

CANADA'S TOP TEN PENSION FUNDS: HELPING DRIVE NATIONAL PROSPERITY

As managers of a major portion of all retirement assets in Canada and with more than \$400 billion invested in Canada, the Top Ten public pension funds represent a major cornerstone of Canada's financial system and economy at large. Over the last ten to fifteen years, they have established themselves as global 'best practice' organizations, with pension funds and other institutional investors in other markets seeking to learn from and replicate their approach to asset management. The Top Ten not only provide Canadians with one of the strongest retirement systems in the world but also contribute significantly to national prosperity.

Aided by well-developed governance structures that allow them to operate in the best interests of members with little or no outside interference, they have helped provide stability and solid returns to sponsors and plan members during a highly volatile period for capital markets.

The Top Ten public sector pension funds include (ranked by size of pension assets): The Canada Pension Plan Investment Board (CPPIB), The Caisse de dépôt et placement du Québec (Caisse), The Ontario Teachers' Pension Plan Board (OTPP), The British Columbia Investment Management Corporation (bcIMC), The Public Sector Pension Investment Board (PSP Investments), The Ontario Municipal Employees Retirement System (OMERS), The Healthcare of Ontario Pension Plan (HOOPP), The Alberta Investment Management Corp. (AIMCo), The Ontario Pension Board (OPB), and The OPSEU Pension Trust (OPTrust).

A Canadian success story on the world stage

The Top Ten collectively represent a **well-known Canadian brand** in the global investment world, having participated in some of the largest deals in the world in recent years, including one of the largest electricity transmission and distribution companies in the U.S., seven UK airports including Heathrow, three Chilean water utilities and one of the largest and most profitable insurance providers in South Korea. Four of the top 20 global commercial real estate investors are members of the Top Ten.

The Top Ten are consistently regarded as global leaders by their international peers in terms of their approach to governance and their investment policies, the scale of their assets and their solid performance. This reputation has helped establish Canada as a **centre of excellence** for managers of quality, large-scale investments.

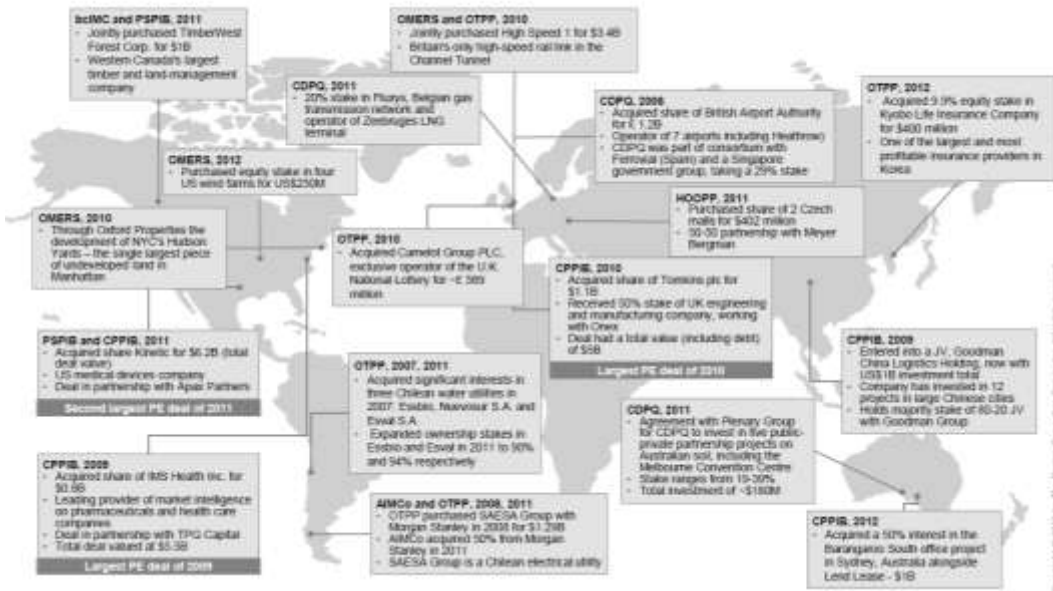
Media around the world have taken notice of the Top Ten. The Economist Magazine referred to them as "**Maple Revolutionaries**," stating "they have won the attention both of Wall Street firms, which consider them rivals, and institutional investors, which aspire to be like them." According to the Financial Times, "The idea of investing directly in infrastructure, which the Canadians first championed, deserves applause." Reuters said, "Large, aggressive and patient, they are pushing into a financing vacuum that neither cash-strapped governments nor private equity alone can fill."

The Melbourne Mercer Global Pension Index, widely considered as the premier international ranking of retirement income systems, has found Canada's to be **among the strongest in the world**. The Index tracks more than forty indicators of system health in such areas as integrity, adequacy and sustainability. In 2012, Canada ranked sixth out of eighteen countries – ahead of the United Kingdom, the United States, Germany, France and Japan, among others.

THE TOP 10 Investing for Canada on the World Stage



Major global transactions by the Top Ten



Key success factors of the Canadian model

- Managed as professional businesses**

The pension funds are managed as a business, with a clear performance mandate and few top-down restrictions. This provides them the latitude to do what is best for their members, investing in a range of asset classes deemed most appropriate by their professionals, and having the flexibility to offer competitive compensation to attract top investment talent from around the world – an essential feature in providing the best long-term, risk-adjusted returns to their members and sponsors.
- Well-developed governance structure**

Their well-developed governance structure is a strong contributor to their success. It is one of the main reasons the funds are emulated by their peers internationally. Given the size, reach and influence of the Top Ten, their governance model also encourages good corporate governance practices in Canada’s capital markets.
- Sufficient scale**

They have sufficient scale on account of their large member base and the fact that members, once enrolled, make regular and automatic contributions to the plan. This scale allows them to participate in alternative asset classes, including capital-intensive assets such as infrastructure. It allows them to manage their investments internally, thereby lowering their cost structure significantly, and puts them in a stronger negotiating position when setting external investment management fees.
- Liquidity certainty**

By virtue of predictable contributions and benefits payouts, the Top Ten have predictable cash flows. This liquidity certainty enables them to allocate assets to less liquid, higher return classes of investments, while reducing their need to invest in ultra-liquid, low-return assets to meet unexpected cash requirements.

Strong employee value proposition

As employers, each of the Top Ten has a strong employee value proposition. They are globally recognized brands within the global investment community that offer compensation that is competitive with leading investment management firms. At the same time, their mission and mandate goes beyond simply generating profits. Employees are proud of their every-day role helping millions of members achieve income security in retirement. Representing highly attractive career opportunities, the Top Ten as employers are able to attract top talent that can execute their overall mandate.

Improving business performance by acting like owners

The Top Ten represent **engaged, collaborative, long-term capital**. They work directly with companies to help improve their performance, and they focus on long-term results, thereby providing their investees with the incentive and support to think and act long-term. In working with investee companies, they focus on several key areas of corporate governance: the independence, composition and qualifications of the board of directors, as well as nomination and election processes and compensation of directors; the compensation of management (with attention given to incentivizing long-term thinking and actions); market capitalization and protection from takeovers; and shareholder rights, including dual share classes, majority voting and individual director elections.

The actions of the Top Ten as **engaged owners can drive improved performance** among their investee companies. A long-term orientation by management and the board of directors can reduce reactive behaviours arising from short-term asset fluctuations, as well as help the company be perceived as a more attractive partner by other potential investors. In 2011 alone, the Top Ten voted on about 200,000 issues, on which they voted against proposals 10% of the time. Many of the Top Ten are signatories to the UN Principles for Responsible Investing.

The Top Ten are also **strong and active contributors to improving corporate governance** practices in Canada and elsewhere. By encouraging good governance practices, they are helping align the interests of management and boards with those of shareholders and thereby ultimately improving the efficiency and effectiveness of Canadian capital markets.

Wide impact on the Canadian economy and retirement security

Investment management is a critical factor in ensuring that Canada's retirement income system remains strong. A main source of that strength in Canada can be attributed to the Top Ten public pension funds. Collectively they **managed \$714 billion in assets at fiscal year-end 2011**, representing ~35% of all Canadian retirement assets and 80% of public pension plan assets. The assets are broadly distributed among the ten. At the end of 2011, the distribution ranged from \$14 billion in assets managed by OPTrust to \$162 billion managed by CPPIB*.

Seven of the underlying pension plans of the Top Ten are **among the top one hundred plans worldwide** and fifteen of those plans are among the top twenty plans in Canada. These plans are healthy, growing and increasingly important to the Canadian economy. They cover all working Canadians through the Canada

* Due to differences in reporting periods the data quoted for CPPIB is from its fiscal year 2012, which ended on March 31, 2012

Pension Plan and Québec Pension Plan, and 3.5 million of these members are also enrolled in public sector employers' pension plans.

From 2003 to 2011, the Top Ten grew their pension assets under management from \$350 billion to \$714 billion, an increase of more than 100%. While about one-third of this growth (\$125 billion) resulted from net inflows to the funds, two-thirds (\$240 billion) was driven by investment returns. In 2011, these pension plans collected more than \$70 billion in contributions, or 45% of all retirement contributions made by Canadians. That same year, they **paid out \$74 billion in retirement benefits to Canadians**, or 49% of all non-OAS retirement benefits.

While the Top Ten pension funds seek the best risk-adjusted returns for their members globally, they are also **major long-term investors in the Canadian economy**. Together they have more than \$400 billion invested across various asset classes in Canada, including \$100 billion in real estate, infrastructure and private equity. Their investment activities have lifted them high on global rankings, with four of the Top Ten placing among the world's top twenty commercial real estate investors.

The Top Ten are a large and stable source of employment and a magnet for Canadian and global investment talent. They directly employ more than 5,000 men and women and provide employment through their real estate subsidiaries for an estimated additional 5,000. Their collective payroll of more than \$1.5 billion, along with more than \$2 billion in spending with various professionals serving their investment activity, is a substantial contribution to national GDP. The Top Ten **offer a unique, global experience to investment professionals**. Their asset management in public equity markets is often global in scope, providing Canadian professionals with a far wider playing field than would smaller, domestic firms. They also offer exposure to infrastructure, real estate and private equity deals that few other asset managers in Canada can offer.

In effect, they serve as the nucleus for clusters of highly sophisticated investment management expertise in several Canadian cities. Their influence works in two directions: they are able to enhance Canada's talent pool by offering **opportunities to work with some of the world's top pension funds** without leaving home, and they are able to expose Canadian talent to some of the world's leading financial centres. This international experience – gained at home or abroad – is critically important to Canada's success on the global investment stage.

Canada's retirement income system is considered among the best in the world. Nonetheless, the system faces significant challenges going forward. With baby boomers set to retire, the ratio of retirees to workers (the "dependency ratio") will decline from one-to-five today to one-to-two by mid-century. As well, people are living much longer in retirement relative to their working and saving years, and building a retirement nest-egg is more difficult due to low interest rates and volatile capital markets.

These issues impact individuals, communities and governments. Fewer working taxpayers to support government social programs will mean a heavier burden on future generations. Given these challenges, the Top Ten will play an increasingly important role in ensuring adequate retirement incomes for Canadian retirees.

Diversification, professional management and low cost structure

The millions of Canadians who are beneficiaries of the Top Ten pension funds accrue some important advantages relative to other types of retirement investments.

The Top Ten have about 35% of their assets invested in **alternative asset classes** such as infrastructure, private equity and real estate. This compares with about 10% in alternative classes for most other pension funds and typically none for retail investors. Holding alternative asset classes has important advantages including greater diversification across the portfolio, better alignment between the assets and the payout profile of liabilities, and the ability to achieve higher returns for the same amount of risk.

The Top Ten's **low cost structure is a significant benefit** for plan members. Their average cost of managing assets (i.e. their expense/asset ratio) is about 0.3% of assets. This level is comparable to passive index exchange-traded funds (ETFs), much lower than the 1.5% - 2.5% (or higher) charged by many other managed mutual funds, and lower than the 0.3% to 1.0% average for many other Canadian pension funds.

The Top Ten are able to achieve these cost savings because they typically manage about 80% of their assets internally compared with less 20% for many pension funds. **Internal management is generally much more cost-effective than external management.**

SOME CLOSING THOUGHTS

The Top Ten represent a **major cornerstone of the Canadian financial system** and, more broadly, the Canadian economy. They have elevated the reputation of Canadian pension funds to a world-class level, and their 'best practice' model has benefitted the pension industry at home and abroad.

Their **innovative approach** to investing has helped provide stability and solid returns to plan members in what has been a highly volatile period for capital markets. As well, their focus on **long-term value creation** is a model worth emulation by other investors and by the business community in general.

Canada's Top Ten public pension funds are truly a Canadian success story and a driver of national prosperity.

***Disclaimer:** Information in this document is sourced from a landmark study commissioned by several members of the Top Ten and conducted by The Boston Consulting Group (BCG) to provide data on the aggregate impact of these organizations. These materials excerpted by the Top Ten from the Study referenced are provided for discussion purposes only and may not be relied on as a stand-alone document. The Study was prepared by BCG at the request of several members of the Top Ten using public and/or confidential data and assumptions provided to BCG by the Top Ten. BCG has not independently verified the data and assumptions and changes in the underlying data or operating assumptions will affect any analyses and conclusions set out in the Study. BCG shall have no liability whatsoever to any third party with regard to these materials or the Study, including the accuracy or completeness thereof.*