HYMANS ROBERTSON

POLICY BRIEFING NOTE:

The Canadian model

On 7 August, the Chancellor met with representatives of the major Canadian public pension funds in Toronto. Between them, these eight schemes (the 'Maple-8') manage more than £570bn in assets. The investment approach used by the Maple-8 is known as the 'Canadian model'.

In a statement ahead of the meeting, the Chancellor said:

> *"The size of Canadian pension schemes means they can invest far more in productive assets like vital infrastructure than ours do. I want British schemes to learn lessons from the Canadian model and fire up the UK economy, which would deliver better returns for savers and unlock billions of pounds of investment."*

The LGPS has a long history of continuous improvement and a readiness to adopt best practice. In that spirit, we examine the Canadian model to see what the LGPS can leverage.

The Canadian model

Canada's retirement income system is broadly similar to the UK so it's a fair place to compare with. Both countries have:

i. State pension funded via mandatory contributions
ii. Voluntary tax-advantaged private pension arrangements that are not directly funded by the state
iii. Public sector employees covered by open defined benefits schemes

However, an obvious difference is the use of funded schemes – the equivalent "state" pension is partially funded (through the Canada Pension Plan and Quebec Pension Plan), as are all public service pension funds eg. Teachers, Civil service. This is different to the UK as of the six largest public service pension schemes, only the LGPS is funded. The remainder operate on a pay-as-you-go basis ie assets are not held to back the liabilities.

The current Canadian pension system was created through reforms in the 1990s to address adequacy and underfunding issues. Public pensions funds set-up/restructured adhering to the following principles:

1. Alignment of interests and collaboration between the different stakeholders without political interference
2. Having an independent and professional Board in place
3. Provide patient capital
4. Exposure to alternative assets
5. In-house management
6. Competitive compensation for investment professionals

This created the 'Maple-8' Canadian public pension funds (amongst others). The investment approach used by the Maple-8 is known as the 'Canadian model', perhaps best known today for using direct investments and internal management of assets, as well as their globally diverse portfolios.

Maple-8

The term 'Maple-8' refers to the major Canadian public funds:

Pension plan		Est	Sponsor	Crown corp	AUM
Canada Pension Plan Investment Board	CPPIB	1997	Federal and Provincial Governments	Y	£362bn
Public Sector Pension Investment Board	PSPIB	2000	Government of Canada	Y	£152bn
Caisse de depot et placement du Quebec	CDPQ	1965	Government of Quebec	Y	£249bn
Alberta Investment Management Corporation	AIMCo	2008	Government of Alberta	Y	£92bn
British Columbia Investment Management Corporation	BCImc	1999	Government of British Columbia	Y	£143bn
Ontario Teachers' Pension Plan	OTPP	1990	Government of Ontario and Ontario Teachers' Federation	N	£143bn
Healthcare of Ontario Pension Plan	HOOPP	1960	Ontario Hospital Association and Unions	N	£65bn
Ontario Municipal Employees Retirement System	OMERS	1962	Various government entities and four unions in Ontario	N	£74bn

Five of the funds are "Crown corporations" meaning they are government organisations which are owned by the Crown (ie Government of Canada or a province) and established by an act of Canadian parliament.

All funds provide retirement income. However, some also have insurance, endowment and special purpose funds (eg financing government programs).

PSPIB, AIMCo, BCImc and OMERS all include local government staff benefits.

The Maple-8 have committed to net-zero portfolios in 2050. Like the LGPS, climate change and the role of long-term investors is a very topical discussion. There is similar debate around how green assets fit with their fiduciary duty of generating a required investment return.

Funding and benefits

Like the LGPS, the retirement income elements of these Canadian funds collect member and employer contributions to provide a range of defined benefit pensions to their members. The benefits are also mostly inflation linked (however, some benefits have capped, discretionary or risk sharing elements to inflationary benefit increases).

Members contributions are broadly similar but it's difficult to usefully compare employer contribution rates.

The Canadian funds are well-funded with funding levels around the same levels as the LGPS (which averaged 107% at 31 March 2022 across England and Wales and 141% in Scotland at 31 March 2023).

Asset allocation

The Maple-8 fund have large allocation to private markets and have a stated focus of long-term value creation. An overview of the asset allocation versus the LGPS is shown below (as at 2022):

	Equities	Bonds (inc cash)	Credit/ private debt	Private Equity	Real estate	Infra	Other
CPPIB	27	7	16	32	9	9	0
PSPIB	26	20	10	15	14	10	5
CDPQ	25	9	21	20	12	13	0
AIMCo	38	32	3	6	13	8	0
BCImc	30	37	4	12	16	10	-9*
OTPP	6	34	-	23	10	13	14
HOOPP	13	58	-	11	10	3	5
OMERS	11	28	6	20	16	19	0
LGPS	**51**	**19**	**2**	**8**	**9**	**6**	**4**

** Strategies including leveraged liabilities and current hedging policies.*

Observations:

- Given that equities and bonds are the main public market asset classes, five out of the eight funds allocate more than 50% to private markets.
- CPPIB has the longest investment horizon (assets only cover post-2000 liabilities) and an absolute return mandate, it is no surprise that this fund has the highest private equity allocation.
- HOOPP is a healthcare multi-employer pension fund, its allocation is a function of its LDI approach and therefore shows a large allocation to 'Bonds'.
- Not all BCImc and AIMCo's clients are pension funds so private assets might be less suited for non-pension mandates (eg 19% and 9% of BCImc and AIMCo are insurance funds respectively)
- The LGPS has a comparatively lower allocation to private markets. However, over the last decade, LGPS funds have reallocated around 12% of total assets from equities into private markets.

Use of internal management

A component of the Canadian model is the use of internal management across all the funds. CEM Benchmarking suggests that 60-80% of assets are internally managed. Whereas, the LGPS has historically had very little internal management, however, this has steadily grown using the LGPS pools.

Given the size of the Canadian funds, it's likely that most of the investments in public markets are internally managed.

The degree of internal management related to private markets is hard to determine due to the variety of investment choices, however, there are example of some fund's internal teams making direct private investments.

Domestic versus overseas investment

The total domestic exposure of each Canadian fund across the whole portfolio is below:

	Canadian exposure
CPPIB	12%
PSPIB	21%
CDPQ	27%
AIMCo	42%
BCImc	29%
OTPP	35%
HOOPP	55%
OMERS	21%

In both countries there has been a trend to invest more globally. According to data provider Global SWF, the Canadian funds invest 27% domestically and 73% overseas (with the majority of the domestic holding in bonds ie likely not a large proportion of domestic "productive" assets). Only 7% of infrastructure investments are domestic. In comparison, the LGPS broadly held 15% of assets in UK equities and bonds, with further UK allocations in alternatives and property.

Looking more closely at investments in publicly traded domestic companies, Canadian funds reduced their holdings from 28% at the end of 2000 to less than 4% at the end of 2023. Similarly, over the last decade the LGPS has moved away from having a high UK equity allocation. In March 2024, Canadian business leaders wrote an open letter to finance ministers calling for new rules and incentives to reverse a decline in domestic investments.

Mirroring the ambition of the UK government (and many others across the world), in its 2024 Budget, Canada's federal government announced measures to increase domestic investment by some of its largest asset holders, including the public funds.

Some have interpreted the push as a call to create a dual mandate for Canada's funds, such as that of Caisse de depot et placement du Quebec (CDPQ), which is the only fund with a mandate to seek the highest returns possible while boosting the local economy.

However, there has been pushback by the funds, pointing to independence being fundamental to their historic success, and noting that Canada represents about 2.5% of global capital market opportunities yet the funds typically allocate double digits (UK global capital market share is c3.5%).

Nonetheless, the Canadian government pledged to collaborate with funds to foster an environment that promotes and identifies more domestic investment, focusing on creating investable opportunities rather than mandating. A working group has been tasked with identifying priority opportunities that benefit both funds and Canadian citizens.

Performance

The annualised 10-year performance taken from 2023 accounts are noted below (all net of fees).

	Annualised 10 year average
CPPIB	9.3%
PSPIB	*
CDPQ	7.4%
AIMCo	7.3%
BCImc	*
OTPP	7.6%
HOOPP	8.4%
OMERS	7.3%
LGPS (EW)	**7.0%**

* *PSPIB and BCImc report April to March – with 10-year average returns of 9.2% and 8.5% respectively. This compares to a 7.3% pa for the LGPS over the same period.*

The LGPS performance is the estimated total return across the English and Welsh funds over the 10 years. The 7% annualised return is the lowest return across all the funds.

However, through the last decade of low interest rates, private markets performed particularly strongly. The relatively larger private markets allocation of the Canadian funds versus the LGPS funds is likely a key contributor to the slightly lower comparative returns.

Costs

The below cost information has been collected from 2023 annual reports, which includes operating, transaction and external management fees (converted to basis points based on average AUM where required).

	2023 Cost (bps)	AUM
CPPIB	59	£362bn
PSPIB	69.4	£152bn
CDPQ	59	£249bn
AIMCo	62.8	£92bn
BCImc	53.7	£143bn
OTPP	75	£143bn
HOOPP	59	£65bn
OMERS	54	£74bn
LGPS (EW)	**54.6**	**c£400bn**

Note the costs of CPPIB, PSPIB, BCImc and the LGPS, are for the 2023 fiscal year running from April to March.

The LGPS cost estimate is an average across the English and Welsh funds. However, there remains some challenge in collating exact costs across the LGPS funds.

The LGPS appears to have a lower cost than the average Canadian fund. However, it's difficult to ensure a like-for-like comparison and consistent calculation method.

The Canadian funds' better performance and larger allocation to private markets would generally mean higher costs. This could also result in masking any cost savings from the greater use of internal investment management.

In general, there are studies which suggest larger funds are more efficient to run, more successful in negotiating better fee-structures with external managers, and potentially have better governance. However, debate remains on the size when this may plateau. From this one-year sample, there is interestingly no evidence in the data to suggest that the very large plans such as CPPIB or CDPQ have comparatively lower costs.

Takeaways

- **Asset allocation –** the Canadian funds have a notably large allocation to private markets.
- **Internal management -** the Canadian funds use a significant degree of internal management.
- **Domestic investment -** similar levels of assets are invested domestically. Despite the Canadian funds high levels of private market investment, a significant proportion is invested overseas (eg only 7% of infrastructure investment is in Canada). Both countries governments are focused on encouraging more domestic investment.
- **Performance –** over the last 10 years the LGPS in England and Wales has had a lower average return than the Canadian funds. However, this is likely due to the higher allocation to strongly performing private markets. As we are no longer in the low interest rate environment of the last decade, how sustainable is private market performance going forward and has the associated risk changed?
- **Costs –** the LGPS appears to have a lower cost that the average Canadian fund. However, the different assets allocations and performance (plus the lack of publicly available data), means it is difficult to ensure a like-for-like comparison.

The shared strengths of the LGPS and Canadian funds include a successful funded model and a clear desire to tackle climate risk and carbon transition challenges.

Get in touch

If you'd like to discuss anything further, please contact your usual Hymans Robertson consultant, or get in touch here.

Annual reports:

LGPS | PSP | CPP | AIMco | BCI | Caisse | HOOPP | OMERS | Ontario Teachers

Additional sources:

Eduard van Gelderen, February 2024. "On the Sustainability of the Canadian Model"

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