



April 1, 1998

Mr. Robert Hamilton
Assistant Deputy Minister
Financial Sector Policy Branch
Department of Finance
L'Esplanade Laurier
20th Floor, East Tower
140 O'Conner Street
Ottawa, Ontario K1P 0G5

Dear Mr. Hamilton:

As you are aware, the Pension Investment Association of Canada (PIAC) has had a long-standing interest in developments leading to the re-organization of the Canada Pension Plan. In addition to the contacts you and others have had with individual Members of PIAC, our association appeared before the Federal/Provincial/Territorial CPP Consultations Secretariat on June 26, 1996, during its hearings on the investment approach to be taken by a restructured CPP.

There are several matters which we would like to bring to your attention now that the public debate on the CPP's proposed structure and investment mandate is gaining momentum.

We understand that draft regulations for the CPP are intended to be issued in final form within the next two months. Recent media reports indicate that the process for identifying prospective members of the Plan's Investment Board has become political and we strongly support you and your colleagues in insistence on compliance with appropriate pension plan governance models. We understand that you have PIAC's model titled "Effective Pension Plan Governance" and have been informed of models employed by several pension plans in Canada. These models suggest that the primary criteria for selection are acceptance of fiduciary responsibility, relevant experience, independence and a commitment to serve. In our view, adherence to such models should immunize the CPP from criticism about the selection process for the Investment Board.

Another matter which has concerned PIAC for some time and, unfortunately, continues to concern us, is the impact a restructured CPP may have on Canada's capital markets. This concern is exacerbated by the anticipation of the restructuring of the federal public service pension plan. It is becoming increasingly clear that amounts available for investment, in the near term, from both plans likely will place a strain on Canadian capital market liquidity. As well, it still makes sense to permit greater investment diversification in global markets in order to reduce risk and maximize returns.

We know from experience that some 85% of all pension payments are funded from investment returns with only the remainder coming from contributions. If it is wise to diversify an RRSP or a pension plan to gain these benefits, then it is even more important to adopt the same approach in a plan as large as either the CPP or the public service plan. Accordingly, we reiterate our previous submissions calling for the modification of the foreign property rule (FPR) to allow the limit to increase by 2% per annum until it reaches 30%, at which time we believe the FPR could be dispensed with safely. This approach was successfully employed in raising the limit from 10% to 20% and, we expect, would again be appropriate. We know that you have heard this argument on many previous occasions but, this time, it is made with even more energy. Not surprisingly, we have serious concerns about the impact that the CPP and public service pension assets will have on Canada's capital markets.

Thirdly, Members of PIAC have long experience in managing pension assets to meet plan liabilities. Each has the knowledge to define an effective investment program to create a pool that is sufficient to keep the pension promise. It is premature to discuss the question of active vs. passive investing at this time except to encourage you and your colleagues to provide adequate flexibility in the investment mandate to allow the CPP Board to make appropriate decisions. We would be pleased, however, to provide input to the new Board on the aspects of indexation and active management. We would appreciate therefore, the opportunity to offer our Members' experience in these matters to members of the new Board in, perhaps, an orientation process or in any other forum you think may be appropriate.

We trust that you find these observations to be helpful and offered in the co-operative spirit in which they are intended. We look forward to further communication with you, especially on ways in which the resources of our Members may best be used to assist members of the CPP Investment Board in addressing many of these critical issues.

Sincerely,

Donald T. Walcot
Director and Chairman, Government Relations Committee