THE GLOBE AND MAIL

OPINION

# 'Canadian model' for approaching public pension funds must evolve

**BERT CLARK**
CONTRIBUTED TO THE GLOBE AND MAIL

*Bert Clark is president and CEO of the Investment Management Corporation of Ontario (IMCO). IMCO manages $62-billion in assets on behalf of public funds in Ontario.*

For the past 25 years, many public pension funds in Canada have followed what's globally referred to as the "Canadian model." This approach focused on independent and professional governance, investing in private assets, active management of public equities and internalization of investment activities to avoid high external management fees. By and large, the Canadian model has generated strong results. It put Canadian pensions on the global investing map.

However, significant changes in capital markets are driving a need to evolve the Canadian model. As well, fund managers can't ignore the success of other institutional asset management models that have emerged outside of Canada. Here's why:

First, successfully investing in private assets has become more difficult. When pensions first began to invest in private assets, they could count on a significant "illiquidity premium" over the public markets' equivalent investment. That is no longer true. Today, because so many investors have identified private equity, infrastructure and real estate as core aspects of their total portfolio, the potential illiquidity premium has been diminished.

There are still good reasons to invest in private assets: The returns are less volatile, they represent a growing portion of the investable universe of equity and they offer opportunities to enhance value that would be difficult in a public-market context.

But, successfully investing in private assets today requires both internal teams and external partners with real skill in generating value enhancement. Today, successful investors in private assets, together with their external partners, must be active and engaged owners. And they need to have the sophisticated capabilities required to create value through private ownership.

Second, outperforming in many public markets is difficult to sustain. This is especially true if these market segments are accessed through more expensive external managers. But the choice between either being always “active" or always “passive” is a false one. While many market segments are efficient, there are still public market segments where sustained outperformance through active management is realistic; and there are lower-cost ways to pursue outperformance in the more efficient markets (for example, factor-based investment strategies). The key is to recognize which strategy to employ and when.

Third, the Canadian model hasn’t been the only successful approach to large public fund management over the past 25 years. For example, several northern European public funds have been successful by focusing on total portfolio decisions as a means of driving returns and long-term value for their stakeholders.

There is strong logic to focusing on total portfolio. After all, asset-allocation decisions drive over-all risk and return. Individual investment decisions within asset classes are dwarfed in comparison. Furthermore, if an investor’s goal is to build a portfolio that can perform under a range of macro-economic conditions, it requires diversification at the asset class level.

The Canadian model still has gas in the tank, but its application needs a tune-up.

It is undebatable that independent and professional governance still produces superior investment results. Private assets still provide investors with less volatile returns than public market equivalents. There are still public equity market segments where sustained material outperformance is realistic. And costs are still a big driver of over-all investment returns and they can be reduced through internalization.

But in today’s lower rate and lower expected return environment, relying solely on strategies that have worked over the past 25 years isn’t advisable. Investors must consider an evolved approach: Private investing teams require more operational know-how to realize value through active ownership; combining passive with active strategies in public equities is required to generate outperformance where it is realistic; and focusing on asset mix decisions is more important than ever.



351 King Street East, Suite 1600, Toronto, ON Canada, M5A 0N1

Phillip Crawley, Publisher