Size matters in world of pension funds

Economies of scale are powerful tools to increase the wealth accumulated for retirement, report says

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Bigger is better, at least when it comes to pension funds.

The largest — funds with $37 billion in assets on average — outperformed smaller plans — with an average of $1 billion — by 45 to 50 basis points, or 0.4 per cent each year, according to a new study.

Researchers at the University of Toronto's Rotman School of Management say the difference can amount to a 13 per cent bigger pension at retirement for employees invested in the plan for their full working lives.

For government-run pension plans, it can mean taxpayers are less likely to have to make up for an unfunded liability.

"It is huge economically," said Lukasz Pomorski, an assistant professor of finance at the Rotman School of Management who co-authored the paper with colleague Alexander Dyck, a professor in pension management.

One thing that makes larger funds different is their increased use of internal (in-house) management. The related costs savings account for up to half of the improved performance, the study found. The other half comes from larger pension funds' flexibility to invest more in alternatives such as private equity and real estate, both of which afford large plans lower costs and higher gross returns.

The findings suggest it may be beneficial to encourage larger funds to manage the assets of smaller pension plans that do not enjoy the same leverage. The results of the study also suggest potential weaknesses in defined contribution saving schemes, for example, RRSPs.

"I would be much happier to be able to invest in a portfolio similar to the Canada Pension Plan Investment Board than in a mutual fund, if only because of the substantially lower costs," said Pomorski.

He said the vast majority of Canadians with pension plans are invested in smaller corporate plans rather than the large public funds such as the Caisse de dépôt et placement du Québec and the Ontario Teachers' Pension Plan.

Pomorski noted that Ontario in 2009 gave the Ontario Municipal Employees Retirement System pension fund the ability to provide third-party management services to eligible clients that include private-sector pension plans. With 400,000 members, OMERS posted a 12.01 per cent total fund return last year on top of a 10.6 cent return earned in 2009.

Pomorski said third-party pension fund management is a trend that faces "some obstacles," including legal questions over ultimate responsibility for fund liabilities.