Streamlined Solutions

CROSS-BORDER ASSET POOLING: WHAT'S IN IT FOR PENSION PLANS?

BY DAVID LESTER AND GWYN KOEPKE

Volatile capital markets and strong growth in emerging economies continue to shape the strategies of pension managers and fund advisors. To meet the challenges of this increasingly global and uncertain investment environment, plan sponsors are seeking ways to enhance corporate governance, manage risk more effectively, achieve scale economies, streamline processes, consolidate service providers and reduce costs.

Asset pooling can be an important step toward achieving these goals. It permits corporations sponsoring pension plans in multiple jurisdictions to commingle pension assets into a single investment pool. Each country plan accesses its entitled tax withholding rates as an institutional investor in its domestic tax jurisdiction. A plan sponsor typically implements a pooled program for long-only global equity due to the need for income tax efficiency but can run as many strategies (or sub-funds) as desired under the umbrella fund. The plan sponsor may also set up fixed income sub-funds.

Many Canadian companies, along with their U.S. and European peers, already participate in cross-border, tax-transparent asset pools and are gaining scale economies through the critical mass this structure offers. Global fund managers have also been setting up these tax-efficient pooled funds to manage assets on behalf of their clients. This will benefit Canadian institutional investors as more international investment product is introduced into Canada.

The Set-up

The cross-border pooling investment governance structure starts with a global committee, which monitors and manages risk and oversees decisions that leverage a company's investment expertise. The critical mass of assets in a larger pool allows the plan sponsor to negotiate lower investment management fees. Legal costs can also be reduced by negotiating one agreement with each asset manager versus hiring a manager independently by country. Each country plan decides how much to invest in a given pool. By offering an expanded set of investment options, plans can diversify risk and are in a better position to achieve target portfolio returns. Overall brokerage commissions should also be lower in a pooled structure. Finally, pooling can enhance returns compared with traditional (non-tax-efficient) funds by eliminating "tax drag," which can occur when tax authorities do not recognize qualified investors in a commingled fund.

Incorporating a pooling solution into an existing pension strategy is a proven path for larger multinational investors where country plans provide the required scale. However, Canadian plan sponsors without global subsidiaries cannot take advantage of this option. Sponsors looking for scale can evaluate the merits of collective investing found in fiduciary management or manager-of-manager business models. In this instance, third-party financial institutions offer similar benefits—collective management fee bargaining, governance, manager oversight and increased diversification—found in global pooling to their clients. The number of providers in this category continues to grow as asset managers and consulting firms establish practices to support their clients' interests.

To create a cross-border pooled fund, plan sponsors will need to decide which investment strategies to pool based on the overlap in assets across plans. They'll also need to select service providers such as asset managers, custodians, fund administrators, management companies and tax and legal advisors. Once the pool is up and running, it is relatively simple to add new asset classes or strategies, expand to new investors and restructure the manager lineup efficiently using the centralized global platform.

Pooling gives a plan sponsor an efficient and simplified global investment platform, scale economies due to critical mass, administrative ease across a wide swath of assets and expanded investment options for investors. In an environment where investors are looking to lower costs, leverage personnel resources and reduce risk, global pooling is a strategy worth considering. **BC**

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