Pension Watch

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The last edition… of Pension Watch we asked the question "Why Save for Retirement?" This edition looks at the changes to the TSE 300 Composite Index.

CHANGES TO THE **TSE 300** COMPOSITE INDEX

One important way to gauge the performance of a mutual fund is by reference to the performance of the most relevant index. An index is a selection of similar types of securities that, together, reflect the activity of the market in which they are traded, or, in the case of sub-indices, describe a defined sub-set of that market. So, for example, the performance of the Phillips, Hager & North Canadian Equity Fund – which invests primarily in stocks of large Canadian companies – is measured against the primary index for publicly traded companies on The Toronto Stock Exchange, the senior stock exchange in Canada.

As fund managers, therefore, we are naturally curious when changes are announced to the TSE 300 Composite Index, a key benchmark of performance for all our funds that invest in Canadian Equities. Similarly, as investors, many clients have been wondering how these changes will impact their investment activity.

The good news is that the changes will have no impact on how our funds are managed, how portfolios are managed, or how our funds perform in absolute terms. The real impact will be administrative in that 1) a new classification standard will be adopted to group the component stocks, and 2) the criteria will be revised to qualify a public company as a component of the "new" index.

Index Changes

Effective May 1, 2002, the TSE 300 Composite Index changed its name to the "S&P/TSX Composite Index". The 300 designation is dropped for the perfectly good reason that there will no longer be the requirement that the index contain 300 stocks. Rather, in order to be included in the new index, companies will have to meet certain minimum criteria in terms of size, trading liquidity and price (there are currently certain minimums in terms of absolute dollar values, but these are so small as to be irrelevant). The TSE 35, 100, and 200 indices are also be discontinued, although comparable data will be available on subscription basis.

Broadly speaking, the changes involve two sets of rules defined by Standard & Poor's. "Inclusion rules" will set the requirements for a company to be added to the index, and "maintenance rules" will set the requirements for companies to stay in the index.

Under the old rules, each time a company was removed from the index (because of a takeover, for example), another company was added. While there were some token minimums of an absolute market value that had to be met (i.e. $1 million dollars) the newly added company was simply the biggest of those not already on the index, as measured by market capitalization (i.e. price of stock multiplied by number of shares outstanding).

New "Inclusion" Rules

Beginning in May 2002, a new company will only be added to the index if it meets the following criteria:

- The company must represent at least 0.05% of the total index
- The company must also meet all three of the following liquidity tests based on the previous 12 months' trading history:
  1. Trading volume must be at least 0.025% of the TSX's total trading volume.
  2. The company must have had no more than 25 non-trading days.
  3. "Float turnover" (the 12-month volume traded divided by the number of float shares outstanding) must be at least 25%.
- The company must have been public for at least 12 months.
- The company's share price must be at least $1.

One other important change is that the Index Committee of The Toronto Stock Exchange may add Initial Public Offerings (IPOs) at its discretion, instead of after the existing six-to-twelve month waiting period. This likely means that companies such as Hydro One would be included in the index almost immediately.

New "Maintenance" Rules

Standard & Poor's undertakes quarterly reviews of the index. At each review, companies must meet certain criteria to remain in the index.

- The company must represent at least 0.025% of the total index.
- The company must also meet two out of three of the following liquidity tests based on the previous 12 months:
  1. Trading volume must be at least 0.02% of TSX's total trading volume.
  2. The company must have no more than 50 non-trading days.

     "Float turnover" (volume traded/float shares) must be at least 20%
- The company's share price must be at least $1.

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CUMIS RETIREMENT SERVICES

PERFORMANCE COMPARISON

For The Period: Ending June 30, 2002	3 Months %	1 Year %	3 Year %	5 Year %	10 Year %
ACTIVELY MANAGED FUNDS					
Balanced Fund	-7.0	-3.7	2.9	5.0	9.6
Canadian Equity Fund	-11.2	-8.2	4.0	5.5	11.4
Overseas Equity Fund (1) (2)	-8.5	-10.8	N/A	N/A	N/A
U.S. Equity Fund (2)	-18.0	-18.7	-9/7	1/1	11/3
Dividend Income Fund (3)	-8.5	3.2	16.9	16.1	18.1
Short-Term Bond & Mortgage Fund	2.4	8.1	6.8	6.4	N/A
Bond Fund	3.1	9.5	6.9	7.2	9.0
Canadian Money Market Fund	0.6	3.0	4.6	4.6	5.0
CUMIS FUND					
Retirement Security Fund	6.1 (4)	6.3	6.7	7.1	7.7
PASSIVELY MANAGED FUNDS					
TSE 300 Equity Index Fund (5)	-8.6	-6.1	2.1	3.8	N/A
U.S. Equity index Fund (2) (6)	-17.3	-18.4	-8.6	5.5	N/A
EAFE Equity index Fund (2) (7)	-7.1	-9.2	-5.8	0.5	N/A
Universe Bond Index Fund (8)	3.2	9.2	6.5	6.9	N/A
Conservative Balanced Index Fund (9)	-2.9	-0.2	2.4	5.3	N/A
Moderate Balanced Index Fund (10)	-5.0	-2.6	2.9	5.7	N/A
Aggressive Balanced Index Fund (11)	-6.1	-5.6	1.7	4.8	N/A
INDICES					
TSE 300	-8.6	-6.1	2.1	3.7	9.9
S&P 500	-17.5	-17.7	-8.0	5.7	14.1
MSCI EAFE	-7.1	-9.2	-5.6	0.4	7.9
ScotiaMcLeod Universe	3.1	9.1	6.4	6.8	8.7
30 Day T-bills	0.6	2.8	4.3	4.3	4.7

(1) Overseas Equity Fund merged with Euro-Pacific Equity Fund March 9, 2001
(2) Subject to Canada Customs and Revenue Agency Foreign Content Limit of 30%
(3) Only available under group RSP and DPSP contracts
(4) Annualized
(5) Fund Inception: October 1999. Performance prior to November 1999 is for TSE 300 Equity Index Fund
(6) Fund Inception: January 2000. Performance prior to February 2000 is for Barclays U.S. Equity Index Fund - Canada
(7) Fund Inception: June 1999. Performance prior to July 1999 is for EAFE Equity Index Fund B
(8) Fund Inception: October 1999. Performance prior to November 1999 is for Universe Bond Index Fund
(9) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset mix and index returns
(10) Fund Inception: June 1999. Performance prior to July 1999 is modeled using the benchmark asset weights and index returns
(11) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset weights and index returns

NEWS FROM THE GOVERNMENT

Old Age Security

Old Age Security (OAS) benefit rates are increased for the July to September 2002 quarter.

Basic OAS benefits, paid to people age 65 and over, are $443.99 per month. The Guaranteed Income Supplement is $527.66. The Spouse's Allowance and the Widowed Spouse's Allowance are increased to $787.69 and $869.62 respectively for the July to September 2002 quarter.

Registered Pension Plan **Vesting and Locking-in**

"Vesting" means the right of the pension plan member who terminates employment to receive a benefit from the pension plan.

"Locking-in" means the requirement that the vested entitlement must provide a retirement income for the life of the pension plan member.

The criteria for vesting are the completion of a specified period of employment or plan membership and sometimes the attainment of a certain age. These are also the criteria for the locking-in of a member's pension. The pension standards legislation of most jurisdictions now base vesting and locking-in on the period of plan membership or years of employment regardless of age.

The following table lists the vesting and locking-in minimum requirements in the respective jurisdictions.

JURISDICTION	VESTING AND LOCKING-IN MINIMUM REQUIREMENTS
Federal	**Benefits accrued from Oct. 1, 1967 to Dec. 31, 1986:** Age 45 plus 10 years of continuous service or plan membership **Post-1986 benefits**: 2 years of plan membership
Alberta	**Benefits accrued from 1967 to 1986:** Age 45 plus 10 years of continuous service **Benefits accrued from 1987 to 1999:** 5 years of continuous service **Post-1999 benefits:** 2 years of continuous plan membership
British Columbia	2 years of continuous plan membership locking-in applies to post-1992 benefits only
Manitoba	**Benefits accrued from Jul. 1, 1976 to Dec. 31, 1984:** 10 years of continuous service or plan membership for vesting. Fully locked-in at age 45 plus 10 years of continuous service or plan membership **Post-1984 benefits:** 2 years of continuous service or plan membership
New Brunswick	**Pre-Dec. 31, 1991 benefits:** No requirement. Locking-in at the same time as vesting according to the pension plan provisions **Post-1991 benefits:** 5 years of continuous service
Newfoundland	**Benefits accrued from 1985 to 1996:** Age 45 plus 10 years of continuous service or plan membership **Post-1996 benefits:** 2 years of plan membership
Nova Scotia	**Benefits accrued from 1977 to 1987:** Age 45 plus 10 years of continuous service or plan membership **Post-1987 benefits:** 2 years of plan membership
Ontario	**Benefits accrued from 1965 to 1986:** Age 45 plus 10 years of continuous service or plan membership **Post-1986 benefits:** 2 years of plan membership
Quebec	Full and immediate vesting and locking-in for all accrued benefits
Saskatchewan	**Benefits accrued from 1969 to 1993:** Age plus service or membership equals 45 (Minimum: 1 year of continuous service or plan membership) **Post-1993 benefits:** 2 years of continuous service

Several jurisdictions also require 100% vesting at pensionable age or normal retirement date even if the plan member has not met the service or membership requirement (Alberta, British Columbia, Manitoba and Saskatchewan).

Employees whose employment terminates before meeting the vesting requirement of a contributory pension plan are entitled to a refund of their own contributions with interest.

CHANGES TO THE TSE 300 COMPOSITE INDEX...continued

What is the impact? Minimal!

The new rules will be phased in on a quarterly basis beginning with the June review and will be fully implemented by December 2002. At current share prices (February 12, 2002) approximately 40 companies would be dropped from the index because they are smaller than 0.025% of the total and we estimate an additional 30 to 35 stocks would be dropped for failing the liquidity tests.

Dropping 75 stocks sounds like a major change; however, it is important to note that the aggregate market weight of the stocks being dropped represents only 1.5% to 2% of the TSE 300's total. By contrast the 75 biggest stocks in the index represent 82.5% of the total.

As such, we see the changes having no significant impact on Phillips, Hager & North portfolios or on the way Phillips, Hager & North manage the portfolios.

Global Industry Classification Standards (GICS)
As its name suggests, GICS is a global standard for classifying companies by industry group that was jointly developed by Morgan Stanley and Standard & Poor's. The TSE presently has its own industry classification standards comprising of 14 economic sectors, whereas the GICS has 10 such sectors. The change is long overdue and is one that The Toronto Stock Exchange indicated it would make well over a year ago.

Our complaint with the current TSE Industry Sectors is that some are too narrow to be useful (Real Estate at less than 1% of the total) and some are too broad (the Industrial Products category has become a catch-all category that includes everything from software companies to fertilizer companies; while biotech stocks are lumped together with breweries in the Consumer Products sector). We believe the GICS will provide investors with a snapshot of their portfolios that will be clearer and more meaningful. These changes will also facilitate comparisons across different countries.

The chart below titled "What Goes Where?" attempts to show where existing TSE industry groups will end up under the new scheme. Some changes are very simple. The Oil & Gas sector is simply renamed "Energy" and the Financials sector is largely unchanged. Other changes are more complicated. The Materials sector includes Golds, Metals and Forest Products, which were previously their own groups, as well as Chemicals, Fertilizers and Steels from the Industrial Products Group.

GICS – What Goes Where?

GICS industry	% Weight in TSE	Existing TSE 300 Index groups (bold) and sub-groups
Financials	30.3%	**Financial Services, Conglomerates, Real Estate**
Materials	14.5%	**Golds, Metals, Forest Products,** Chemicals & Fertilizers, Steels
Energy	11.8%	**Oil & Gas**
Info Tech	10.1%	Tech Software & Tech Hardware
Industrials	8.8%	**Transportation,** Fabricating & Engineering, Trans Equip
Consumer Disc	7.7%	Telephone Utilities
Telecom Stores,	5.3%	**Comm & Media**, Hospitality, Dept Autos & Parts
Utilities	4.6%	**Pipelines,** Gas & Electrical Utilities
Consumer Staples	3.6%	Food Stores, Food Proc, Bev
Health Care	3.3%	Biotech & Pharmacy

Note that this chart is only broadly descriptive – there are some notable exceptions at the individual security level. For example, the Conglomerates sector largely moves into the Financials category with both Power Group and Brascan joining, but Onex Corporation is deemed to be a technology stock due to its interest in Celestica.

Internally, Phillips, Hager & North have been using the GICS to classify Canadian stocks at an industry level for over a year now. We see the adoption of the GICS by the new S&P/TSX Composite Index as having no impact on the management of our portfolios other than changing the format of our external reports.

The table below demonstrates the differences between the TSE 300 Index industry groups and the GICS in February 2002

Present TSE	% Weight	New GICS	% Weight
Financial Services	28%	Financials	30.4%
Industrial Products	18.5%	Materials	14.5%
Oil & Gas	12%	Energy	11.8%
Utilities	7%	Info Tech	10.1%
Golds	5%	Industrials	8.8%
Metals	5%	Consumer Disc	7.7%
Consumer Products	4.8%	Telecomm	5.3%
Communications	4.5%	Utilities	4.6%
Merchandising	4%	Consumer Staples	3.6%
Pipelines	3%	Health Care	3.3%
Transportation	3%		
Forest Products	2%		
Conglomerates	2%		
Real Estate	0.9%		

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