organizations.

To find out how the industry is approaching these many issues, we surveyed 50 of Canada's leading asset owners. Our research explores the wide ranging concerns that are top of mind for Canadian asset owners, how they plan to rise to these challenges, meet demands and expectations from stakeholders, and accelerate on the path forward.

Canadian pension plans, funds and their managers continue to be seen as industry leaders within Canadian financial services markets and across the globe. The "Canadian model" of jointly trusteed, shared risk, strongly-governed modern defined benefit plans continues to find rising awareness on the global pension stage.

The themes that hold true to Canada's financial landscape — innovation, stability and resilience — all carry weight for Canada's asset owners as similar motifs can be uncovered not only across our primary research but across a parallel array of client conversations, reviews of market documentation and comparisons with global market trends. In many aspects, Canadian asset owners are ahead of global peers, and the insights found here offer relevant applications and critical strategic questions worth investigation by other institutional investors and pension industry stakeholders. These players are likewise concerned about navigating today's challenging investment landscape even as they look to secure the pension promise for plan members over decades ahead.

In this multi-part report, we present the findings of our research; there is much to unpack. The research also revisits themes and findings from our previous research. "In Search of New Value" **(www.cibcmellon.com/isonv)**, in particular extending the core theme that "no one size fits all": asset owners are building, exploring and deploying a diversity of approaches based on their unique strategic goals.

The first chapter will address how respondents currently distribute their allocations and expect those distributions to evolve in the near term. In addition, we will discuss how the pandemic has changed their thinking, such as in allocating more towards fixed-income instruments and alternatives. We will also address the key investment models that our respondents prefer and how their strategies may develop in the near term, with an emphasis on direct investments and/or joint ventures and co-investments, respectively.

Through 2022 and into 2023, we will share additional insights including:

Chapter 2: Transforming Operational Models
Chapter 3: The New Consolidators
Chapter 4: Future Trends

The CIBC Mellon team will continue to collect insights through client and industry conversations with asset owners and their industry peers. To learn more, to request an individual consultation for your organization, or to share comments with our research stakeholders, please reach out to your CIBC Mellon relationship management contact or email **alistair.almeida@cibcmellon.com**

CHAPTER 1

Changing Investor Strategies

EVOLVING INVESTMENT ALLOCATIONS

INVESTMENT ALLOCATIONS

70% of respondents increased their fixed-income holdings

68% raised exposures to alternative asset classes and privately owned assets

26% are looking to increase their allocations to digital assets

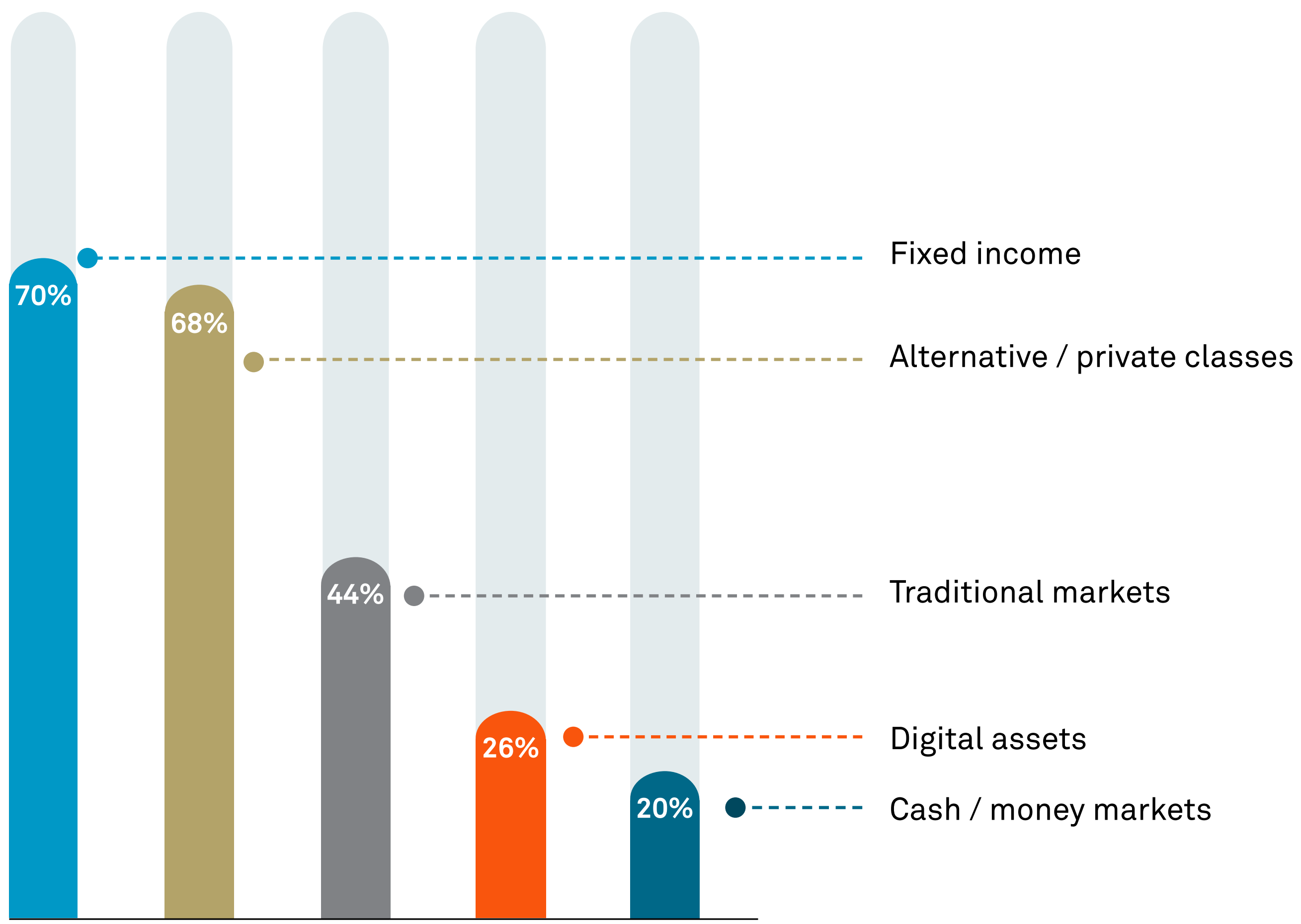
> “Investment and fund-related strategies are affected vastly by the economic unrest. We cannot contemplate the level of disruption that will arise in the next few months.”

Managing Director
government entity

External challenges abound; the questions of which challenges to address and how to allocate scarce time and resources are recurrent strategic focus areas for asset owners. Organizations can transfer risks, operations and activities to providers and partners, but they cannot outsource overall responsibility. Asset owners remain ultimately accountable for their stakeholders' future outcomes and must demonstrate the highest levels of prudence, diligence and foresight."

Darlene Claes-McKinnon
Executive Director
Relationship Management

How has your organization increased its investment allocations in response to the pandemic? (Select all that apply)



Asset Allocation Strategies Adjust to Rising Pressure from Externalities

The Covid-19 pandemic, geopolitical conflict, rising interest rates, evolving regulatory requirements, emerging opportunities from technological development, and shifting ground amid ESG factors are just a few of the standing uncertainties, providing potential for further volatility in asset classes worldwide. This context has prompted many Canadian asset owners to make significant changes to their investment allocations, variously seeking diversification, opportunity or stability in the face of market volatility.

Certain asset classes saw more consensus focus, most notably fixed income, where 70% of respondents in our research have increased their holdings.

Private Markets

Private markets have been a consistent theme, and an area where Canadian asset owners continue to see opportunities to diversify portfolios, increase alpha and reduce risk; 68% of asset owners raised their exposure to alternative asset classes and privately-owned assets, such as funds of hedge funds, private equity, real estate and liquid alternatives. Alternative assets, such as private equity, real estate, infrastructure, and private debt have been viewed as offering institutional investors shelter for their capital from short-term risks and market movements while also generating strong returns.

> “Amid shifting ground, asset owners are responding to standing uncertainties with a variety of approaches; ones that we have seen change quickly over the past few months of volatility. In our client conversations, we have gathered anecdotal evidence that many plans have reversed course and moved in new directions.”

Alistair Almeida
Segment Lead
Asset Owners

Caution and Diversification

Consistent with their status as investors of long term capital, Canadian asset owners' focus appears to incorporate a healthy portion of caution and prudence, even as they hunt for yield. Asset owners are faced with challenges in a marketplace where central banks had historically pursued ultra-loose monetary policies to support pandemic-stricken economies. Fixed-income asset classes were seen as offering the prospect of reduced volatility, while areas such as private debt may offer increased yield.

Investment allocations and specific investment decisions made by individual funds (or the outsourcing of those decisions) will inevitably reflect their specific circumstances — for example, the maturity of their plans, their risk appetites, and the available comfort and expertise related to more complex or challenging investment arenas. Nevertheless, in several areas, large numbers of the Canadian pension funds surveyed have plans to alter the mix, or at least refine their portfolios.

The shifts in investment allocations have left asset owners with portfolios split relatively evenly across a broad range of asset classes. Equities account for the single biggest exposure for respondents, with the average asset owner in our study holding 13.6% of their portfolio in stock market securities. However, that is only marginally ahead of real estate (13.3%) and fixed income (13%). Infrastructure, private debt, private equity, and cash are all areas of focus, too.

Allocations to hedge funds, exchange-traded funds (ETFs) and derivatives, on the other hand, account for smaller percentages of most asset owners' holdings.

Increases to ETFs and Infrastructure

ETFs and infrastructure are the areas where asset owners are most likely to increase their allocations over the next 12 to 24 months, albeit by modest amounts — 0.5 percentage points and 0.2 percentage points, respectively. Over time, these are the respondents that may show interest or engage in direct investment in digital assets.

These higher allocations seemingly come at the expense of hedge funds and private equity, where respondents are most likely to report that they intend to trim back their exposures. This would be in keeping with findings from earlier research published in 2019 ("The Race for Assets: Canada vs. the World"; **www.cibcmellon.com/raceforassets**), which indicated Canadian institutional investors utilize hedge funds at lower rates than some of their global peers.

No asset owner reported holding digital asset allocations of material note, though this exposure may have been secured indirectly through ETFs investing in these assets. The low allocation levels as a portion of overall contrasts with the significant degree of attention asset owners are directing to the digital asset space.

Digital Assets: Canadian asset owners cautious but attentive

The term "digital assets" is an umbrella term that includes cryptocurrencies (such as bitcoin or ether) as well as a wide array of capabilities and uses such as stable coins, central bank digital currencies, tokenizing bonds, leveraging blockchain technology to fractionalize other assets, smart contracts, NFTs (non-fungible tokens) and more. Broadly, financial ecosystems worldwide continue to evolve to support institutions and individuals who choose to engage in the digital asset space, and we anticipate further focus.

The digital asset space continues to shift rapidly, in particular as regulatory clarity improves with respect to the financial services available to support integration between digital assets and broader markets. 2022 saw Canada step into the forefront of the digital asset economy globally, with the launch the first exchange-traded bitcoin and ether funds making those asset classes more easily available to both retail and institutional investors.

While investor interest in digital assets such as cryptocurrencies soared in Canada and globally, many Canadian asset owners that engaged in our survey appear, for the most part at least, to have felt that the pandemic was not the time to be making their first forays into this area. Actual allocations as a percentage of overall allocations are essentially negligible, but a material portion nonetheless leaned into this emerging space: 26% of asset owners opted to increase their allocations to digital assets. **Furthermore, when asset owners were asked to name the most significant trend they expect to see over the next three years, digital assets only ranked fifth overall, with just 12% naming it as the top trend.** However, nearly a quarter of respondents (24%) named it as their second most important priority — by far the highest response among secondary focus areas. In short, Canadian asset owners are watching the digital asset space closely even if they are not at this time directing significant portions of their overall asset allocations into digital assets.

2022 brought both highs and lows for those who stepped into the digital asset space. The significant downturn of the cryptocurrency market in early 2022 (the "crypto winter" as some dubbed it) seems to vindicate asset owners' cautious approach. The fall continued through the year, with Bitcoin shedding more than 75% from its value of over CAD$87,000 in November 2021 to approximately CAD$21,000 in November 2022. A number of other high profile digital asset project failures (for example the collapse of the FTX crypto exchange) further compounded the downside risks for those who entered the space, and the clear upshot is that the space remains.

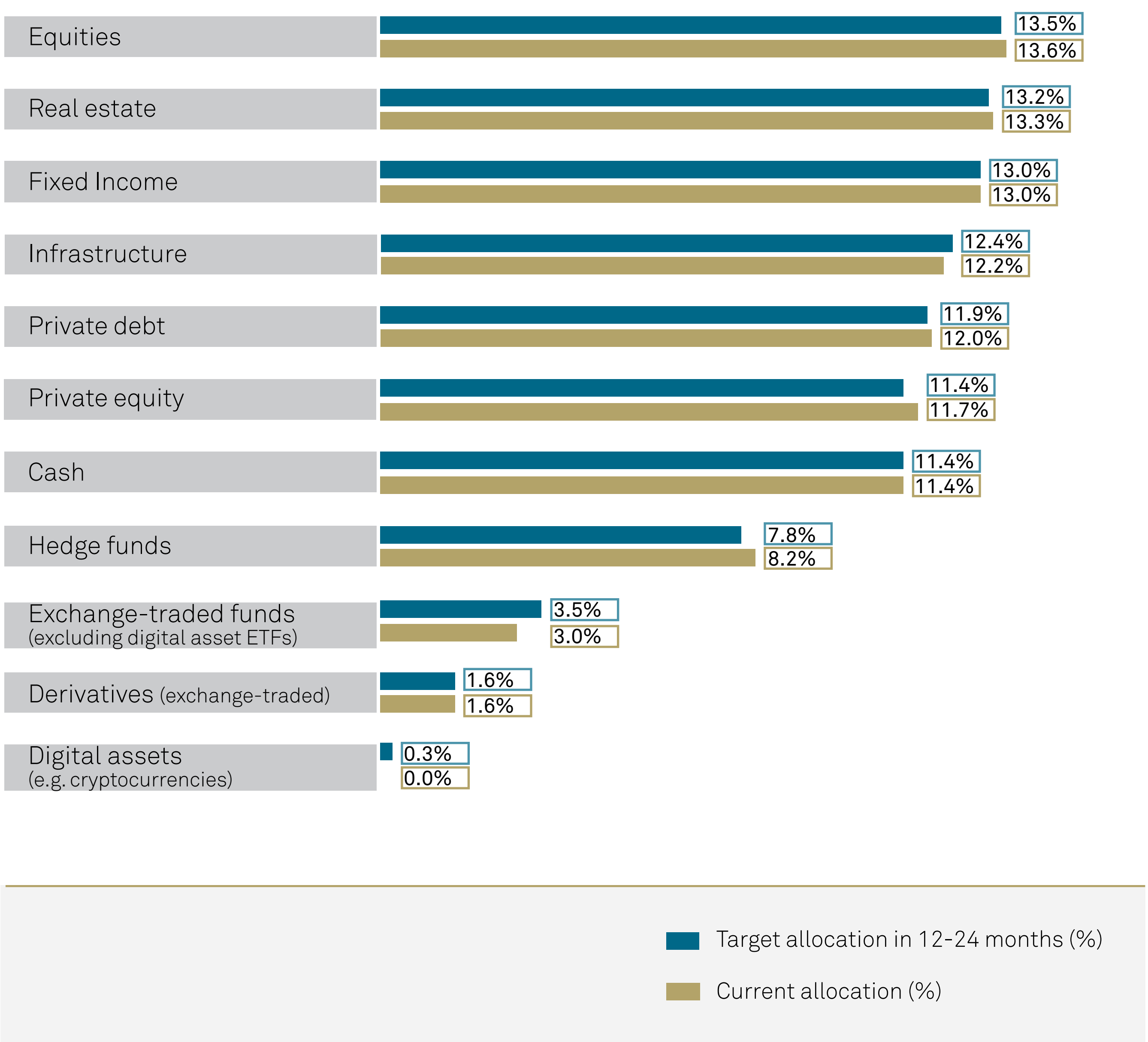
LOOKING 10 YEARS OUT:

"The use of new asset classes will become more familiar to Canadian pension funds. Their main objective would be to diversify their allocations as much as possible. Diversification will be more prevalent in Canada than the rest of the world."

Head of Investments
endowment/foundation

How do you expect your level of investment to change in the following asset classes over the next 12-24 months?

(For each asset class give current and target allocation where applicable as a percentage)



Investment Models and Structures: no one size fits all

As for how they invest, many asset owners are pursuing multiple investment models simultaneously. The debate around the respective merits of in-house and outsourced asset management will be addressed in detail in Chapter 2 of our report — a debate that continues from our prior "In Search of New Value" research **(www.cibcmellon.com/isonv)**, but the operational reality is far more nuanced. While 80% of asset owners who participated in our survey maintain in-house asset management teams, most also have external arrangements of one form or another. Once again, no one size fits all.

> "Canadian asset owners require timely insights, effective solutions and responsive execution as they work to position their organizations to succeed in today's rapidly shifting environment. They continue to reinforce their position as global leaders with the strategy and the resources to succeed and win on the global stage."

Ash Tahbazian
Chief Client Officer

“By transferring the operational risks to external asset managers, we can simplify many of our responsibilities. These external managers have the talent to handle most types of risks. Their teams are well aware of our expectations of them.”

Head of Investments, endowment/foundation

“

In-house asset management is essential to get a better overview of allocations. With in-house teams, there is more control over allocation decisions. Overall, we can ensure that the decisions and strategies align with our longer-term investment objectives.”

Managing Director, government entity

“

Green bonds have become more attractive recently. Many more options are available now compared to the conditions five years ago. These bonds will deliver good yields over the next few years.”

Head of Investments, multi-employer pension entity

“Canadian pension funds take a nuanced approach to asset management. Where appropriate, they operate with in-house teams. Elsewhere, they are pursuing partnerships and collaborations, as well as full-scale outsourcing arrangements.”

Darcie James Maxwell
Head of Canadian Operations
Data and Platform Solutions

No one size fits all... but some sizes fit more.

Canadian pension funds take a nuanced approach to asset management. Where appropriate, they operate with in-house teams. Elsewhere, they are pursuing partnerships and collaborations, as well as full-scale outsourcing arrangements.

Asset owners' most popular primary investment model, employed by 26%, is direct investment and/or joint ventures, incorporating aspects of both in-house and external management. This model has risen to the forefront over the past two years; in research we published in 2021, only 8% of asset owners selected this approach as their primary model.

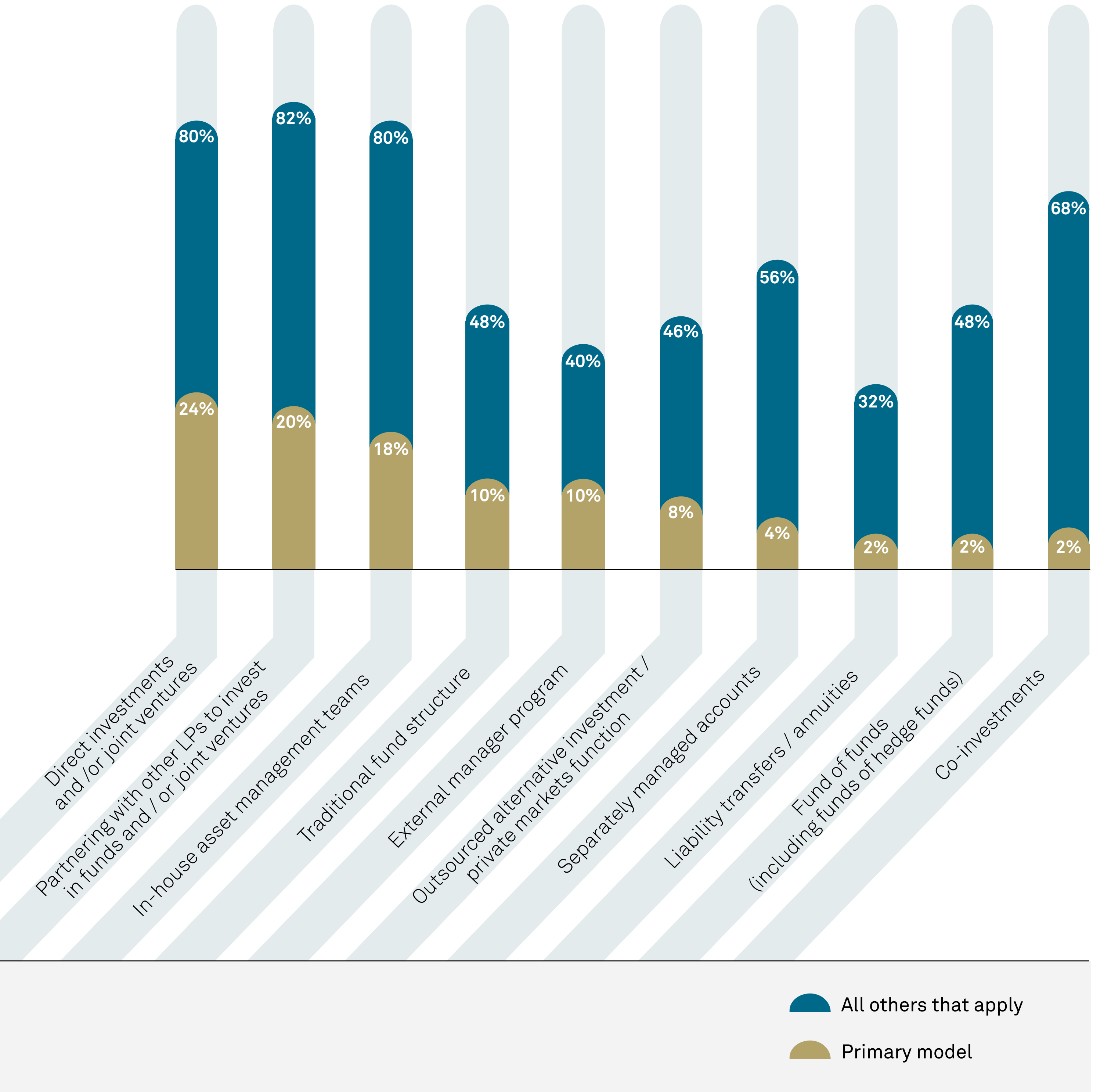
Meanwhile, 20% of respondents say their primary investment model involves partnerships with other limited partners, while 18% regard their in-house teams as their starting point. Even where respondents do not regard one of these three investment models as their primary approach, they are highly likely to use them; in each case, 80% or more employ these models in at least some capacity.

It should also be noted that, while there are certain investment models that very few asset owners regard as appropriate for their primary approach, these models are still widely used. Most notably, only 2% of respondents describe co-investments as their primary model — but 68% use them as part of their go-to-market strategies. Similarly, only 2% of respondents focus primarily on funds of funds, but almost half (48%) make use of these vehicles in some capacity.

“Bringing outsourced investments into a portfolio comes with an array of challenges. For small to mid-sized institutional investors, building a diversified and high-performing private market program requires a skillful investment team that is set up to maximize knowledge across an array of asset classes and close any talent gaps. For example, having one person to cover real estate and infrastructure, which have a lot of commonalities, can add efficiency to the team. *It's also important to have the right governance structure with an established approval framework with some sort of autonomy and discretion to the investment team. In that way, you can benefit from time-sensitive opportunities in alternative asset classes.* At Trans-Canada Capital, we approach this with a holistic view of the portfolio. We're not tied down to one asset class – multiple private market assets in one program diversifies the portfolio across asset classes, geographies, vintages and sectors.”

Tarik Serri
Senior Director, Hedge Funds &
Alternative Investment
Trans-Canada Capital

Which investment model does your firm employ? (Select one primary model and all that apply)



ESG: an urgent yet ambiguous imperative

The growing focus of Canadian asset owners on environmental, social and governance (ESG) issues was a substantial trend in our findings.

Asset owners recognize ESG as an imperative to which they must respond, and with a substantial degree of conviction across organizational type, investment strategy, size and geography. The question of what specific actions however, speaks to the broad array of overlapping, intersecting and occasionally contradictory options available to institutions and investors with respect to what constitutes the "right" ESG action. Asset owners face an array of standards, expectations and pressures — from plan members, sponsor organizations and even evolving regulatory requirements in Canada and globally.

Asset owners are still seeking to chart a course that fits their organizations, including assessing what should be done, how to achieve goals and indeed who should be made responsible. Many respondents are looking to outside partners for support, while others see in-house teams as best positioned to navigate the complexities. Some are motivated by defensive choices designed to ensure they stay compliant with mandatory requirements, some are driven by stakeholder pressures, some are moving to mitigate risk to reputations or investments, while others state that investment outperformance and opportunities have made ESG-themed investing a lever to improve financial returns.

More than two-thirds of respondents (68%) say they will look to fund managers to help them incorporate ESG factors into their investment approach; that includes 16% of asset owners who regard this as likely to be their most important development over the next 12 months. On a related theme, a further 16% of respondents say improved governance will be their most pressing priority.

> "It is quite difficult to expect compliance with our ESG strategy when dealing with an external team. It takes a long time for them to identify with our organization's primary objectives in this regard."

Chief Investment Officer
government entity/agency

“We have to observe external and public ESG benchmarks and note any changes. We are referring to the benchmarks followed by our industry, different sectors, and also those set by the regulatory authorities.”

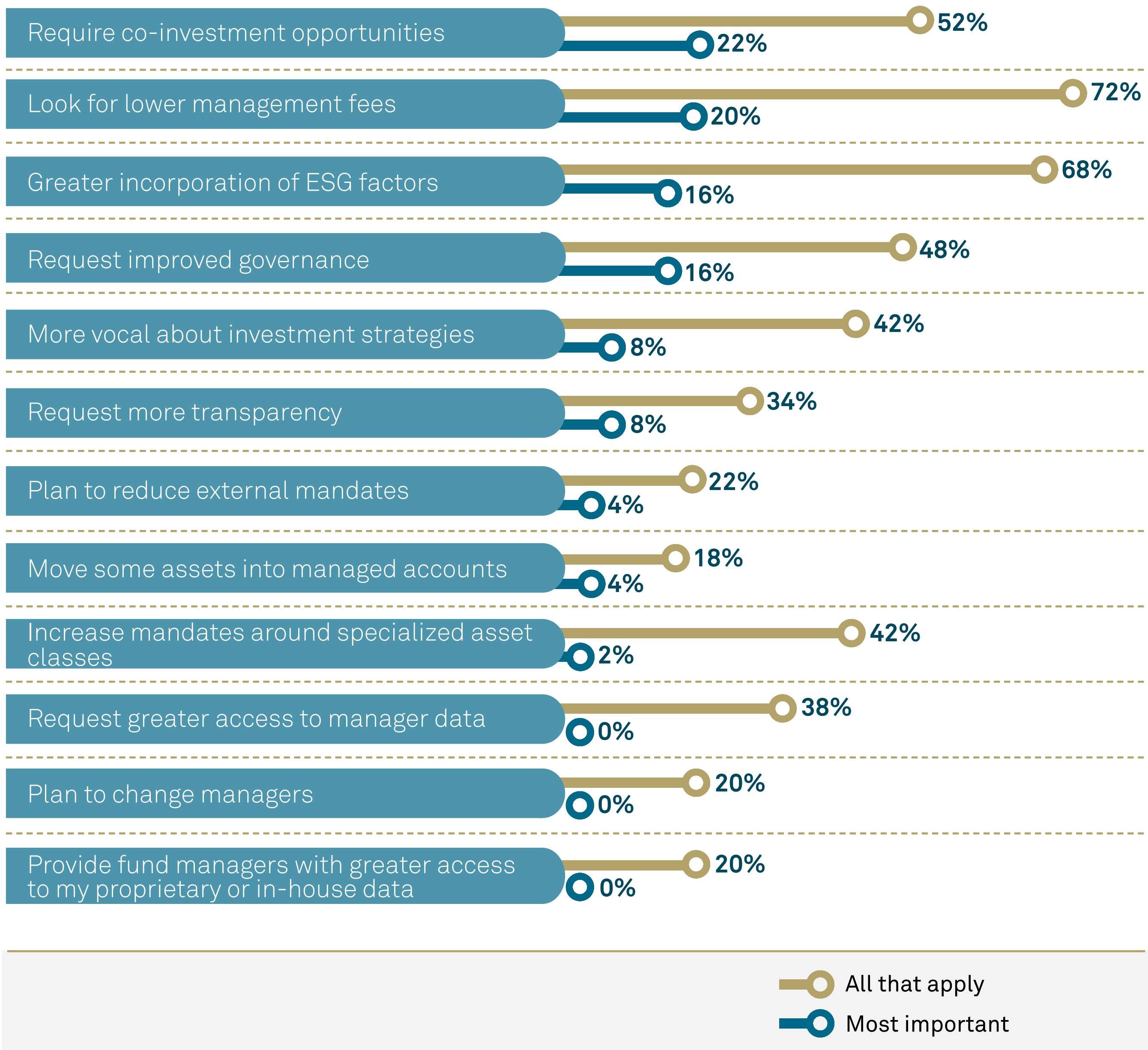
Head of Finance, endowment/foundation

“There is an ongoing effort to implement ESG considerations internally. We have appointed dedicated personnel to monitor our ESG progress and there is a reporting process for non-compliance.”

Managing Director, single-employer pension entity

Asset owners' evolving expectations for investment fund managers

In what ways do you expect your approach to investing in fund managers to change in the next 12 months? (Select all that apply)



Asset owners have clear priorities regarding how they plan to work with investment fund managers in the near term. Consistent with our prior research findings, cost containment is front and centre. 72% of respondents are determined to drive a harder bargain with fund managers, demanding lower fees. This will be the most important change for 20% of asset owners.

Asset owners intend to pursue overall financial outcomes and control cost ratios beyond fees alone; 22% of asset owners also say they will expect fund managers to provide more co-investment opportunities. The rising focus on co-investment speaks to the idea that the divide between internal and external asset management approaches is not black and white; asset owners are looking for approaches that combine elements of both.

Transparency and Specialization

Most asset owners wish to enhance transparency to meet the rising demands of Boards, trustees, regulators and others — and are structuring their investments and operations to help them achieve this. Asset owners have myriad issues on their minds as they re-evaluate their relationships with fund managers. Large shares respondents expect both to increase the number of mandates they award in specialized asset classes (42%) and request greater access to fund managers' data (38%). Only small numbers of respondents see these as the most important tasks for the next 12 months, but they will nonetheless be on the agenda.

We anticipate innovation and change will continue as Canadian pension fund managers focus on agility and responsiveness in the context of a fast-moving investment environment.

72% of respondents are determined to drive a harder bargain with fund managers, demanding lower fees. This will be the most important change for 20% of asset owners.

Questions worth asking: asset allocations, investment models, in-house vs. outsourced, digital assets, ESG

We recognize that asset owners face an array of opportunities and challenges, and that each organization's choice must be driven according to its own specific situation, circumstances and resources. We encourage our asset owner clients and their stake-holders to consider our research findings in their specific contexts, and we continue to welcome your feedback.

1. How are you evolving your asset allocations?

- What opportunities and risks are you addressing amid major external changes — inflation, technology, and more?

2. What portion of your asset allocations and assets managed should be handled by in-house teams? What should be outsourced?

- Are there specific asset classes, markets or arenas that are better suited to in-house or external asset management teams?

3. How are expectations for external managers and providers changing?

- What risks have you transferred to outside providers and how are you managing them?
- How are you continuing to advance your vendor governance and oversight?

4. Is your organization engaging or monitoring the digital asset market?

- How is your organization gaining fluency and understanding in this space?

5. How will your organization engage with ESG?

- What are your specific regulatory and compliance obligations?
- What do underlying pension plan members, foundation stakeholders or sponsor organizations expect from your investment activities?
- How will you navigate the individual E, S and G obligations?
- How publicly will you disclose your ESG activities?
- How will you measure and report ESG success / performance gaps?
- For those electing not to incorporate ESG, how will you respond to public / stakeholder pressure?

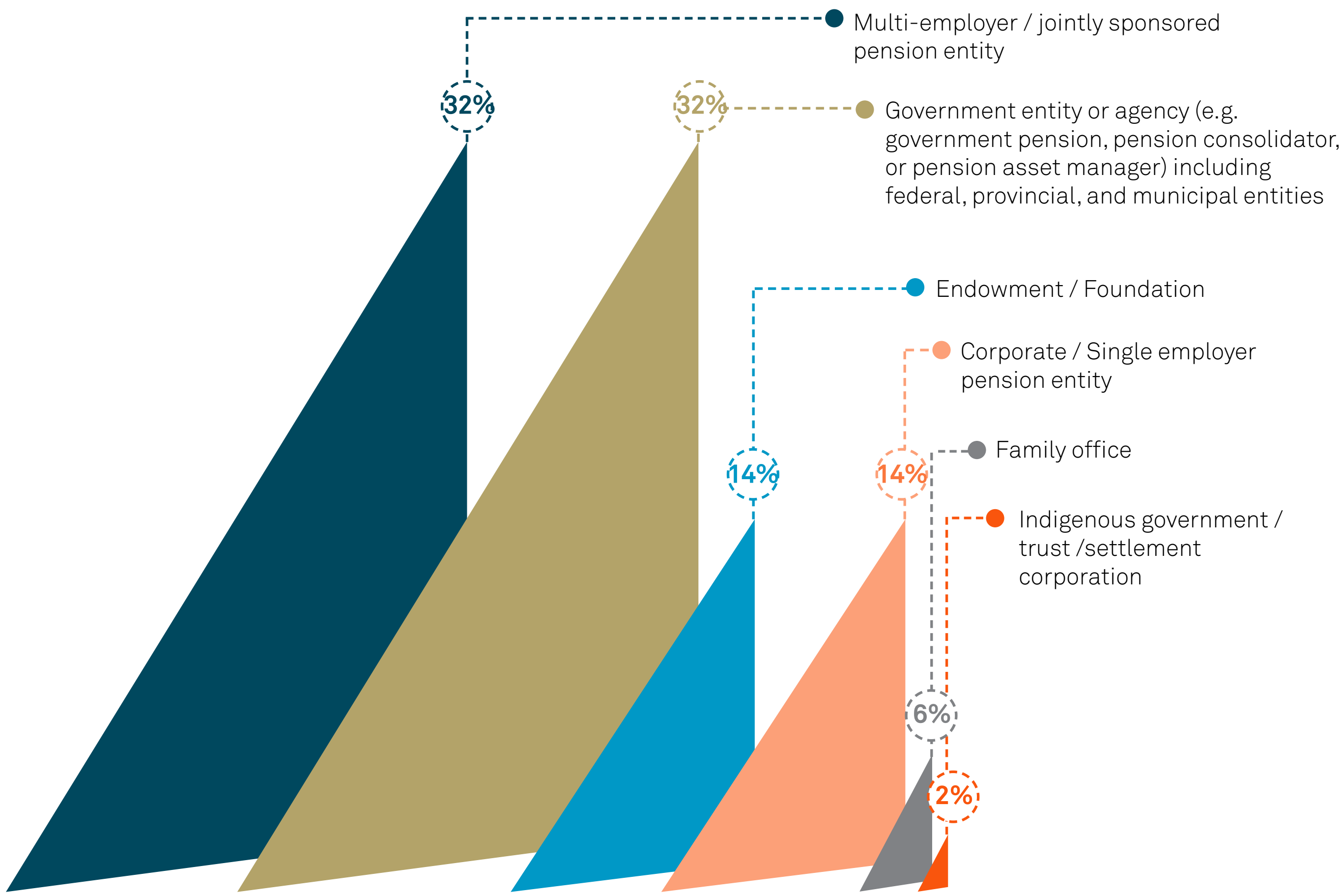
“Compared to the rest of the world, Canadian pension funds are adopting the latest ESG efficiencies faster. In the next 10 years, they will be in a stronger position to meet long-term ESG targets.”

Chief Investment Officer, government entity/agency

“Pension funds are facing challenges because members are not content with the returns. The plans are no longer favorable to sustain financial pressures and inflation. These conditions will change gradually as funds learn to adapt.”

Managing Director, single-employer pension plan

Which of the following best describes your organization's primary structure? (Select one)



Methodology & Respondent Profile

In Q1 2022, CIBC Mellon's research provider interviewed senior executives from 50 asset owners headquartered in Canada to assess key market and management trends. Of the asset owners surveyed, 19 have AUM of between CAD$700m-CAD$5bn; 16 have AUM between CAD$5bn-CAD$20bn; and 15 have AUM over CAD$20bn.

Just under a third of respondents (30%) say that their main operations and leadership are in Toronto. Almost two-thirds of respondents work for a multi-employer or jointly sponsored pension entity (32%) or a government entity or agency (also 32%).

To register for advance copies of forthcoming research or to learn more about some of the performance, accounting and data solutions available through our global enterprise, contact your relationship manager or email **alistair.almeida@cibcmellon.com**

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