Intelligence MEMOS

From: Bob Baldwin

To: Finance Minister Chrystia Freeland

Date: May 28 2024

Re: **Don't Handcuff Big Pension Plans to Canada**

Last month's budget unveiled a working group led by former Bank of Canada governor Stephen Poloz to collaborate with pension fund leaders to encourage funds to invest more of their assets in Canada.

This initiative is not consistent with the proper management of pension fund assets. It also lacks proper supporting evidence, is unlikely to be effective in achieving its objective except under one unacceptable condition and ignores the use of alternative tools to achieve its stated goals.

The legislation creating the Canada Pension Plan Investment Board includes a statement of "Objects and Powers" that summarizes the approach to investing consistent with fulfilling the fiduciary duty of the fund managers. The objects include: Assisting the Canada Pension Plan in meeting its obligations to contributors and beneficiaries; managing any amounts transferred and its right, title or interest in any designated securities, in the best interests of the contributors and beneficiaries under that legislation; and finally, to invest its assets with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the factors that may affect the funding of the CPP and its ability to meet its financial obligations on any given business day.

Almost identical wording was used to establish the objects and powers of PSP Investments, the public service plan.

Quite properly, the exclusive focus of these objects and powers is the best interests of plan members. After all, it's their money – now nearly $900 billion between the two plans. Notably absent from the objects and powers is any suggestion that investments be made to support a government's issue of the day.

I realize, of course, that the Finance Minister was urged to move in this direction in an unusual **open letter** from 100 senior business leaders. The proposal in the budget document can be viewed as a milder version of this letter. The **budget** talks about encouragement rather than compulsion, which is implied in the letter. But it still provides the wrong frame of reference for pension fund investors and is bound to create pressures for them to follow "encouragement" from the Poloz working group.

Notably absent from the letter and the brief discussion in the budget document is any evidence that Canadian pension funds are passing over good Canadian investment opportunities in favour of foreign investments. In the absence of such evidence, calling on Canadian pension funds to invest more in Canadian securities seems to suggest that they should accept concessional returns. It is hard to see how this is in the interests of the plan members.

The budget and the open letter share the goal of an increase in real capital investment, not simply about the purchase of securities. In fact, the letter persistently confuses the two. One might have hoped for some evidence that real capital investment projects are going unfulfilled because there are no takers for Canadian securities that would finance them – even if they offer globally competitive returns.

No evidence is provided in the letter or in the budget document on this matter. Without this evidence, asking pension funds to invest more in Canadian assets may have the same effect as pushing on a string: Canadian securities prices will go up, but nothing changes in terms of real capital investment.

Note, too, the effectiveness problem is only overcome if pension plans are forced into concessional investing. Being forced into concessional investing is an unacceptable outcome.

Even if it was possible to overcome the fiduciary responsibility problem – which is doubtful – why lean on pension funds to promote the government's objectives when Ottawa has so many other tools it can use: tax and regulatory law; the Canada Growth Fund; the Infrastructure Bank; the Business Development Bank of Canada; and so on.

If the government wanted to do something of value to pension fund investors and society in general, it would move ahead on the development of the taxonomy of climate transition investments as recommended by the Sustainable Finance Action Council. There is no conflict with fiduciary duty in this area. Nor is there any fiduciary duty problem with the other tools just mentioned.

Although it is unlikely to happen, we should scrap the working group to encourage pension funds to invest more in Canada or, at the very least, have a commitment that any recommendations from this working group will be consistent with the objects and powers of the CPPIB and PSP Investments. It is important to repudiate the view expressed in the letter that says: "Government has the right, responsibility and obligation to regulate how this [pension] savings regime operates." This view is totally at odds with the objects and powers of the CPPIB and PSP Investments.

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A version of this Memo first ***appeared*** *in* The Globe and Mail.