Views of Key Stakeholders on the CPP Investment Board's Mandate

STAKEHOLDER REPORT

Submitted to:

Canada Pension Plan Investment Board
One Queen Street East, Suite 2700
Toronto, Ontario
M5C 2W5

EKOS RESEARCH ASSOCIATES INC.
March 2002

Table of Contents

Introduction

This report is the outcome of a series of interviews with a number of different stakeholder groups — actuaries, financial planners, public policy and advocacy groups, labour organizations and pensioner groups. The stakeholder research is one part of a broader study into issues surrounding public confidence in the activities of the Canada Pension Plan Investment Board ("Investment Board").

There are two other broad components of this research initiative: a benchmark telephone survey with the Canadian general public and a series of tracking surveys that will be conducted over the next year and a half.

The objective of this study component was to gain in-depth insights into the views of influential players from key segments of Canadian society as these pertain to confidence in the Investment Board and its activities.

Organization of the Report

The report is organized thematically according to the issues addressed in the stakeholder interviews. Each chapter is prefaced by a summary of the key findings from that chapter. While we would encourage a detailed reading of the report, these summaries can be used to gain a reliable understanding of the main findings from this research.

Research Methodology

A total of 40 interviews were conducted with actuaries, financial planners, labour representatives, individuals from public policy and advocacy groups, and representatives from pensioner organizations. These individuals were identified in consultation with the Investment Board. To preserve confidentiality, the list of selected individuals was longer than the number actually interviewed, and the identity of participants were not released to the Investment Board.

The study targeted senior level individuals and those who are regarded as leaders in their respective fields. A focus was also placed on interviewing individuals with expertise in pension plans and, more specifically, the CPP. This latter targeting was particularly important for identifying respondents from both labour and public policy stakeholders. While these individuals may not be representative of their industries in a strictly statistical sense, they were individually selected to represent the views of the key players in the public forum on pension matters, and as such, their views reflect the broad range of well-informed opinion.

Each of the individuals selected in the samples were sent a cover letter from the President of the Investment Board along with an Annual Report by overnight courier. The cover letter identified the overall purpose of the study, the reason why the informant was being approached for their participation, and the specific nature of their participation required. Subsequent to receiving the initial package from the Investment Board, stakeholders were contacted by telephone and appointments were arranged for interview. Once participation was secured, respondents were sent a two page backgrounder document by either fax or email and requested to review it prior to the interview.

The breakdown of interviews by stakeholder group is as follows:

Stakeholder Group	Number of Interviews
Actuaries	7
Financial Planners	8
Public Policy and Advocacy Groups	10
Labour	12
Pensioners	3
Totals	**40**

The interviews were conducted by telephone. While the initial length of the interviews was estimated to be approximately 20 minutes to help ensure participation from senior level individuals, the majority of the interviews took between one hour and one and a half hours. One of the key reasons for this variation was the heightened level of interest and overall thoroughness of the informants involved. Many of those interviewed had obviously prepared for the interview by reading the Annual Report and backgrounder and were readily able to engage in detailed discussions pertaining to many of the issues discussed. Interviews were conducted using interview guides developed in consultation with the Investment Board The information gathered through the interviews was noted, transcribed, analysed, and integrated into the findings of this report.

It should be noted that while the documentation provided to respondents prior to the interviews undoubtedly had some impact on their views (particularly as it pertains to familiarity with the Investment Board and perceptions of performance), most of those interviewed were very knowledgeable about both the CPP and, to a lesser extent, the Investment Board. It became evident through the course of the interviews, that many respondents were previously aware of the circumstances surrounding the establishment of the Investment Board as well as developments since its establishment (e.g., loosening restrictions on active investing).

Perceptions of the Canada Pension Plan

Key Findings

Health of the CPP

- Stakeholders have high confidence in the long-term health of the CPP
  - the great majority of stakeholders agree with the Chief Actuary's latest assessment of the Plan's fundamental health
  - for many, positive views of the CPP are driven by an optimistic outlook for the long-term health of the Canadian economy
  - increases to contribution rates have improved expectations about the Plan's performance as has the establishment of the Investment Board
  - while few, those with negative views about the long-term health of the CPP are generally opposed to the CPP in principle
- Labour stakeholders generally take the view that the CPP is an important program for Canadian workers whose assets have traditionally been used to support social policy
  - several see the move to equity investing as a reversal of this role for CPP funds and feel it introduces an unnecessary level of risk

Stakeholders and their Constituents

- Labour organizations are well organized around pension issues and generally incorporate advice about the CPP as part of their service to members
- Financial planners report that client expectations about the CPP are modest at best

Formal Positions on the CPP

- Most labour groups have a formal position on the CPP, but very few of the other stakeholder organizations do

Health of the CPP

Given the circumstances surrounding the establishment of the Investment Board, it is necessary to recognize that perceptions of stakeholders (and the public more broadly) are inextricably entwined with their views of the Canada Pension Plan (CPP). Confidence and other attitudinal positions relating to the activities of the Investment Board are linked to a definite extent with perceptions of the CPP. If the broad objective of the Investment Board is to help stabilize the long-term health of the CPP, current views on the state of the pension plan will have a bearing on the extent to which the Investment Board can obtain the confidence of Canadians in meeting its goal.

Accordingly, the research investigated stakeholders' perceptions of the CPP at a broad level. This was done in the context of the Chief Actuary's most recent projections to assess the extent to which stakeholders are confident in the long-term viability of the plan.

Five broad findings emerge from this portion of the research:

- stakeholders generally have high confidence in the long-term health of the CPP
- recent changes to the plan have had a positive impact on confidence, most notably increases to contribution rates and the establishment of the Investment Board
- confidence in the long-term health of the Canadian economy also helps to influence confidence in the stability of the CPP
- those with negative views about the long-term stability of the CPP are generally opposed to the Plan in principle
- labour stakeholders feel that the CPP is an important program for Canadian workers and that its assets have traditionally been used to support social policy and should continue to do so

In general, the vast majority of those we spoke with feel the CPP is in good health. Most stakeholders from each group agree with the Chief Actuary's most recent projection that the CPP will be in good health until 2075 (Table 1). Relatively few either disagree with this assessment or are unsure about it.

Table 1: Agreement with Chief Actuary's Projection

Group	Yes	No	Don't Know
Actuaries	5	1	1
Financial Planners	6	2	--
Public Policy and Advocacy Groups	8	2	--
Labour	9	1	2
Pensioners	2	--	1

Q: The Chief Actuary's most recent report projects that with current and planned contribution increases, as well as investment income, the Canada Pension Plan will be able to meet benefits obligations until at least 2075 without any further increases to contribution rates. In general, do you agree with this assessment?

Stakeholders were probed to find out what factors influence their perceptions of the plan's health. The key findings are organized below according to positive and negative views.

Positive Perceptions

- ❖ Three broad factors influence the thinking of those who agree with the projected long-term stability of the CPP — trust in the professional integrity of the Chief Actuary, agreement with past changes to the CPP and economic optimism. (Certainly, the focus on the Chief Actuary was influenced by the question wording.)
  - — Changes to the CPP were cited by a large number of stakeholders as an explanation for their favourable stance towards its long-term stability. Approximately half of all stakeholders point to either the current and planned increases to contribution rates or the establishment of the Investment Board or both as positive developments.
  - — The establishment of the Investment Board provides confidence in the health of the CPP both on the basis of a general optimism about the earnings potential of equity markets and strong levels of confidence in the Investment Board itself.
  - — Many stakeholders feel that the long-term economic outlook is strong and will likely reinforce the positive effects of increased contribution rates and equity earnings.
  - — The most common factor cited by stakeholders' is a high level of trust in the professional integrity of the Chief Actuary and actuaries more broadly. As one financial planner put it, "the Chief Actuary is a professional and I know his assumptions are scrutinized by outside actuaries." Although stakeholders from all groups express trust in the Chief Actuary, this view was more common among financial planners.
- ❖ A number of stakeholders from different groups were somewhat qualified in their agreement with the Chief Actuary's projections. These respondents have a number of concerns about future developments.
  - — A number of actuaries are concerned that the Chief Actuary's projections for equity investments are somewhat aggressive and projected too far into the future. As one actuary cautioned, "many things can happen that the Chief Actuary can't see."
  - — Concerns about equity market volatility are prevalent among labour stakeholders as well as a few public policy stakeholders.

Negative Perceptions

- ❖ All but one of those with negative views on the long-term stability of the CPP are opposed to the Plan in principle. These stakeholders simply take the opposite stance of those with positive views.
  - — Skepticism surrounding the accuracy of actuarial projections and the specific assumptions underlying the Chief Actuary's projections.
  - — Strong concerns about volatility, the long-term stability of equity markets and future reliance on equity income to secure the CPP. As one public policy stakeholder stated, "after 2021, they are relying too much on the Investment Board's performance."
  - — High levels of economic uncertainty or pessimism towards the long-term outlook.

Labour organizations were more likely to express concerns about equity markets, though this was by no means universal. They also take a somewhat defensive stance towards the CPP generally and several suggest that the crisis in the plan has been overstated and, by extension, that the changes — particularly the move to investing funds in equity markets — were unnecessary. These latter individuals also view the establishment of the Investment Board as a major policy reversal from secure investing in government bonds that support a social policy to less stable investments with purely market driven objectives.

Stakeholders and their Constituents

Advising Constituents on the CPP

Recognizing that stakeholders can play a key role in influencing broader opinions, the research investigated the kinds of advice that both labour organizations and financial planners provide to their members/clients with respect to the CPP.

In general, labour organizations advise their members of the CPP as part of their bargaining and negotiating for pension plans, and also as part of various policy groups and committee educational efforts. Virtually all the organizations we spoke with provide some kind of advice to membership through education campaigns. In general, this advice is oriented towards explaining the CPP and its benefits structure and how this fits with other sources of retirement income (principally member pension plans). Some of the broader labour federations indicate that they conduct conferences and have committees working on pension policy issues. These organizations generally make efforts to inform their members of CPP policy changes as well.

Virtually all financial planners indicated that they factor the CPP into their calculations when providing professional advice to their clients. That being said, most indicated that it is only a very modest portion of their retirement income and that it is not a significant factor when providing advice. Clearly, as individuals seeking advice on financial investments, clients of financial planners are generally affluent and represent an elite economic segment of Canadian society.

Financial Planners and their Clients' Views

Financial planners were also questioned about their clients' views of the CPP. They were asked about clients' general views of the CPP, its importance to their retirement savings and whether or not they had noticed any changes in their clients' views of the CPP over the past five years. It should be noted that these are financial planners' perceptions of their clients' views rather than the views of their clients *per se*.

In general, financial planners report that their clients are fairly sceptical about the CPP and that this scepticism intensifies with younger clients and has generally worsened in recent years. According to financial planners, their clients' expectations for the CPP are modest at best. Perhaps this is indicative of the fact that the CPP is somewhat unimportant for many of these clients as a source of retirement income — most financial planners report that the CPP is "not at all important" to their clients' retirement planning.

Formal Positions on the CPP

Labour organizations, public policy groups, and pensioner organizations were asked whether their organizations have a formal position on the CPP. Only one public policy group had a position formally articulated, whereas most of the labour organizations we spoke with had one. In total nine labour organizations have a formal position on the CPP. Only three labour organizations indicated that they had no formal position. While most public policy groups do not have a broad formal position on the CPP, many indicated that they have articulated formal positions on different specific issues pertaining to the CPP at one time or another.

Labour organization positions generally focused on increased benefits. This varied from moderate increases to levels that would ensure beneficiaries were above the poverty line to fully funded retirement. One organization takes the position that the plan should be universal.

Another labour group focuses its position on the social investing question. In their view, the move to equity markets is a strong reversal in policy away from social investing. They point to the fact that government bonds have been used for social purposes (e.g., the establishment of community colleges was funded by CPP funds). Though not always a formal position, this was a common sentiment among labour stakeholders.

Perceptions of the Investment Board

Key Findings

General Perceptions of the Investment Board

- Attitudes toward the Investment Board are almost universally favourable
  - both the Board of Directors and the management team are seen as being made up of competent professionals
- Some feel there is a lack of general public representation on the Board of Directors
  - this view was widespread among labour stakeholders, but other stakeholders would also like to see a more public face on the Board of Directors as well
- The governance structure is highly regarded
  - the governance model is seen as appropriate for an institution operating at arm's length from government, though there is confusion about how it provides public accountability
- Diversification of the portfolio is generally seen as appropriate
- Virtually all stakeholders believe the Investment Board should be open and transparent in its operations
- A "virtual corporation" is viewed positively, but it causes confusion
  - a lean management structure is welcomed, however, the term "virtual corporation" has a negative connotation that employees are seconded to the Investment Board.
  - This gives rise to concerns about possible conflict of interest.

Organizational Model

- Lean is good — but not too lean
  - stakeholders say there needs to be a good balance between external managers and internal staff
  - the model allows the Investment Board to use the best external talent and gives the flexibility to change managers in the advent of poor performance
  - it provides fresh insights and renewal of opinion
  - however, it needs to have sufficient internal strength to avoid being pushed by powerful external interests; several feel this can lead to conflict of interest situations

Independence

- ❖ Independence in making investment decisions is widely seen as crucial to the Investment Board's success and ability to maintain stakeholder and public confidence
  - — government or political interference is widely viewed as a recipe for disaster
  - — at the same time, many stakeholders think the Investment Board must be publicly accountable
- ❖ Most stakeholders give the Investment Board the benefit of the doubt when asked if it is currently independent, but there are serious concerns regarding the future
- ❖ There are concerns about the Investment Board's ability to stay independent as it grows in size
  - — these concerns are influenced by the weight the Investment Board will have in the Canadian market leading to a high level of scrutiny and possible attempts to influence its behaviour on markets
  - — politicians will eye its large pool of funds as a way to achieve public policy goals
  - — the media will view it as a source of stories
- ❖ To counter outside pressures, stakeholders offer a number of suggestions:
  - — the Investment Board should identify closely with the interests of its members, imparting a sense of ownership
  - — the Investment Board should be completely open in its practices
  - — independence must be vigilantly protected: "They must never say 'yes,' even once, or they will lose their independence"

Performance and Measuring Success

- ❖ Stakeholders rate the Investment Board's performance of non-investment activities (e.g., communications, governance) strongly, more than compensating for equivocal support for investment performance to date
  - — at this early date, views of investment performance are mixed but sympathetic — the jury is out
- ❖ Success will be measured in terms of investment performance, communications and maintaining independence of action
  - — Labour stakeholders will also measure success in terms of meeting social policy objectives through investment activities

General Perceptions of the Investment Board

Understanding general perceptions of the Investment Board is a critical component for framing the more specific views stakeholders may have on issues such as independence, confidence and investment strategies. Without question, these perceptions have a significant influence on more specific views and the two are inextricably interrelated.

The structure of the interviews flowed from this view. Once stakeholders had been asked about the CPP the interview turned to general perceptions of the Investment Board. Stakeholders were first asked to rate their familiarity with the Investment Board and then, in an open-ended fashion, express their general perceptions of it.

Several key findings emerge from this portion of the research:

- There are modest to strong levels of familiarity with the Investment Board (although familiarity was influenced by the fact that documents were sent to stakeholders prior to the interview).
- In general, perceptions of the Investment Board are very positive. Even among those with negative views of the CPP or the move to equity investing, there is a generally high level of regard for the Investment Board and what it has accomplished thus far.
- Five key factors drive these positive views: the composition of the Board and management team; independence and the governance structure and policies adopted by the Investment Board; the concept of equity investments as a means to help stabilize the CPP; the corporate model; and, communications efforts and transparency.

Familiarity

There is a fairly strong level of familiarity with the Investment Board among stakeholders. Only seven respondents say they are anything less than somewhat familiar with the Investment Board. Most stakeholders say they are either somewhat familiar or familiar. Public policy stakeholders, on the whole, demonstrated the highest levels of familiarity with two indicating that they are extremely familiar and none indicating that they are anything less then somewhat familiar (Table 2).

Table 2: Level of Familiarity with the Investment Board

Group	Not at all familiar	Not too familiar	Somewhat familiar	Familiar	Extremely familiar
Actuaries	--	1	2	4	--
Financial Planners	1	1	--	6	--
Public Policy and Advocacy Groups	--	--	4	4	2
Labour	1	2	4	5	--
Pensioners	--	1	--	2	--

Q: The Canada Pension Plan Investment Board has been up and running for about three years. How familiar are you with the Board's activities — extremely familiar, familiar, somewhat familiar, not too familiar, or not at all familiar?

These findings need to be understood in the context of the study methodology. Prior to the interview the respondents were sent a copy of the Annual Report as well as a two page background document. Reflecting a high level of interest in the study, every respondent had read the background document and most had at least skimmed through the Annual Report. A number of those who had read the Annual Report indicated that they had been previously unaware of the Investment Board.

This being said, there were a perhaps surprising number of stakeholders who were previously aware of the Investment Board and had some fairly detailed understandings of its background. Respondents were generally probed about prior awareness and there was an evident correlation between this and a higher level of expressed familiarity. In general, those rating their familiarity higher than "somewhat" had some prior knowledge of the Investment Board.

General Perceptions

Overall, initial perceptions of the Investment Board are very positive. Virtually none of the respondents had an overall negative stance, although some concerns were expressed. Most of these concerns were relatively minor compared to the positives or offset as future anxieties about markets and independence. Five key themes are found to be common factors informing perceptions of the Investment Board:

- ❖ Board and management team composition
- ❖ Independence in making investment decisions and governance structure
- ❖ Equity investments
- ❖ Transparency and communications
- ❖ Corporate model

Board and Management Team Composition

One of the strongest factors generating positive perceptions of the Investment Board is the view that both the Board of Directors and management team are made up of highly competent and professional individuals. "I think the Board [of Directors] is clearly competent, it's a competent, professional Board," stated one public policy stakeholder. "I have every confidence that given the mandate they have, that in fact they are doing a conscientious and knowledgeable job," said one actuary. Views of this nature are widespread among stakeholders.

Many individuals noted that they either know members of the Board or management team or had encountered them during presentations. These stakeholders were unrestrained in the praise, particularly of the Chair and President. As one financial planner put it, "there's no question about their expertise." These types of views were expressed even among those with some of the most negative views of the CPP and the Investment Board. There is a strong perception that the people running the Investment Board operate with a high level of professional integrity: "The Investment Board has a clear mandate and their behaviour has been consistent with that mandate."

This being said, there was strong dissention regarding Board composition from most labour organizations, although this did not result in an overall negative view of the Investment Board itself. While not objecting to any particular directors, many labour stakeholders voiced dissatisfaction with the fact that labour and other groups outside the financial sector are excluded from the selection process. "Board members are principally from the financial community. Perspectives of workers aren't necessarily going to be addressed in Board deliberations." Others felt the Board of Directors needs to more regional representation. One felt this represented a conflict of interest: "We would see from our history with joint trusteeships that this kind of strategy is fuelled by considerable self-interest on the part of people who are attached to the financial industry, who are on the Board."

Several stakeholders (not solely from labour organizations) expressed the view that making the Board of Directors more representative of the general population would help to secure public confidence in the Investment Board's activities. In their view, it is important for the Investment Board to strengthen its connection with Plan contributors to help impart a sense of ownership.

Independence and Governance Structure

Stakeholders are also impressed by the efforts made to ensure independence in making investment decisions and an arm's length relationship to government. Those who are more familiar with the Investment Board or had read the Annual Report were impressed with the governance structure. "I feel fairly reassured that they have done so much on governance," said an actuary. "[It's an] in-your-face requirement for them anyway because of the new focus on governance, and they recognized that." The establishment of the governance structure was, in his view, "a very good first step." A public policy stakeholder effused, "a highly professional organization in both governance and operations, with a good degree of independence from the government."

Some expressed concerns about increasing political pressure as the size of the portfolio under the Investment Board's management grows. As one actuary put it, "the Board's biggest challenge is to make sure it operates on sound investment principles and not some political pressure." These concerns are forward looking and many felt that independence was contingent upon the people involved — both in terms of governments and Ministers of Finance, as well as the Board of Directors and management team. The governance structure (whether probed in terms of the nominating process, the relationship between the directors and management team, or the need for provincial-federal cooperation in selecting directors) provided scant assurance to these individuals that independence could be maintained over the long-term. These issues are discussed in greater detail below.

Equity Investments

Generally speaking, stakeholders are positively disposed towards both the concept of investing, efforts to diversify the portfolio, as well as the general investment approach of the Investment Board. A number of individuals feel these changes were long overdue and welcomed them — "it should have happened a long time ago." Others like the proactive steps taken by the Investment Board in this regard. In the words of one actuary: "I like their courage to move forward and make recommendations that resulted in some change to the mandate as to what they can invest in."

A few stakeholders qualified their positive views of equity investments with concerns about risk and market volatility. These concerns are not confined to any one particular group, but neither are they widespread. They generally circulate around caution about eventually investing too much of the overall CPP portfolio into equities or investments in more risky forms of equity. Several are mildly concerned about short term performance, but recognize that the Investment Board has been operating in a difficult investment climate.

A number of labour stakeholders are fundamentally opposed to equity investments, feeling they introduce an unnecessary element of risk. These individuals generally recognize that the mandate was established by governments and realize that the Investment Board is working within such a framework. Opposition to equity investing is not, however, universal among labour stakeholders — an equal number see a strong rationale behind trying to increase investment earnings through equity investments and support the move (albeit not unconditionally). These issues are discussed in greater detail in the following chapters.

Transparency and Communications

Stakeholders' positive perceptions are also driven by an appreciation for the emphasis the Investment Board has placed on transparency and communications. Some remarked that their very first impressions were that the Investment Board is open and transparent. Several stakeholders noted that they were originally skeptical about the establishment of the Investment Board but were later impressed by various communications efforts, including presentations by Investment Board officials. As one actuary stated: "I appreciate that they are trying to raise awareness of the Investment Board and its functions. … At first I was concerned when the Investment Board was created, but I think they've done a really good job."

A number of stakeholders were pleasantly surprised upon reading the Annual Report and the background information, but felt more could be done to get the message out. A pensioner stakeholder remarked that the communications are "… underwhelming in terms of getting [the message] out to the public. I was really pleased to get [the Annual Report] and think it's a critical thing to have in our hands."

Corporate Model

Though less common, a number of stakeholders are impressed by cost efficiencies associated with the corporate model. The "lean and mean" model articulated in the Annual Report was seen as a key factor. These views are generally combined with the view that the Investment Board will be successful in securing the services of talented external managers.

While the term 'virtual corporation' conveys a lean organization, there is also confusion attached to it. A scattering of comment indicated that several people feel that employees in a virtual corporation are only part time, being seconded from other organizations. This leads to suspicions about conflict of interest and the way the term 'virtual corporation' is used should perhaps be amended to correct this misunderstanding.

Another issue that arose with the concept of a virtual corporation is the perception that there may not be adequate staff to properly monitor external managers. This explored in greater detail below with the discussion on the corporate model.

Regardless of the stakeholder group or philosophical orientation towards the CPP, overall perceptions of the Investment Board are very positive, although some concerns do exist. In particular, there are serious concerns about independence in some circles, notably with actuaries (though still only a few offered up such concerns when asked about their general perceptions). Such concerns are not, however, with the present situation, but rather the future as the size of the assets under management becomes very large. Labour organizations are more negative than any other stakeholder group, but this negativity is generally confined to either Board of Directors exclusivity or issues with the decision to transfer assets from government bonds to equity investments. Still, it would be unfair to characterize even one stakeholder as having an overall negative view of the Investment Board itself at the present time.

Organizational Model

As found with general perceptions of the Investment Board, there is a strong level of overall support for the organizational model. In a brief statement, respondents were provided with a description of the virtual corporation model and asked what advantages and/or disadvantages they perceive.[1] Overall, stakeholders enumerated far more advantages than disadvantages. Many respondents were unable to find any disadvantages at all. While finding it difficult to pinpoint disadvantages, stakeholders did raise a number of caveats the Investment Board should guard itself against, particularly as it pertains to relationships with external managers both in terms of monitoring their activities and potential conflicts of interest.

Four key advantages to the corporate model were voiced repeatedly across all stakeholder groups: cost effectiveness; leveraging talent; flexibility in using different managers; and, a flow of competing and fresh viewpoints.

While cost effectiveness is clearly seen as an advantage of the Investment Board's corporate model, there is a widespread sentiment that while lean is good, the Investment Board must be careful to avoid being too lean — there needs to be a good balance between external managers and internal staff. Of particular concern with many stakeholders is the ability of the Investment Board to monitor the activities of investment managers as the size of the assets under management grows.

While many raised concerns about the ability of staff to monitor investment mangers, one public policy stakeholder with a particularly high level of familiarity with the Investment Board viewed this in an entirely different light. In her view, "the management team is basically used for good governance, instead of trying to find the hotshots with the highest success in the marketplace. … being one step removed could strengthen accountability and governance." This perception is certainly anomalous, as most stakeholders have the sense that a virtual corporation implies a very small management team (perhaps too small to effectively govern the activities of external managers).

The perceived advantages of using external managers are closely tied to perceptions of cost efficiency, but many other benefits were identified. Of particular importance is the flexibility the relationship offers. Many stakeholders feel the Investment Board will have the ability to switch managers more easily if performance is wanting. An ability to generate competing and fresh insights through the use of different external managers is also seen as a key advantage. Many expressed the view that an over-reliance on in-house talent leads to an ossification of organizational thinking and a tendency to fall into investment habits that may be deleterious to performance. In the view of these stakeholders, the corporate model is an effective means to avoid such problems.

Concerns were raised by a number of stakeholders across all groups that there could be "potential" conflict of interest issues. This is generally seen as a potential future problem rather than an existing one. As one actuary put it, the potential for a conflict situation would arise "if a particular outsider is pushing a particular perspective; if he can convince the Investment Board that they have enough money to drive the market in a particular direction." Concerns about conflict problems was a recurring issue with many different stakeholders throughout different parts of the interview.

---

[1] "The Investment Board operates as a virtual corporation with a small management team. To leverage available expertise in the marketplace, the board develops partnerships with external investment organizations rather than building up its own staff resources. What advantages do you see in this model?"

Independence

The Investment Board's independence in its investment activities is a critical factor in maintaining the confidence of stakeholders. The importance of independence to stakeholder confidence was anticipated prior to the study and certainly confirmed through the course of the interviews. Independence "from government" was explored in considerable detail at three separate levels — its importance, perceptions of current independence, and the impact of increasing asset size on independence.

A number of key findings emerged from this portion of the research:

- Independence is widely regarded as being crucial to the Investment Board's success. Moreover, concerns about independence from government are highly focused on investment policies and practices.
- While government non-interference in investment activities is widely and strongly urged (whether this be at the provincial or federal level), there is also a strong feeling that there must be some form of public accountability.
- Although many feel that the Investment Board is currently independent, there is a great deal of uncertainty and, in some quarters, suspicion. Moreover, many of those who think the Investment Board is presently independent, feel it is "only a matter of time" before there is some kind of government or political interference.
- While the interviews focused on independence from government broadly, it is clear that there are also significant concerns about independence from the broader business and investment communities.
- It is universally believed that the Investment Board will face serious pressures as the size of the assets under its administration grows. These pressures are seen as coming from a number of different sources and taking a wide array of forms.
- There are many doubts as to whether or not the Investment Board will be able to maintain its independence as it becomes a major force in Canadian capital markets. Stakeholders perceive that a number of factors will intensify this problem — namely, the foreign property restriction and investments into private equities.
- Stakeholders feel there are a number of different actions that can be taken to help mitigate threats to the Investment Board's independence. Key suggestions include developing a closer connection with the Canadian public or Plan contributors, as well as thorough and consistent transparency policies and practices.

Importance

Without question independence is widely considered to be a crucial ingredient to the success of the Investment Board and confidence in its activities. Only a very few (all from labour organizations) rated independence from government as anything less than important. Most stakeholders from virtually all groups rated such independence as "very important" (Table 3).

Table 3: Importance of Independence

Group	Not at all important	Not too important	Moderately important	Important	Very Important
Actuaries	--	--	--	--	7
Financial Planners	--	--	--	--	9
Public Policy and Advocacy Groups	--	--	--	1	9
Labour	--	1	3	3	4
Pensioners	--	--	--	1	2

Q: In your opinion, how important is it that the Investment Board operates independently from government — would you say it is very important, important, moderately important, slightly important or not at all important?

When probed further on why they rate importance this way, it is clear that independence from government is closely tied to successful investment performance for most stakeholders. Clearly, federal and provincial decision makers exercised a good deal of foresight in attempting to establish a governance structure that would help ensure independence. Government or political interference in the activities of the Investment Board is widely viewed by stakeholders from all groups as a recipe for disaster. It is generally felt that government officials and politicians lack the expertise and/or trust to be involved in formulating investment strategies and decisions for the Investment Board.

While most stakeholders view the idea of government interference negatively, many also feel that the Investment Board needs to be publicly accountable. This represents something of a difficult conflict for some stakeholders. As one public policy stakeholder said, "I would like it to be under public control, but I don't want a politician getting his fingers on the pie." One respondent suggested that keeping the government out of investment decisions would lend itself to a greater degree of accountability; that it would make it easier to see who is responsible for performance and stand as an impediment to 'buck passing'. "It will be clear," according to this financial planner, "who's responsible for the losses and gains."

Generally speaking, those who rate independence as less than "very important" are concerned about ensuring some kind of accountability. These stakeholders feel that too much independence implies a lack of accountability. Despite the overall strong sentiment that the Investment Board must keep a strong distance from government, it is clear that this is largely focused on investment activities. Several certainly see an oversight role for government being necessary, and many assumed as much is in place in some form (although these stakeholders were not particularly attuned to the accountability built into the relationship between the Board of Directors and management team). Most stakeholders recognize that an arm's length relationship to government implies some form of relationship — that at least a minimal involvement with government is inevitable.

Perceptions of Current Independence

While many stakeholders are uncertain as to whether the Investment Board is currently independent from government, only one said "no" when asked if the "Investment Board has this independence." A significant number of stakeholders are uncertain about the Investment Board's independence and many are skeptical, or even suspicious, but they are outnumbered by those who feel there is current independence by approximately two to one for all stakeholder groups except labour, where it is about half and half (Table 4).

Table 4: Perceptions of Current Independence

Group	Yes	No	Don't Know
Actuaries	5	--	2
Financial Planners	5	--	3
Public Policy and Advocacy Groups	9	--	1
Labour	5	1	6
Pensioners	2	--	1

Q: Do you believe the Investment Board has this independence from government?

Of those who indicate that the Investment Board is currently independent, few were overly assertive in this claim. Most simply stated that they "have no reason to believe otherwise." Many of these same individuals also feel quite strongly that it is only a matter of time before independence begins to erode. "Yes," said one financial planner, "but just because it's not a tempting target yet." The notion that the Investment Board's mettle has yet to be fully tested was pervasive among those answering affirmatively. A few feel the governance structure is sound enough to give them a high level of confidence in the organization's independence. These same individuals also mentioned that they are familiar with a number of directors and/or members of the management team, and that this also provided them considerable assurance.

A number of those who are uncertain of the Investment Board's independence, were merely unwilling to make an uneducated guess. But there is a definite level of scepticism and even suspicion among this group. "Structurally the Board may be independent, but in terms of individual connections, it may not be." This view can be found among labour and public policy groups and is tied in many cases to a perceived lack of representation of individuals outside the financial community on the Board of Directors. Restricting the selection of directors to only those with investment or related expertise suggests to a number of stakeholders that there are 'behind the scenes' connections with government (i.e., 'Bay Street connections' with politicians). "I'm not entirely clear on the Board selection process, but at the end of the day I'm assuming it's a political process." Indeed, these individuals feel the optics of such exclusivity, its performance merits notwithstanding, would harm public confidence in the Investment Board's activities.

A number of stakeholders also noted government involvement in the selection of directors when qualifying responses as to the Investment Board's independence from government. While it spells out for them that there are clear connections with government, these individuals also feel that the mechanisms of the selection process go a long way to protect the Investment Board from political interference. In particular, these respondents focused on the need for federal and provincial cooperation in the selection process, feeling that this provides the necessary safeguard against political patronage. As one actuary stated, "the only thing that gives me any hope that it will be able to avoid political influence is that the provinces and federal government are involved and they never get along, so it may be impossible for them to get their act together to manipulate anything."

The Impact of Size on Independence

The eventual enormous size of the assets managed by the Investment Board was an issue raised without any prompting prior to it being addressed explicitly during the interviews. It is a top-of-mind concern for many stakeholders and perhaps the one factor that may present the greatest future challenge. This view was certainly reflected in the statements of many stakeholders and was evidenced by the responses to questions on the issue.

Without exception, all stakeholders from each group feel that the Investment Board will face increased pressure as the size of assets under administration grows (Table 5).

Table 5: Increased Pressures with Growth in Assets

Group	Yes	No	Don't Know
Actuaries	7	--	--
Financial Planners	8	--	--
Public Policy and Advocacy Groups	10	--	--
Labour	12	--	--
Pensioners	3	--	--

Q: Assets under administration by the Investment Board are growing quickly — as already stated, it is anticipated that they will exceed $130 billion within ten years. The Investment Board will thus emerge as Canada's largest pension fund and a major player in the Canadian capital market and investment industry in a relatively short time. Do you think the Investment Board will be pressured as a result of its size?

When stakeholders were probed about what kinds of pressures they feel would be brought to bear on the Investment Board, there are a myriad of different types of pressures anticipated, coming from a wide array of sources. The two principal sources of perceived pressures are business and government/political pressure. Almost as equally cited, many respondents also feel significant pressures will arise from shareholders (through proxy voting) or the investment community more broadly, and social activists or "special interest groups."

Different groups are expected to exert different types of pressure. Perhaps the strongest finding here is that stakeholders from all groups anticipate significant pressures to emanate from both business and investors to influence the way capital is moved. As one actuary put it, "whenever it sneezes then everyone else will sneeze. Everyone will be looking at what the [Investment] Board is doing."

Many stakeholders feel that these pressures will be intensified by a number of factors that could potentially be avoided. Clearly, these views are related to the weight the assets will have in Canadian markets. Indeed, many respondents feel that the foreign property rule will exacerbate this problem, suggesting that it must be relaxed before it becomes a major issue. A number of stakeholders feel that the weight of the Investment Board in the Canadian market will increase pressure to expand foreign limits or even eliminate them.

A number of individuals also feel that the move to active investing, as well as private equity investments, will further contribute to pressures from the business and investment community as they attempt to influence decisions that may affect them. "The more the Board strays from straightforward index investing, the more opportunity there is for the perception of conflicts of interest or political interference."

Political and/or government interference is also perceived as a major problem looming on the horizon. Many suggest that the temptation to use the funds will be too great for politicians and officials to resist. While there is a feeling that the mandate and rules governing the Investment Board currently protect it against political pressure, many also feel that it is only a matter of time before governments change the rules to make this possible. There is a sense in many quarters that governments, particularly provincial governments, will find it difficult to function without access to cheap cash as more and more government bonds roll over.

Other sources of anticipated pressure include the public (as they become more aware of the Investment Board), labour, media and investment managers, as well as internal pressures coming from directors to exert more influence over how investment decisions are made. It is noteworthy that the latter view was imparted by someone with a great deal of confidence in the governance structure and the integrity of current directors.

Maintaining Independence

As much as stakeholders feel there will be increased pressures as the size of the assets grows, there is an equally strong sense that the Investment Board has to be well prepared to resist the "inevitable" pressures that will brought to bear. "They must never say yes, even once, or they will lose it [i.e., independence]." Indeed, there is a high degree of uncertainty as to whether or not the Investment Board will be able to maintain its independence. Less than a half of stakeholders from virtually all groups feel independence will be maintained as the value of the assets under its control increases. While many merely express uncertainty, a not insignificant number feel that it will not be possible to maintain independence over the long-term (Table 6).

Table 6: Maintaining Independence

Group	Yes	No	Don't Know
Actuaries	2	1	4
Financial Planners	2	3	3
Public Policy and Advocacy Groups	4	1	5
Labour	2	4	6
Pensioners	2	--	1

Q: Do you feel the Investment Board will be able to maintain its independence from government as the value of the assets under its control increases?

A number of suggestions were offered up to help mitigate potential threats to independence.

- A number of stakeholders from all groups emphasize the need for the Investment Board to get the public (or contributors) "on their side." Among these individuals, there is a view that if the public has a strong sense of ownership in the CPP and what the Investment Board is doing, it will be much more difficult for governments to interfere. As noted previously, many suggest that making the Board of Directors more representative of the public will help to achieve this end; many others point to keeping the public well informed about the Investment Board and its activities.
- Others suggest the need to be vigilant and thorough in the Investment Board's transparency and disclosure policies and practices. In the view of these respondents, any secrecy will leave room for various forms of influence and suspicions about improprieties. The particular nature of the transparency and disclosure stakeholders have in mind is explored more fully in Chapter Six.

Performance and Measuring Success

It is clear on the basis of these interviews that the success and performance of the Investment Board will be measured on a number of different levels. Certainly, financial performance is a crucial measure of performance and success for virtually all respondents. But other factors enter into the picture due to the nature of the assets being invested. In some senses this makes the Investment Board's job more difficult than if they were simply investing private funds, but it appears as though the circumstances surrounding the public nature of the funds, particularly as it pertains to issues such as government involvement, disclosure and communicating with the public, lends itself to some sympathetic views.

Several key findings emerge from this part of the research:

- ❖ Performance is being measured both according to financial performance and corporate behaviour (e.g., communications, transparency, governance structure set-up, Board members and management team selections) — the latter being more positively rated than the former.
- ❖ Overall, the Investment Board enjoys favourable, though not overwhelmingly positive, performance ratings. Although not overly positive in their assessment of investment performance, stakeholders are sympathetic to the Investment Board on this score. The jury is out in the eyes of most stakeholders.
- ❖ As with performance, the success of the Investment Board will be measured on a number of different levels, not simply restricted to investment performance. Aside from investment performance, key measures of success will include the ability of the Investment Board to communicate with the public and stakeholders, transparency, and maintaining independence.

Performance

Stakeholders were asked to rate the Investment Board's performance to date. Overall, the results are positive with only a few from any stakeholder groups feeling performance has been poor (Table 7).

Table 7: Rating Performance

Group	Very Poor	Poor	Neither good nor bad	Good	Very Good	Don't Know
Actuaries	--	1	--	3	2	1
Financial Planners	--	--	2	3	--	3
Public Policy and Advocacy Groups	--	--	--	6	2	2
Labour	--	1	5	3	1	1
Pensioners	--	1	--	1	--	1

Q: All things considered, how would you rate the Investment Board's performance to date — very good, good, neither good nor bad, poor or very poor?

While these are positive ratings, it is important to bear in mind that they are based on an intermixture of perceptions of investment performance and views on other corporate factors — the latter being much more positive than the former. This is not to say that stakeholders are negative in the assessment of the Investment Board's investment performance (although a few are), but rather that they are extremely positive on the other factors. Those who rate performance as poor or at least not good, are generally focused on financial performance, though not exclusively so.

Of particular importance for many stakeholders are the establishment of good governance procedures, policies, a clear vision and mandate — in short, most feel the Investment Board has done an admirable job in getting itself up and running. Several financial planners and one actuary noted positively the establishment of benchmarks. Also significant for a number of observers are various communications and liaison initiatives; many noted favourably efforts to communicate with and inform the public and stakeholders.

In terms of financial performance, stakeholders are less favourable towards the Investment Board, though sympathetic in light of various circumstances. It would be safe to say, however, that for most of those who offered an opinion on financial performance, they feel it is either too early to make a sound judgement or that the performance is decent given a difficult economic climate. In general, stakeholders are sympathetic when assessing financial performance, but a few are critical, suggesting the Investment Board should have been more active when markets began to sour. Others noted operational constraints, especially the foreign property rule, but also the difficulties associated with being a large pension fund and having to work within parameters establish by governments.

Measuring Success

It is evident that the stakeholder community will measure the Investment Board's success on a number of different levels, financial and otherwise. There are three key levels upon which stakeholders measure success:

- investment performance
- communications
- independence

Without question, meeting investment objectives over both the long and short terms were mentioned by virtually all those who offered a response on this issue. At the same time, it was equally common for them to speak to other measures of success — success is not simply a bottom line issue, not even for those in the financial community. (Financial planners and actuaries are indeed focused more on bottom line results than most others, but by no means exclusively so.)

Virtually all stakeholders feel some measure of investment performance is crucial. While short term measures against benchmarks or other pension funds were mentioned frequently, the most critical factor for most stakeholders is meeting the board objective of making the CPP more secure. Many simply stated that it is too early to measure success; that it must be measured over the long term. Improving the long term security of the CPP is a given for most when thinking about measuring the Investment Board's success.

Outside of investment performance, communication was the most commonly held measure of the Investment Board's success. This includes reporting to the public, helping them understand the Investment Board's activities and objectives, building public confidence, as well as engaging in public and stakeholder consultations.

Almost as important as communications and disclosure or transparency, is the need for the Investment Board to maintain its independence. Many cited the need to "stay the course" and not bend to various pressures. There is a strong sense among many individuals that the Investment Board must stick to its governance procedures and policies as well as its mandate. Certainly, success will be measured by many stakeholders in light of the Investment Board's ability to prepare itself to resist being pressured once the value of assets grows.

Outside of these three areas, labour stakeholders stood out in measuring performance against things that would involve some fairly major changes, including revisions to the mandate (particularly as it pertains to allowing social investments), changes to the selection criteria for directors, as well as contributing to the Canadian economy and creating jobs

Views on Investments

Key Findings

Investment Strategies

- There are real divisions between stakeholder groups on issues of investment strategy
  - on the one hand, is the view (most firmly held by actuaries, financial planners and most public policy stakeholders) that the Investment Board should focus on maximizing returns
  - on the other hand, there are those (principally labour stakeholders) who feel the Investment Board should use its investments to achieve social policy objectives
- While most stakeholders support equity investing, approximately half of the labour stakeholders oppose the move because it represents unnecessary risk and a loss of funds for achieving social policy objectives
- Most stakeholders support the Investment Board's move into active investing
  - in general, active investing is supported as long as there is proper monitoring and measurement of performance
  - some feel active investing opens the door to considering broader social, economic and political goals with investment decisions — this view results in both support (principally with some labour stakeholders) and opposition
- Investments in private equities raise warning flags
  - the overwhelming majority of stakeholders support investment in private equities, but cite issues that are different from investments in public markets
  - the practical difficulty of finding appropriate benchmarks is an issue
  - the Investment Board's growing size in the private equity market may bring new pressures (e.g., private sector pressure to support particular investments, labour stakeholders and others may press social investments, politicians may be tempted to meddle)
- Real estate is a term with different meanings
  - the great majority of stakeholders support investments in real estate, but for different reasons
  - many see real estate as a good long-term investment that is appropriate for pension funds
  - a number of labour representatives think of real estate as social housing and other forms of public infrastructure whereas others see it as income generating investments
  - many stakeholders view real estate as a category of investment that requires special expertise to avoid market losses and political interference

Social Investing

- ❖ There are significant divisions on the issue of social or ethical investing
- ❖ Attitudes to social investing reflect broader political values ranging from opposition to soft support to firm support
  - — on the one hand, there are those who are adamantly opposed to the Board implementing social policy through its investment strategies and feel the mandate is entirely appropriate and should not be compromised — most actuaries, financial planners and several public policy stakeholders
  - — on the other hand, are those stakeholders who want the Investment Board to do just that — principally labour, as well as a few pensioner and public policy stakeholders
  - — in the considerable middle, are those who fully support the idea of maximizing returns, but feel it should done with some guidelines that reflect the core values of Canadians
- ❖ Those with soft or firm support for social investing (or ethical screens) do not see obtaining high returns and investing in a "socially responsible" or ethical fashion as mutually exclusive; a number of these stakeholders are unclear about what is meant by "maximizing returns"

Supporting the Canadian Economy

- ❖ Opinion is split on the Investment Board's responsibility for supporting the Canadian economy
  - — in a forced vote, all the actuaries and financial planners say that CPP funds should be invested to maximize returns whether or not in Canada
  - — all but one labour stakeholder and some pensioner and public policy stakeholders say CPP funds should be invested in the Canadian economy "even if it means lower returns" (a proposition many call into question)
- ❖ The limitation on pension funds investing outside Canada is a contentious issue
  - — as pension funds grow, many stakeholders consider the current constraints will become unbearable given the size of Canadian markets
  - — others, particularly labour stakeholders, feel the limitation should either remain or be further restricted to ensure the funds are invested to support the Canadian economy

Investment Strategies

Investment strategies (or, more precisely, investment decisions) may prove to be an area of considerable debate and controversy for the Investment Board. Unlike many of the findings presented to this point, investment strategies reveal clear differences between stakeholder groups. While there is broad support for each initiative, the differences between why one group and another support them can be striking. (Please not that the questions in this section were not asked of pensioner stakeholders.)

The key findings from this portion of the research reveal:

- ❖ Stakeholders agree at a broad level with different investment strategies presented to them, but are divided on their reasons. It is at the level of particular investment decisions where this division may give rise to considerable debate rather than at a strategic level.
- ❖ Two sharply opposed standpoints emerge with respect to investments: a number of stakeholders consider that the sole focus of the Investment Board should be on ensuring the long-term stability of the CPP for future beneficiaries. Others, notably labour stakeholders, perceive that the funds are more public in nature and should be directed to achieving social goals.
- ❖ This latter point is particularly important when considering views on active investing. While most stakeholders from all groups agree with more active investing, the reasons are quite different.
    - — many stakeholders simply feel it will allow the Investment Board to better maximize returns
    - — other stakeholders feel it opens the possibility for the Investment Board to target investments for broader social, economic and/or political objectives (this view leads some to support active investing, but others to oppose it)
- ❖ There are definite concerns about some types of investments (e.g. private equities, infrastructure), both in terms of risk and potential political consequences.

Equity Investments

With the exception of some labour stakeholders, there is broad agreement with the Investment Board investing solely in equities at the current time (Table 8). There is a general understanding, however, that this is a temporary situation. As one actuary said: "I agree for the moment until they bring the aggregate portfolio into a balanced pension fund, " a view echoed by a financial planner: "The Board has some catching up to do. I'm assuming the Board will also be diversifying more as its assets increase."

Table 8: Agreement with Equity Investing

Group	Yes	No	Don't Know
Actuaries	7	--	--
Financial Planners	6	1	1
Public Policy and Advocacy Groups	9	--	1
Labour	5	7	--

Q: How do you feel about the Investment Board investing solely in equities? Are you in favour of this kind of activity?

Some labour representatives express the contrary view. One stated a philosophical objection to equity investing: "The Board doesn't need to be there at all. CPP has been invaluable for providing infrastructure money to provinces at bond rates. We think this role should stay." A number of labour stakeholders feel that the decision to move into equity investments represented a major policy reversal away from a traditional focus on social investments through government bonds.

One labour representative expressed the dilemma that he and his colleagues perceive in this situation, a position that can be expected to sharpen as the fund grows in market size: "Should the policy be to grow the funds in terms of assets? And I believe the answer to that question is yes. But I also think it should be a tool of public policy to help us realize the goals that we hold as Canadians and as a government. To limit it solely to a very narrow band of activity is, I don't think, the way to go. When you're talking of a fund in excess of $130 billion… it could be potentially a huge public policy instrument."

Active Investing

Most stakeholder groups support the change that allows the Board to be an active investor (Table 9). An actuary commented: "It's a bold move. They have the courage of their convictions." Broad support comes from professionals who feel that passive index investing has earnings limitations.

Table 9: Agreement with Shift to Active Investing

Group	Yes	No	Don't Know
Actuaries	7	--	--
Financial Planners	7	1	--
Public Policy and Advocacy Groups	7	2	1
Labour	10	2	--

Q: Until recently, the Investment Board engaged in only passive investments through indexed funds. As they move forward, the Investment Board will begin to use a mixture of passive and active investment strategies. Are you in favour of this kind of activity?

Despite this broad support, there are a few caveats. There is general recognition that active investing requires additional skills, measurement and controls because of the increased risk.

Several observers wonder about the true value of active investing. A public policy stakeholder hesitated to support the idea because "active investing can be lots of effort without lots of rewards. Thus I'm not really in favour of it. Costs would go up." On the other hand, a financial planner offered this assessment: "I would like to see more allocated to active management and less to passive management. The only advantage to passive investing is lower costs, but costs aren't really an issue with such a large fund as the CPP."

People who are close to the issue stress the importance of the "right controls" as the Investment Board moves into this kind of activity. An actuary stated: "I'm in favour as long as they have a way to measure their active investments. They need proper monitoring and measurements of their performance."

Most labour stakeholders also favour this kind of activity because they feel it will help improve investment performance. Yet others, including some public policy stakeholders, feel it will allow for various social, political or ethical considerations. As one labour stakeholder put it, "I'm in favour as long as it's done with ethics. I would hate to see us investing in some kind of activity that supports or relies on child labour or sweatshop activity. So long as it's an ethical approach, then yes, I think it's a good idea." It would appear that moving towards more active investing may open the door somewhat wider to consideration of broader social, economic and political objectives in the formulation of investment decisions. It was precisely for this reason that some stakeholders vehemently opposed active investing, feeling it may lead to political pressures.

Investing in Private Equities

Another area of investment strategy that gives rise to concerns about political issues is private equities. Despite such concerns, most stakeholders from all groups support the initiative (Table 10).

Table 10: Agreement with Investing in Private Equities

Group	Yes	No	Don't Know
Actuaries	7	--	--
Financial Planners	7	1	--
Public Policy and Advocacy Groups	9	1	--
Labour	8	3	1

Q: How do you feel about the Investment Board investing in private equities? Are you in favour of this kind of activity?

Although there is widespread agreement with the idea of investing in private equities, it gives rise to a number of concerns and divisions. Some respondents recognize that investment in private equities leads to a different degree of involvement in the market from purchasing public equity, either passively or actively. This raises issues for stakeholders, some technical and some philosophical.

A simple technical matter (though a difficult one to solve) is how to benchmark performance. An actuary commented: "This is a newer asset class that offers new returns, but you need to be able to know how well you are doing."

There is also recognition that the Investment Board's position in the market will change as it becomes more of a player. One actuary had concerns because "they could end up owning every private firm in Canada," and a policy group stakeholder added: "If you are going to invest in private equities, you have to be prepared to play an ownership role. You're no longer a passive investor."

The underlying concern among a number of observers is that private investments will drag the Investment Board into the political arena. As one actuary stated: "That's where a lot of undue political pressure could come from," a comment echoed by a public policy stakeholder: "The Board could be subject to unseen political interference when making these kinds of investments, such as choosing privileged funds or choosing things that could benefit supporters of the government. This is very problematic."

Labour stakeholders have concerns about the need to conduct this kind of activity within a socially responsible context, that all investments should be fully disclosed, not unduly loaded in foreign hands, and they should be screened "so that it's not lining somebody's pockets."

It is apparent from these comments, that many stakeholders do not judge private investment activity solely on its investment merits. If people support the concept of having the Investment Board, they are almost certain to approve of passive index investing; and even active equity investing in public markets, still a fairly transparent activity. Private equity investing, on the other hand, is seen as a different game with different rules and new challenges.

Investing in Real Estate and Infrastructure

Another area of investment strategy investigated was investing in real estate and infrastructure projects. As with most other investment strategies, stakeholders from all different groups are supportive of the idea to invest in real estate and infrastructure (Table 11).

Table 11: Agreement with Investing in Real Estate and Infrastructure

Group	Yes	No	Don't Know
Actuaries	7	--	--
Financial Planners	6	2	--
Public Policy and Advocacy Groups	8	2	--
Labour	11	1	--

Q: How do you feel about the Investment Board investing a portion of its assets into real estate and infrastructure projects? Are you in favour of this kind of activity?

Similar to findings with other investment strategies, most stakeholders are in favour of investing in real estate and infrastructure, but for differing reasons. As one labour representative said:

> "I actually think this is probably a wise idea. I believe that real estate investment is probably a more solid investment in the long run. That is something that gives this Board an advantage – they do have a very long window to look at. In the long run, real estate, especially not passive real estate but real estate that generates income, is a really good idea. It's lower risk by far than venture capital, and it provides some return on investment on a yearly basis."

Although all but one of the labour stakeholders favour this type of investment, it is not usually for the same reasons as the representative quoted above. Their idea of real estate is something quite different and generally reflects their support for public infrastructure projects – "for social housing investment, not for malls." As one labour representative said: "Municipalities are in strong need of infrastructure funding. This is needed to build healthier and safer societies and communities, which of course leads to healthier Canadians and reduced health care costs."

In this view, public infrastructure moves not only into reduced health care costs, but other forms of social good if carefully handled – "we can afford to use long-term capital to create some stability in our economy and communities." By the same token, it should not be used for a reactionary social policy – "investing in real estate that has the effect of pricing people out of the market, in excessively expensive housing or property and plant that ordinary Canadians can't afford or benefit from. I wouldn't be in favour of that."

The opinions of other stakeholders about real estate investments are more scattered. Many think they are a normal part of any pension fund's portfolio and support it on that basis alone. One public policy representative stated: "It's fine as long as the investments are well selected and well managed, and continue to be a relatively modest portion of the total." Another from the same group considered real estate to be "almost a must investment, and alternative investment strategies, such as hedging, could also be investigated. Every investment alternative should be considered by the Board."

Some technical issues are mentioned, such as the need to have the appropriate expertise in place, because real estate can have a "huge downside risk." An actuary pointed to the practice of a large pension fund whereby they manage the bulk of real estate investments internally, outsourcing only US and international investments.

There are also some concerns about the politics of real estate and infrastructure investments that mean that the Investment Board has to be "extra-careful" and there are "worries about public/private sector partnerships that the [Investment] Board will attract." At the heart of many of these worries is the political one. "Real estate could be part and parcel of a government infrastructure project, and then the arm's length relationship is severed," according to a public policy stakeholder. A financial planner even thought "the [Investment] Board should stay away from infrastructure projects because the dangers of political interference are too great."

Like the other new asset classes, real estate is mostly favoured as a place for the Investment Board to expand its investments, but for widely different reasons. All the reasons labour and a few of the public policy stakeholders support the Investment Board expanding into various new investment areas are precisely the reasons the financial professionals warn they should stay clear.

Comparing Strategies with Other Pension Funds

Labour and public policy groups were specifically asked to compare the Investment Board's mandate and strategies with that of other public sector funds. While most feel they should be similar, a significant number, particularly with labour stakeholders, see clear differences (Table 12)

Table 12: Similar or Different Investment Strategies

Group	Similar	Different	Don't Know
Public Policy and Advocacy Groups	7	2	1
Labour	5	5	2

Q: Do you think the Investment Board should have an investment mandate and strategies similar to or different from other public sector pension funds?

Perceptions of whether or not the Investment Board should be similar to or different from other public sector pension funds hinge around key structural differences that many perceive. There are two such differences that virtually all of those who feel the Investment Board's mandate and strategies should be different: the mandatory nature of contributions; and the CPP's broad national base of contributors.

Due to the CPP's national scope, many labour and a several public policy organizations hold that the Investment Board needs to take public expectations and issues of social responsibility into account in its investment decisions. As one labour stakeholder put it, "the CPP is a national pension fund of wide scope, and therefore has to have a national mandate." One labour stakeholder, reflecting a fairly prevalent view, states that, "CPP is a social programme! Thinking otherwise is toeing the government line. The best pension promise the government can make to younger people is to make sure there are jobs and that communities are healthy."

Some of the key reasons cited for similar strategies include the perception that public sector pension plans have done relatively well in the marketplace, and that these plans "are just beginning to come to grips with the role that they can play in the economy," as one respondent remarked. Both public policy and labour organizations who see similarities between the Investment Board and public sector plans consider the areas of corporate governance, economic development, and socially responsible investing to be ones where the Investment Board could play a leadership role.

Labour groups were also asked the same question with respect to their own pension funds. Seven feel the Investment Board's mandate and strategies should be similar to their own, the remaining five feel they should be different.

As with the above findings, although labour stakeholders differ as to whether or not the Investment Board's mandate and strategies should emulate those of their own fund, this was more a result of different perceptions and levels of satisfaction with their own funds, rather than an indication of strong differences in terms of investment strategies.[2] Many indicate that their own funds are presently working towards developing a social responsibility policy for investment strategies. Others indicate that they are highly dissatisfied with their own pension fund because it is not moving in this direction. Most of these stakeholders feel that the Investment Board should take a leadership role on this front.

Among those who cited differences, the financing structure and national scope of the CPP were again mentioned as aspects that distinguished the CPP from respondents' own pension plans. One respondent added a further dissimilarity in terms of investment strategy: "I don't expect trade union pension plans to restrict themselves to public sector investment. But we do expect the CPP to have as its primary purpose to develop a pool of capital for borrowing across the broader public sector inside Canada."

Social Investing

Perhaps one of the most contentious issues that will face the Investment Board as it becomes more publicly visible, social investing produces clearly distinct positions between different individuals and especially labour and other stakeholder groups.

Key findings from this portion of the research include:

- ❖ There are significant divisions on the issue of social or ethical investing
- ❖ Attitudes to social investing reflect broader political values ranging from opposition to soft support to firm support
  - — on the one hand, there are those who are adamantly opposed to the Board implementing social policy through its investment strategies and feel the mandate is entirely appropriate and should not be compromised — most actuaries, financial planners and several public policy stakeholders
  - — on the other hand, are those stakeholders who want the Investment Board to do just that — principally labour, as well as a few pensioner and public policy stakeholders
  - — in the considerable middle, are those who fully support the idea of maximizing returns, but feel it should done with some guidelines that reflect the core values of Canadians
- ❖ Those with soft or firm support for social investing (or ethical screens) do not see obtaining high returns and investing in a "socially responsible" or ethical fashion as mutually exclusive; a number of these stakeholders are unclear about what is meant by "maximizing returns"

Adhering to the Mandate

After being reminded again of the Investment Board's legislated mandate, respondents were asked to identify any problems such a mandate might pose in relation to the investment of public funds. As is clearly evident from previous discussions about investment strategies, labour stakeholders generally sit on one side of the fence, and most other stakeholders on the opposite side (Table 13).

[2] It should be noted that most of the labour stakeholders interviewed worked with larger federations and national offices for various organizations. As a result, they work on broad policy issues relating to pensions and not so much with their own organizations' pension funds.

Notably, every group except actuaries and pensioner stakeholders are more or less firmly decided on this issue.

Table 13: Problems with Mandate

Group	Yes	No	Don't Know
Actuaries	--	4	3
Financial Planners	1	6	1
Public Policy and Advocacy Groups	--	10	--
Labour	10	1	1
Pensioners	1	--	2

Q: The Investment Board has a legislated mandate to maximize returns without undue risk of loss. The legislation prohibits the Investment Board from investing for any purpose other than maximizing returns. Do you feel this creates any problems for the Investment Board, given that they are investing public funds?

Almost all public policy groups and financial planners hold that the Investment Board's mandate is "entirely appropriate," with many in both groups underlining that the Investment Board's main purpose is to ensure the viability of the CPP and its responsibilities to beneficiaries. Financial planners especially were almost unequivocal in their approval of the mandate, and could not see any other purpose for the Investment Board other than to maximize returns. The one financial planner who did foresee problems was concerned only that the Investment Board was not emphasizing the avoidance of unnecessary risk as a counterbalance to the maximization of returns. A few public policy stakeholders suggested that the question alludes to an incompatibility between return maximization and socially responsible investing, adding further that they feel the two goals are not mutually exclusive.

Actuaries and pensioners' groups are less certain with respect to the potential for problems. Those actuaries who saw no conflict considered CPP funds to belong to contributors and beneficiaries, and are thus not 'public'. One specifically cited the independence of the Investment Board from government as a condition for avoiding future problems. But another actuary did not believe that CPP funds can be separated from government, and is thus unsure as to whether or not problems would be created. However, this stakeholder also holds that the Investment Board's mandate was acceptable.

Pensioner stakeholders are unclear as to whether or not the requirement to maximize returns precludes the question of ethical investing and whether or not there was a role for the Investment Board to play in national economic development (the Caisse was cited as a model to be investigated)

The vast majority of labour stakeholders feel that problems will arise due to the Investment Board's mandate and the public nature of CPP funds. These stakeholders consistently consider CPP funds to be public funds, and therefore strongly emphasize the importance of socially responsible or ethical investing. As one respondent put it, "when it comes to public money, ethical considerations should be amongst the highest, if not *the* highest [consideration for investing]." In addition, some respondents specifically express concerns that CPP funds could be invested in a manner leading to a loss of jobs and reduced wages. The only stakeholder who does not feel that there are conflicts believes that there is ample room for the Investment Board to overlay the mandate of maximizing returns with other considerations, notably ethical ones.

A number of respondents from almost every group specifically mentioned that investments in good, socially and even ethically responsible companies would certainly contribute to, rather than impair, the Investment Board's mandate of maximizing returns without undue risk of loss.

Expectations

The issue of social investing, which many stakeholders across all groups introduced into their answers for other questions, was posed to interviewees in terms of whether or not the Investment Board should be expected to take into consideration the views of different groups and individuals when making its investment decisions. Most actuaries, financial planners and public policy stakeholders feel that social, political, and religious views should not play a role in investment decisions (Table 14). Conversely, almost all labour stakeholders and a number of public policy and pensioner groups feel the opposite way.

Table 14: Expectations to Engage in Social Investing

Group	Yes	No	Don't Know
Actuaries	--	6	1
Financial Planners	--	5	3
Public Policy and Advocacy Groups	3	6	1
Labour	11	1	--
Pensioners	2	1	--

Q: Given their mandate to maximize returns, can the Investment Board be expected to reflect the social, political and religious views of different groups or individuals when making its investment decisions?

Actuaries are most clear that the Investment Board cannot address issues of social investing in its investment decisions as this would be seen to compromise the Investment Board's mandate. Not surprisingly, most financial planners share this sentiment. Several financial planners — and the one actuary who was ambivalent on the question — also cite the great difficulty in deciding among the range of ethical concerns that would have to be addressed by the Investment Board, if it chose to embark upon this route. At the same time, even financial planners who emphasize the mandate of maximizing returns suggest limits on the certain kinds of investments. For example, these respondents mentioned domestic or international investments contributing to environmental degradation, poor human rights, and exploitation of child labour as ones that probably should be avoided. The three financial planners who are unsure of their responses to the question could not resolve this tension between reaching financial objectives and setting some ethical limits on investing.

The responses to the question of social investing among public policy groups are largely a function of where each group sits on the political spectrum. Those more on the political right feel that the Investment Board's mandate is exclusively to maximize returns and fulfil responsibilities to beneficiaries. In their view, the very idea of ethical investing or corporate responsibility is "nonsense." In contrast, those groups in the centre or on the political left generally believe that at least some ethical considerations need to be taken into account when investing and that social investing is not inconsistent with earning good investment returns.

Consistent with earlier findings, representatives from labour organizations had the most to say on this question, with almost every stakeholder agreeing that the Investment Board needs to take social and ethical investing into account in its decisions. The lone labour respondent who disagreed did so because of the phrase 'religious views', while at the same mentioning that "social objectives need to be part of the investment strategy." Essentially, labour organizations strongly hold that investments should reflect the core values of a broad majority of Canadians. Investments in social and economic development are also seen as desirable for a number of labour stakeholders. Echoing similar comments from members of other groups, a few labour organizations do not see a conflict between good investment return and social investing. They do, nevertheless, note the difficulty in reconciling the wide range of values that would have to be considered.

Types of Investments

As a follow-up to questions on social investment, all respondents were asked about the kinds of investments they felt the Investment Board should be making. Most financial planners and actuaries are satisfied with the Investment Board's investment planning, while some underlined that the organization needs the "broadest possible mandate" in terms of investing. Most also advise cautious and prudent investing supported by careful research and diversification strategies. At the most extreme, one planner thinks it might be best for the Investment Board to stay with investments in stock indexes in order to avoid any perceptions of political interference. In general, most public policy and pensioners' groups feel that investments should be made only to maximize returns, although two respondents add that this should be done within the context of ethical guidelines or screens.

As seen previously, many labour stakeholders are not averse to equity and venture capital investments — within ethical guidelines. Their suggestions focus on ways in which CPP funds can be "an exciting possible tool to support public policy" and promote Canadian social and economic development. Suggested areas of investment include: infrastructure (e.g., transportation, water, sewer, electric power); environmental clean-up; venture capital (including microcredit); real estate development; social housing; and, regional and community economic development. A number of public policy stakeholders likewise echo a desire for investments to promote the growth of the Canadian economy.

Supporting the Canadian Economy

Responsibility for Investing in Canada

To help clearly distinguish between those who support the mandate and those who feel other objectives should be involved in investment decisions, stakeholders were provided with a forced choice question between the mandate and investing in the Canadian economy "even if it means lower returns." All of those who have uncertainties about either problems with the mandate or whether or not the Investment Board should be engaging in social investing fell in with the mandate when forced to choose between the two (Table 15).

Table 15: Maximizing Returns or Supporting the Canadian Economy

Group	Invest Solely to Maximize Returns	Invest to Support the Canadian Economy
Actuaries	7	--
Financial Planners	8	--
Public Policy and Advocacy Groups	7	3
Labour	1	11
Pensioners	1	2

Q: Some people might feel that the Investment Board has a responsibility to invest in Canadian businesses to support the Canadian economy and contribute to job growth. Which of the following two statements is closer to your own point of view?
a) CPP funds should be invested solely to maximizing returns regardless of whether or not the investments are in Canada.
b) CPP funds should be invested in Canadian businesses even if it means lower returns.

As in the questions related to social investing, responses are consistent across groups. Actuaries and financial planners unequivocally think that the Investment Board should invest to maximize returns. Among those respondents in these groups who offered comments on their selection, a fear of political manipulation and the concern with a good return on investment inform their choice.

Labour and most public policy and pensioners' groups hold that CPP funds need to be invested primarily in Canada. Four respondents (primarily from labour organizations) took issue with the framing of the options. For them, it is by no means a given that investing in the Canadian economy necessarily implies lower returns on investment.

The Foreign Property Rule

Foreign property restrictions is a significant issue for many stakeholders. As discussed earlier in this report, there is serious concern that it will create a significant imbalance in Canadian equity markets once the assets grow to their expected size. On the other hand, many others feel that if it were relaxed it would have a deleterious effect on the Canadian economy and result in job loss.

Stakeholders were asked the extent to which they agree with the foreign property rule. While there are stakeholders from almost all stakeholder groups who agree and those who disagree with the rule, actuaries, financial planners and public policy stakeholders express higher levels of opposition, and labour and pensioner stakeholders show higher levels of support (Table 16).

Table 16: Foreign Property Rule

Group	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
Actuaries	4	1	--	2	--
Financial Planners	4	3	--	--	1
Public Policy and Advocacy Groups	3	2	3	2	--
Labour	1	3	--	3	5
Pensioners	--	--	--	2	1

Q: Legislation currently stipulates that 70 percent of any Canadian pension fund assets at cost must be invested in Canada. How much do you agree with this policy?

Although those who agree do so for similar reasons (namely, to support the Canadian economy), stakeholders who disagree with the foreign property restriction do so for entirely opposite reasons. On the one hand, actuaries, financial planners and public policy stakeholders disagree because the foreign property restriction is too high. Conversely, labour stakeholders generally disagree because it is too low. Those who feel the restriction is too severe feel the small size of Canadian markets and the need for diversification, requires more investment outside Canada in order to realize good returns. In contrast, those who feel it is too low think Canadian pension funds should be principally — if not solely —invested to benefit the Canadian economy and, in turn, working Canadians.

Confidence and Market Volatility

Key Findings

Meeting the Canada Pension Plan Promise

- ❖ The Investment Board is off to a reasonable start in building confidence that it can improve the long-term stability of the CPP
  - — more stakeholders say they are confident that the Investment Board will make a difference than express doubts
  - — any lack of confidence relates to the mandate (labour) and market conditions rather than to the Investment Board itself
- ❖ Most are unconcerned about the level of risk the Investment Board will have to assume to meet its objectives
  - — most stakeholder groups are not overly concerned about the risk the Investment Board will have to take to meet the Chief Actuary's projections
  - — nevertheless, a number of stakeholders from each group expresses concerns about the level of risk that will need to be taken to meet the broad investment objectives
  - — concerns about risks are more prevalent with labour stakeholders, some expressing the view that the very risk of transferring funds from bonds to equity was unnecessary in the first place

Market Volatility and Public Confidence

- ❖ In general, stakeholders understand market volatility and are not overly concerned about it
  - — the majority of stakeholders express no concern about short-term fluctuations in value, and almost all the rest are only slightly concerned
  - — a number of stakeholders warn the Investment Board not to worry about quarterly results but to keep its focus on the longer term
- ❖ There is a high tolerance for loss that relates to the overall performance of the market
  - — multi-year losses or performance consistently below benchmark would be grounds for concern

Reporting, Disclosure and Public Confidence

- There is an overwhelming conviction that transparency will enhance public confidence in the Investment Board's activities
- Full disclosure should consist of organizational structure as well as investment performance and portfolio details
  - organizational structure includes policies, objectives, background about directors and staff, outside managers, fees and minutes of significant conferences and meetings
  - full investment information should be available to those who want it
- Stakeholders offer suggestions about ways to deal with the need for quarterly reporting
  - the Investment Board is advised to keep a longer term focus and report results in the context of longer term performance
  - ensure that contributors and beneficiaries are well informed and educated about the nature of the fund
  - report openly and completely

Meeting the Canada Pension Plan Promise

Fundamental to the Investment Board's very existence is its ability to help ensure the long-term stability of the Canada Pension Plan. Should confidence wane in the Investment Board's activities it could jeopardize overall confidence in its ability to help meet the CPP promise. This section of the report explores stakeholders' views with respect to both confidence in meeting the Investment Board's broad objective and concerns about the risks assumed in meeting this objective.

Several key findings emerge from this portion of the research:

- Reflecting the generally positive views revealed throughout the report, the Investment Board is off to a reasonable start in building confidence that it can improve the long-term stability of the Plan.
- Most stakeholders are not concerned about the risks the Investment Board will have to assume, but a number from each stakeholder group does express concerns.
- Concerns are more prevalent among labour stakeholders. In part, this results from the view that the increased risks associated with equities on the whole are unnecessary for sustaining the long-term health of the CPP.

Confidence in Meeting the Broad Objective

The ultimate measure of confidence in the Investment Board is undoubtedly whether or not it will meet the broad objective of improving the long-term stability of the CPP. Accordingly, respondents were asked how confident they are in the Investment Board meeting this broad objective. Overall, confidence is strong, but not overwhelming. With the exception of labour, most stakeholders from all other groups feel either confident or "very confident" (Table 18).

Table 18: Confidence in Helping to Stabilize the CPP

Group	Not at all confident	Not too confident	Somewhat confident	Confident	Very confident	Don't know
Actuaries	--	--	--	5	2	--
Financial Planners	--	1	1	3	3	--
Public Policy and Advocacy Groups	--	--	2	5	3	--
Labour	1	2	4	2	--	3
Pensioners	--	--	1	2	--	--

Q: Given what you know of the Investment Board, how confident are you that its investment activities will improve the long-term stability of the CPP — very confident, confident, somewhat confident, not too confident, not at all confident? Why do you say that?

These findings are indeed encouraging and a good starting point — it is clear based on discussions that most feel the Investment Board is off to a very good start, despite less than favourable circumstances.

Actuaries are the only group in which all respondents rated their confidence at the two highest points. This is no doubt significant given this is a group whose profession it is to render projections.

Labour groups are the least confident with only two at the high end and several at the low end. It is clear based on these findings, as well as subsequent discussions, that the Investment Board has some distance to travel if it wishes to secure the confidence of labour.

A number of key factors enter into the thinking of those who have strong levels of confidence. It is evident from discussions that, for most of this group, the Annual Report made a favourable impression. Reasons cited for confidence include:

- The long-term investment focus.
- Investment policies, strategies and previous investment decisions
- Expertise from the Board of Directors, management team and external managers. "I get the impression from the Annual Report that these are professionals who know what they're doing."
- Independence and governance policies safeguarding independence
- Reporting and communications practices/policies

These views could be found to some extent with virtually all stakeholder groups, although actuaries and financial planners are inclined to focus on investment strategies, professional expertise, and independence.

Other reasons cited by a number of individuals include the clarity of the mandate, confidence that markets will improve over the long-term and, as one respondent suggested, the high profile that will come with increased size will ensure a high level of scrutiny of the Investment Board's activities.

Yet even those who demonstrate a high level of confidence express concerns. Most who do are fairly confident that the Investment Board will meet its broad objective, but nevertheless offered some cautionary remarks. Such remarks include:

- concerns that the level of compensation for directors is too high
- a feeling that a small staff could leave the corporation vulnerable if a key person were lost
- the ability of the Investment Board to move in a relatively small capital market
- market instability

Those few who have little or no confidence in the Investment Board's ability to help ensure the long-term stability of the CPP are concerned with the risks associated with equity markets. This includes the Investment Board's approach to markets, the manageability of market risks in general and concern over private equities.

A number of labour stakeholders feel that the Investment Board was unnecessary in the first place and that the Plan would have been stable without the move to equity investments. For these stakeholders, the Investment Board represents unnecessary risk.

Concerns about Assumed Levels of Risk

Assuming risk is one of the principal factors that may undermine public confidence as the Investment Board establishes its investment activities, stakeholders were questioned specifically on this issue following a series of questions addressing some potential investment strategies of the Investment Board. Stakeholders who are not concerned outnumber those who are in every group with the exception of labour stakeholders (Table 19).

Table 19: Concerns about Risks Associated with Meeting Actuarial Projection

Group	Yes	No	Don't Know
Actuaries	2	5	--
Financial Planners	2	6	--
Public Policy and Advocacy Groups	2	8	--
Labour	8	3	1
Pensioners	--	2	1

Q: The Investment Board will have to earn a fairly high level of return on investment in order to meet their long-term objective. Are you at all concerned with the level of risk they will have to assume to do that? [Question worded differently for actuaries: "The Investment Board has projected a 4.65 percent real rate of return on the Investment Board's equity investments over the long-term. Are you at all concerned …"]

Those who are not concerned about the level of risk the Investment Board may assume, feel the investment objectives are reasonable and that it is prudent to be focusing on long-term results. As one financial planner stated, a long term outlook means "volatility is your friend." Other factors influencing respondents' confidence regarding risk include:

- a sense that the Investment Board is approaching risks in a gradual and prudent fashion
- the view that by building up a reserve of funds over the next twenty years, short-term volatility will not jeopardize the ability of the CPP to pay benefits
- placed in an historical context, the projected rate of return is conservative

Those who expressed concerns about risk have concerns that markets will not perform as well as they have in the past and that the projected rate of return implies a high level of risk.

Several labour stakeholders feel that the risk involved in equities as a whole are unnecessary, arguing that the crisis with the CPP has been overstated and that there was no need to move into equity markets.

Actuaries were also asked whether or not they felt the 4.65 rate of real return based on projections by the Chief Actuary is a realistic goal or "doable." Results are identical to those for concerns about risk with five feeling it is doable and two indicating that it is not. Each of those who feel the projected rate is realistic focus on historical trends and feel that the Chief Actuary was conservative in his projections. Conversely, one of those who said it is not doable interprets historical trends differently, suggesting that the rate is high relative to past performance. The other dissenter objected to the length of the projections, indicating that 75 years is far too long into the future and that projections should have been based on a 15 year outlook.

Market Volatility and Public Confidence

There is significant potential for market volatility to erode both stakeholder and public confidence in the Investment Board. Accordingly, the study investigated stakeholders' concerns about market volatility as well as the level of tolerance they may have for losses.

Three key findings are revealed through this part of the study:

- Stakeholders generally have a sound understanding of the relationship between short-term volatility and long-term market stability.
- There is a high level of tolerance for short-term losses, although this varies both in terms of the level of loss and the timeframes involved. Sustained multi-year losses or poor performance would certainly cause widespread concerns and an erosion of confidence.
- Labour stakeholders express concerns about losses more due to the potential it offers critics of the CPP to use it as political capital in their opposition to the plan rather than concerns about the losses themselves (although this is not absent).

Concerns about Market Volatility

As already alluded to, stakeholders appear to possess a sound understanding of the trade-off between short-term volatility and long-term returns in equity markets. In the context of earnings focused on a 20-year or greater outlook and the need to report quarterly, stakeholders were asked whether they would be concerned if the Investment Board might make or lose billions of dollars in a quarter. Placed in this context, stakeholder express even lower levels of concern about potential investment losses (Table 20).

Table 20: Concerns about Market Volatility

Group	Not very much	A little	A lot
Actuaries	5	2	--
Financial Planners	8	--	--
Public Policy and Advocacy Groups	7	2	1
Labour	3	9	--
Pensioners	3	--	--

Q: The Investment Board is focused on earning returns over at least 20 years, yet it is required to report results quarterly. Given the short-term volatility of equity markets, the Investment Board stands to make or lose billions of dollars in market value in each quarter. Does this concern you?

It should be understood that while some labour stakeholders are uncomfortable with equity markets in general, market volatility *per se* is not necessarily the primary concern here. As one labour stakeholder put it: "Anything that allows critics of the fund to try to discredit it on the basis of financial stability is of concern. The CPP is a very important programme for the labour movement, and it has been allowed to become a kind of whipping boy." The feeling expressed by many in this group is that the media and other "mischief makers" will sensationalize poor quarterly results as an opportunity to discredit the CPP.

In general, stakeholders feel that quarterly loses are "no big deal." Of the few that elaborated on what small level of concern they may have, several were concerned that the quarterly reporting requirement may influence the Investment Board to lose sight of the long-term objectives. They likened this to the situation with public companies that focus on short-term results to appease shareholders. Others have concerns about the types of investments the Investment Board may include in the portfolio, point to private equities and derivatives as somewhat problematic.

Tolerance for Loss

Stakeholders were further probed in this part of the interview about what level of loss would give them cause for concern. It is evident that there is a high threshold of tolerance for short term losses among most stakeholders. This is particularly true of those working in the financial services sector, though by no means exclusively so. As one financial planner put it, "Despite 30% market decline over the past 23 months, I have great faith that the markets are coming back." Clearly, some have a higher level of tolerance than others.

Some stakeholders offered percentage figure losses that would give them cause for concern. These ranged from 10 percent of the portfolio to as high as 30 percent. But even here, these figures were qualified by most as longer term losses. Only a few expressed this in absolute dollar figures and of those who did, they demonstrated a remarkable level of unconcern. "If they lost the entire $12 billion right now,' said one labour stakeholder, "this wouldn't prevent the government from still issuing pension cheques, so I'm not really concerned that much."

The levels that would cause significant concern among stakeholders generally would be multi-year losses or performance that was consistently below benchmarks.

Reporting, Disclosure and Public Confidence

Disclosure and transparency are widely believed to be critical factors for ensuring public confidence in the Investment Board's activities. These issues were examined within the context of the Investment Board's quarterly reporting requirement.

This portion of the research reveals several key findings:

- There is an overwhelming conviction that transparency will enhance public confidence
- In keeping with strongly held views that transparency enhances public confidence, stakeholders are generally of the mind that disclosure should be as thorough as is reasonably possible.
- Stakeholders offer a number of suggestions on how to deal with the need for quarterly reporting and concerns it may generate due to market volatility. These include remaining focused on the long-term both in terms of reporting and investment activities, ensuring that contributors are well informed, and reporting openly and completely.

Quarterly Reporting and Maintaining Public Confidence

Stakeholders were requested to provide advice to the Investment Board on how to maintain public confidence in the face of reporting short-term losses. It should be stated at the outset that many feel quarterly reporting is overkill. This view emerged at a number of different places during the interviews and was strenuously emphasized by a number of stakeholders. Even those who expressed a strong belief in the importance of disclosure and transparency feel quarterly reporting to be somewhat excessive, particular in light of past reporting practices by the CPP. "In the past the CPP provided no reporting, so you don't have to go to the opposite extreme."

Nevertheless, stakeholders offered a number of suggestions on how to counteract the potentially negative consequences quarterly reporting may have on public confidence. Several commonly held views were offered as advice:

- ❖ By far the most common view is that short-term results must be placed within a broader context — both in terms of performance relative to the market or benchmarks and in the frame of a long-term horizon. "Keep focused on the long term and remind people that this stuff doesn't come out of anyone's pockets. This is merely something that bears out over 50 years. The point has to be made more forcefully. This is so counterintuitive to Canadians. … the Investment Board needs to keep hammering this point." It was also suggested that results should be compared to other large pension fund performance.
- ❖ Communications, public education and explanatory efforts are also considered by a wide number of stakeholders as a critical factor for maintaining public confidence. This will be discussed in greater detail below, but several key forms of public education and communications were repeatedly emphasized:
  - negative results should be understood relative to market
  - market dynamics — the ups and downs of markets; short-term volatility/long-term stability
  - investment strategies, decisions and the need for equity investments
  - workings of the CPP and how the Investment Board's activities fit into the broader picture
  - regular public and stakeholder meetings
  - using reporting as an opportunity to educate the public
  - transparency and disclosure — it is widely believed that transparency is a critical factor

Disclosure

Bearing in mind that the Investment Board has adopted a policy of full disclosure, stakeholders are asked what they expect full disclosure to include. Things stakeholders expect to be included with full disclosure fall into two broad categories: organizational structure and operations; and, investments. Given the restraints of time, respondents merely enumerated what they view as most important or top-of-mind items to disclose.

While there are differences in the amount of information provided through various mechanisms, it is appropriate to see stakeholders generally feeling that disclosure and transparency should be as thorough as possible. Given the widespread view that secrecy will give rise to suspicion, it is safe to assume that most stakeholders feel disclosure should include a wide array of information.

Stakeholders did not always state how various items should be disclosed but were cognizant that some would be included in reports and others merely made accessible (likely on the Investment Board's website).

Stakeholders expect full disclosure to include a high level of detail on the Investment Board's organizational structure and operations as well as information on investments. Clearly, not all respondents agree on the level of detail, but it is consistent across all groups that most of the following are expected to be included either through reporting or via some easily accessible mechanism such as the Investment Board's website:

Organizational Structure and Operations

- ❖ governance structure and policies (including conflict guidelines)
- ❖ broad objectives, vision and mission statement
- ❖ details on how the fund works and the way in which the Investment Board falls into the broader picture of the CPP
- ❖ detailed information about Board members, including: turnover, bios, remuneration, potential conflict relationships; links to political parties, holdings/private transactions
- ❖ key staff members and turnover reports
- ❖ information about outside managers — identity, terms of contracts or partnerships
- ❖ administrative costs and other operational expenditures, including transaction fees and premiums
- ❖ meetings and correspondence, including: Board meetings, correspondence with politicians and government bureaucrats, minutes of public meetings
- ❖ Compliance statement from an auditor

Investments

Many stakeholders feel there is a paucity of details on the Investment Board's investment portfolio and suggested that additional information is necessary to provide what they expect from full disclosure.

- ❖ most stakeholders indicated that information on the portfolio should include:
  - — asset mix
  - — amounts and types of investments
  - — rates of return on particular assets or groups of assets.
  - — transaction details by particular funds and companies
- ❖ Other information on investments that are expected include:
  - — performance reporting with comparison against "reasonable" benchmarks
  - — policies and guidelines
  - — decision making process (who makes what decisions, internal vs. external)
  - — strategies
  - — proxy voting guidelines or policies
  - — identification of private investments

Clearly, no stakeholders identified all of these various disclosure items. These are items that were repeated by a number of different stakeholders and they are listed in descending order of the frequency by which they were cited under each category.

Transparency and Public Confidence

Consistent with unprompted discussions of the issue earlier in the interview, there is widespread consensus that transparency will help to enhance public confidence in the Investment Board and its activities (Table 21). Only one stakeholder feels transparency would weaken public confidence.

Table 21: Transparency and Public Confidence

Group	Enhance	Weaken	Don't know
Actuaries	7	--	--
Financial Planners	8	--	--
Public Policy and Advocacy Groups	10	--	--
Labour	10	1	1
Pensioners	3	--	--

Q: Do you think transparency will help to enhance or weaken public confidence in its activities?

As one financial planner put it, "the more you know, the less you suspect." The overriding sentiment with respect to transparency is that it will help to enhance trust in the organization through a sense of openness and that the disclosure of information will ease concerns.

Other Issues with Public Confidence

At the conclusion of the interview, stakeholders were asked if there were any other issues facing the Investment Board that might have implications for sustaining public confidence. Perhaps a reflection of the thorough-going nature of the interviews, stakeholders were by and large unable to think of any issues that had not been addressed. As one public policy stakeholder said, "I think we've just about covered everything there is to cover."

Of the few who did raise other issues, this is what was found:

- One financial planner feels there may be opposition from the investment industry ("RRSP people") vis a vis their opposition to CPP.
- "They will have the problem that any public enterprise has — they are a target for the media to sensationalize. The media does it to everyone."
- The spectre of Enron – concerns about accounting malpractice, and the credibility of audits