Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

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Via e-mail to: marta.rilling@oecd.org

Dear Ms. Rilling:

Re: Submission on the Draft High-Level Principles of Long-Term Investment Financing by Institutional Investors

The Pension Investment Association of Canada (PIAC) has reviewed the recently released draft of the OECD's High-Level Principles of Long-Term Investment Financing by Institutional Investors ("the Draft Principles"), and welcomes the opportunity to provide comments. PIAC appreciates the efforts of OECD Task Force on Institutional Investors and Long-Term Financing, and commends the OECD for the depth of its analysis and the insights put forward in the Draft Principles.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over $1 trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

PIAC is in general agreement with the Draft Principles as presented, and given the long-term nature of its members' pension obligations, PIAC supports the OECD's efforts to focus its attention and research efforts on long-term investing issues. Despite their intuitive appeal, PIAC believes that the largest challenges associated with long-term investments lie in their implementation. In this regard, while PIAC supports the thinking (as described in Draft Principle 3) that the governing body of an institutional investors should:

i) have the right mix of skills to design, assess, monitor and review long-term investment strategies;

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ii) ensure it understands the long-term assets in which it invests and the associated risks; and
iii) ensure that it can properly identify, measure, monitor and manage any risks associated with long-term assets,

the practical reality is that many PIAC member organizations do not have the resources to meet these objectives. In particular, many long-term investment options are complex, making them difficult to evaluate for prospective pension plan investors. On this basis, PIAC believes that the OECD should encourage the creation of less complex investment structures and vehicles that present relevant risks and costs more clearly.

Infrastructure assets, which are often held out as strong candidates for long-term investment, are a good example of the need for improved simplicity. In particular, infrastructure assets present a variety of significant risks (e.g. regulatory, financing, partnering, GDP-sensitivity, greenfield/development, governance) that can only be assessed by investors possessing significant resources. This assessment is even more complicated in the case of defined contribution plans, which must also take into account plan members' potential liquidity requirements.

Staying with the infrastructure example, most pension plans invest in such assets for their stable cash flow characteristics over the long-term. PIAC therefore understands why governments encourage private sector participation in long-term infrastructure projects (per Draft Principle 1.6). Similarly, PIAC supports OECD efforts to encourage investment in young firms with high growth potential, and other small and medium-sized companies (per Draft Principle 1.3). However, the increased risk associated with new and smaller businesses makes them less attractive to pension plan investors in many instances. PIAC therefore suggests that in order to attract long-term investments in such companies, governments will have to use the types of risk mitigation mechanisms referenced in Draft Principle 5.2.

In addition to the points already raised here, PIAC believes that the following steps could also be taken to encourage and facilitate long-term investment by pension plans:

i. In order to address investor demand, governments should be encouraged to issue longer-term debt, both nominal and inflation-linked. As investors with liabilities that are sensitive to changes in interest rates and inflation, longer-term government debt issuance would improve pension plans' liability-hedging efforts.

ii. In many cases, the holding periods for long-term investments extend well beyond a government's typical term of office. This creates the spectre of changes to investing rules when governments leave office. To reduce the risk associated with this uncertainty, PIAC submits that governments should establish protocols for how such changes will be handled. Doing so would provide investors with confidence that the terms of their long-term investments are not subject to change based on the whim of a new government. In the absence of such confidence, investors will inevitably seek an incremental risk premium on any long-term investments that could be affected by government action.

iii. While most investors do not make long-term investments with the intention of selling, issues such as liquidity needs or changes in liability profiles may dictate a need to dispose of long-term holdings. On this basis, PIAC believes investors must have unilateral rights to sell if deemed beneficial for the plans they manage.

iv. As pension plans, PIAC members have a natural interest in long-term investing. However, since pension funding requirements in Canada and other jurisdictions are based on point-in-time funding measures, a desire to avoid short-term volatility in funded status is a legitimate consideration that discourages some investors from undertaking certain long-term investments. As a consequence, PIAC believes that to the extent the OECD wishes to encourage more long-term investment, it should also encourage governments to implement pension funding frameworks that are not punitive based on short-term valuation changes in such investments.

Conclusion

Each PIAC member has a fiduciary responsibility to its own members, and each PIAC member’s decisions concerning long-term investments are informed by unique risk - return preferences. On that basis, governments should strive to create frameworks that facilitate investors’ understanding of risks associated with long-term investments, which will allow for better decisions based on individual investors’ profiles. PIAC also believes that while the Draft Principles provide useful guidance to governments in an effort to encourage long-term investing, there are additional points, highlighted herein, that could be more clearly emphasized, leading to a more useful and instructive document. In this regard, PIAC notes that there are other government- and industry-sponsored initiatives aimed at fostering long-term investment, so to the extent the groups behind such initiatives can work together to meet their common objectives, it will ultimately have a greater impact.

In closing, we appreciate the opportunity to comment on the Draft Principles and hope you find our comments useful. Please do not hesitate to contact Kevin Fahey, Chair of the Investment Practices Committee (1-416-673-9006; kfahey@caatpension.on.ca), if you wish to discuss any aspect of this letter in further detail.

Sincerely,

Brenda McInnes
Chair

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