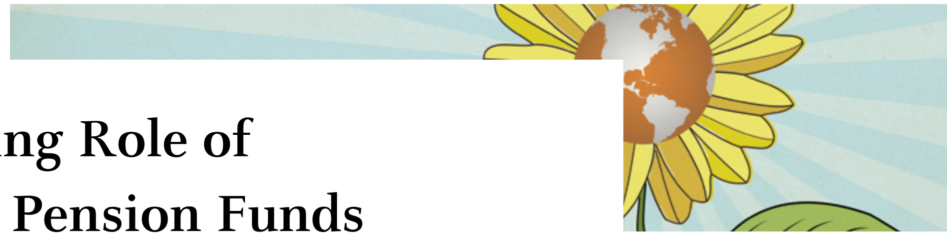


The Leading Role of Canadian Pension Funds at Home and Abroad

by John Groenewegen & Steven Smith

Investment Activity in 2013: Canadian pension funds continued to be significant players on the global investment landscape in 2013. Pension funds participated in many of the year's most noteworthy transactions: the Alberta Investment Management Corporation (AIMCo) and the Ontario Municipal Employees System (OMERS) jointly acquired Vue Entertainment for $1.48 billion; the Ontario Teachers' Pension Plan (OTPP) provided equity financing to the Hudson's Bay Company for its US$2.9 billion acquisition of Saks Incorporated; and the Canada Pension Plan Investment Board (CPPIB), together with a large U.S. private equity fund, acquired upscale retailer Neiman Marcus for US$6 billion.

As a whole, Canadian pension funds continued to focus on alternative asset allocation as an investment strategy throughout 2013. Pension funds have increased their direct investments in private equity, infrastructure and real estate as they continue to seek to align fund investment horizons with their long-term liability profile and reap the rewards of higher returns. Preliminary results from an ongoing survey by global consultant Mercer LLC reveal that the percentage of Canadian pension funds investing in alternative investments climbed to 38% from 25% over the past three years and that the average allocation to alternatives has increased to 18% from 15% in 2010.[1] As their allocations to these areas have increased, Canadian pension funds have become highly visible in these markets. Smaller Canadian pension funds have also demonstrated an inclination towards alternative asset investing, guided by the expertise of Canadian pension consultants.

Osler Comments *on The Leading Role of Canadian Pension Funds at Home and Abroad*

Watch video »

1 According to Mercer's survey, real estate showed the largest gain, rising to 34% of the total alternatives asset mix from 13% in 2010, while infrastructure assets now account for 24%, up from 8% previously.

Leading the Way

The success of Canadian pension funds such as CPPIB, OMERS and OTPP has garnered worldwide attention and praise. Referred to as "Maple Revolutionaries" by *The Economist*, the Canadian funds have been recognized as rivals of Wall Street firms and are the envy of institutional investors.

Canadian pension funds have been very prominent internationally as they have continued to focus their investment strategies outside Canada in a significant way. For example, OTPP recently announced an agreement to acquire Burton's Biscuit Company, a major player in the UK biscuit market, and CPPIB announced its intended $480-million equity investment in Brazil's Aliansce Shopping Centers SA to pursue growth in the Brazilian retail sector. CPPIB also announced an alliance to acquire office buildings in major metropolitan areas in India.

The competitive edge of Canadian pension funds is largely attributable to their development of sophisticated internal management teams. This investment model has enabled them to compete directly with large alternative asset managers for investments. A primary driver for internalizing the asset management function is a reduction of fees paid to external managers. Smaller pension funds and pension funds outside Canada have taken note, and this emphasis on cost reduction by managing investments internally is a long-term trend that we see continuing.

Even with strong internal management capabilities, Canadian pension funds continue to invest through external managers in order to leverage their strategic relationships for co-investments and to further penetrate foreign markets. Canada's large pension plans are also expanding their international reach by opening foreign offices. Last year we saw the OPSEU Pension Trust (OPTrust) open an office in Sydney and OTPP now has an office in Hong Kong; CPPIB is reported to be opening offices in New York and Sao Paolo.

OPB's strategic asset allocation provides for a further shift away from public markets to private markets investments. Infrastructure has been and will continue to be a great addition to OPB's real asset class. We like the diversification aspect of infrastructure assets and their inflation-linked characteristics. In private equity we like the prospect of higher returns with much less volatility than has been experienced in public equities.

Jill Pepall
EVP and Chief Investment Officer,
Ontario Pension Board

The Year Ahead

We expect these long-term trends to continue into 2014 for Canadian pension funds. Large pension funds will continue to make opportunistic investments both at home and abroad. Pension funds generally face less time pressure to put money to work as compared to private equity funds, and they enjoy longer investment horizons. Such flexibility enables pension funds to be more selective when making investment decisions.

We believe that large pension funds will continue to expand their international reach through increased deal flow in locations such as South America, Africa and Asia, places where they currently invest but have a less established presence. Domestic investment opportunities may be limited, but we expect Canadian pension funds to participate in infrastructure, real estate and select private equity transactions. If Canadian governments pursue a divestiture strategy, the subject of recurring discussions, we anticipate that Canadian pension funds will be active participants. We also anticipate a continued interest in the oil and gas sector. With regard to the smaller pension funds, we expect a broadening of the scope of their investment programs and a move further into alternative investment classes.

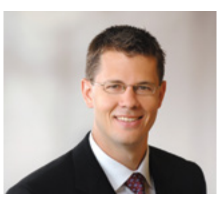
We founded our group at OP Trust in 2006 with the intention of building a global portfolio and now have investments in North and South America, Europe, China, and Southeast Asia. Some of our more noteworthy investments have been in the distressed area, especially in Europe. We recently opened an office in Sydney, to accompany our London and Toronto teams. We find Australia provides a conducive environment for domestic investing and also gives us exposure to the growth story in Asia, with less risk. As Canadians , we are proud of the leading role pension funds have played in diversifying Canada's global exposure.

John M. Walsh
Director, General Counsel
OPTrust Private Markets Group

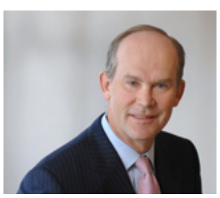
We will continue to track with interest the proposals regarding changes to the pension plan landscape such as expansion of the CPP, coined the "Big CPP"; the consolidation of pension plans in Ontario recommended in the 2012 report by special adviser Bill Morneau (the Morneau Report)[2] and the move to shared risk plans in certain jurisdictions; and the Ontario government's newly established technical working group to advise concerning the implementation of a new pooled asset management entity for public-sector single employer pension plans. Any such developments may impact the investment programs of these pension plans in terms of the size of investment, activity levels, a focus on alternative asset classes, the choice to build out internal teams and the move toward direct investments.

Overall, we foresee 2014 being another active year for Canadian pension funds on the investment front, both at home and abroad.

CONTRIBUTORS



John Groenewegen
Partner, Corporate
jgroenewegen@osler.com
416.862.6458



Steven Smith
Partner, Corporate
ssmith@osler.com
416.862.6547

2 The Morneau Report set out numerous recommendations intended to improve efficiencies in the investment management of public sector pension plans; most notably, the implementation of a pooled asset management framework.