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The Honourable Wayne Easter

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● (1305)

[*English*]

The Chair (Hon. Wayne Easter (Malpeque, Lib.)): I call the meeting to order.

Today, pursuant to Standing Order 108(2), we are studying the Canada Pension Plan Investment Board, which we do at least annually.

With us from the Canada Pension Plan Investment Board is Mr. Mark Machin, President and Chief Executive Officer, and Mr. Michel Leduc, Senior Managing Director.

I believe, Mark, you have an opening statement. Go ahead. The floor is yours.

Welcome, and thank you. I hope we didn't upset your schedule too much by moving you up a little earlier.

Mr. Mark Machin (President and Chief Executive Officer, Canada Pension Plan Investment Board): No.

Thank you, and good afternoon, Mr. Chair and members of the committee.

[*Translation*]

Thank you for having me here today to discuss and answer your questions.

It is an honour to appear on behalf of the Canada Pension Plan Investment Board, or CPPIB. How we are helping ensure that the CPP remains sustainable for future generations of Canadians is an important issue to this committee.

[*English*]

With me is Michel Leduc, Senior Managing Director and Global Head of Public Affairs and Communications for the Canada Pension Plan Investment Board.

We welcome the opportunity to discuss CPPIB and how we are investing the funds that have been entrusted to us.

We're strong believers in the value of transparency and open dialogue as one element of public accountability, especially through Parliament. I know your schedule is quite busy, so I'm not certain whether you've had a chance to read our submission and annual report, but regardless, I look forward to the committee's questions. I'll keep my opening remarks brief with that in mind.

I'll start by sharing a few observations on the global investment climate and trends that are affecting how we operate. I'll then touch on our recent financial performance and some strategic considerations for the years ahead, including preparations to receive, invest, and manage additional CPP.

Beginning with the investment climate, competition for investments continues to be strong. There is a glut of capital with, in essence, more money chasing fewer opportunities. There are signs of this across various asset classes. The lengthy bull market in stocks, growing demand for private assets, low yields on income-oriented investments, and high valuations on infrastructure are some examples.

In this type of environment, CPPIB's advantages are even more important. These include our exceptionally long investment horizon, our size, the certainty or predictability of our assets, our people, our expert partners, our unique approach to managing our portfolio, and increasingly, our corporate brand and reputation in the world's most hotly contested investment markets.

It's equally important that we remain patient and disciplined. We must continue to be highly selective about what investments we will make. The businesses we buy need to be able to preserve their value through cycles and achieve growth in the longer term.

The businesses we are buying should also be able to withstand or benefit from disruption, but this does not mean rushing to invest in the latest innovations; rather, it means thoughtfully studying how disruptors might affect the assets we like today in the decades to come. For example, what will autonomous vehicles mean for toll roads that we own, or for parking lots? These are the types of questions we continue to examine.

When we're considering trends like the heightened competition for assets and new disruptive forces, we look well beyond the immediate horizon. We're not trying to beat the market each and every year; we're looking to add value over decades. Our strategy aims to deliver steady, absolute, long-term returns over time through significant upswings and corrections.

I continually remind our stakeholders that we fully expect that one year in 10, the fund will drop by at least 12.5%. This is planned for. We design our strategy and actions to deliver strong performance measured over multiple generations of contributors and beneficiaries.

Amidst this backdrop, our return for fiscal 2018 was 11.6%, after all of our expenses. This was driven by strong public equity markets through the first nine months of the fiscal year, and when market volatility picked up during the fourth quarter of our year, the diversification of the portfolio provided resilience.

Investment income was $36.7 billion after all of our costs, and when combined with net inflows from CPP contributions of $2.7 billion, this brought the CPP fund to $356.1 billion as of March 31. When I last appeared before you about 18 months ago, the fund stood at about $300 billion. The 10-year return on the investment portfolio is 8% and the five-year is 12.1%. After inflation, these figures were at 6.2% and 10.4% respectively, well above the office of the chief actuary's assumption of an average 3.9% return to keep the fund sustainable over the 75-year projection period in their report.

Before concluding, I'll briefly touch on a few operational and strategic considerations for the years ahead.

As you know, in January 2019 CPPIB will receive and invest its first cash flows from the CPP enhancement that the federal and provincial governments have collectively put in place. Our preparations to manage additional CPP contributions are well under way and firmly on track. Our teams are diligently working to receive these new funds. We will structure the fund going forward in a way that will respect the funding differences between the base and additional CPP, while also ensuring that we make full and efficient use of our existing platform and global investment capabilities.

You will have gathered from our remarks that given our investment horizon, we are continually looking ahead into the future. As we do this and assess the various trends that I've discussed, we know that we can't rest on our laurels. The asset management industry is changing, and we must continually adapt. Our investing strategy will become more agile so we can seize opportunities and continue to be resilient as we face a number of forces whose precise outcomes remain uncertain, whether it's global growth trajectories, technological disruption, geopolitical forces, or climate change.

To position our international competitiveness, we will invest responsibly in new technology and data capabilities. This will augment our investment talent and skills, and we'll focus on improving operational efficiencies and increasing collaboration and knowledge-sharing across our diverse investment teams and corporate functions.

Our culture will be even more innovative and ambitious, while firmly rooted in our compelling public purpose.

That concludes my formal remarks, and on behalf of my colleagues, we thank the Standing Committee on Finance again for inviting us here today. I look forward to our discussion and I'm pleased to answer any questions you may have.

Thank you.

● (1310)

The Chair: Thank you very much.

We'll go to approximately six-minute rounds. That way we can get everybody on with one round of questions.

We will start with Mr. McLeod.

Mr. Michael McLeod (Northwest Territories, Lib.): Thank you, Mr. Chair.

Thank you for the presentation here today. I read your report with interest. I find it very interesting that some of the emerging threats included climate change. That's an issue that has generated a lot of concern in the Northwest Territories.

I want to talk about vulnerability, which you mentioned in your report. In your annual report you outlined various measures through which the CPPIB is held accountable to the federal and provincial governments. Given the distinct nature of the territories, can you outline how the CPPIB currently engages with the governments and the contributors and the beneficiaries in the three territories? As well, is there an interest from the board to increase its accountability to northerners either through a more formal process or an informal process?

That's my first question.

Mr. Mark Machin: Thank you very much for the question.

Yes, we are accountable to northern Canada through the federal government. It's our understanding that the territorial ministers are present at all the finance ministers' meetings where discussions and decisions on the CPP take place. In addition, we understand that territorial officials are members of the CPP committee of officials that acts as the main forum for the exchange of information and policy ideas among the federal, provincial, and territorial officials.

Mr. Michael McLeod: Thank you.

Maybe we can work on arranging a little more in terms of round table discussions and information sharing in the Northwest Territories specifically, and I'd be glad to help with that.

I do have a question on another issue that you raised in your report. The report mentions that the CPPIB values diversity at its highest levels, and that this year the board achieved gender parity. How does the CPP currently fare at addressing other forms of diversity, such as inclusion of people of colour and/or indigenous Canadians in the board, in management positions? Is there a commitment to addressing these areas if there is a shortfall?

Mr. Mark Machin: That's a terrific question.

As you pointed out, our board is 50% women, and we have a policy that there should be no greater difference than 60:40. Our senior management team today is just over 30% women, and overall we're at about 44% women.

In terms of targets for other aspects of diversity, we're very focused on that at both the board level and at the management level. We have put in place targets, and we're a meritocracy. We have to be a meritocracy to compete internationally, but we do think there is a value in having some targets in the future, so we aim in particular to increase the representation of visible minorities at the more senior levels of the organization.

Today in Canada, visible minorities are about 41% of our employees, but it's a lower percentage at the more senior level, and we want to increase that significantly. It is the same with the LGBT community. We also have a target to increase representation there. For the senior levels of women, we also have a target to increase that over time as well.

Mr. Michael McLeod: Do you have specific targets also for indigenous Canadians, and if you do, what is the strategy to reach those targets? Is that something you can share with this committee?

Mr. Mark Machin: Today we don't have a target for indigenous Canadians. About half a per cent of our employee population are indigenous Canadians, but it's something we will examine in the future.

● (1315)

Mr. Michael McLeod: What does “in the future” mean?

Mr. Mark Machin: Well—

Mr. Michael McLeod: At what point do you start to include indigenous Canadians as part of your targets?

Mr. Mark Machin: It's something that I think we should look at over the next year or so, so by the next time I come here, I should certainly have a crisper answer for you than telling you where we are today and where we aim to be.

Mr. Michael McLeod: Okay. I look forward to that information. Thank you.

The Chair: Mr. Albas is next.

Mr. Dan Albas (Central Okanagan—Similkameen—Nicola, CPC): Thank you, Mr. Chair.

Thank you to both Mr. Machin and Mr. Leduc for your presentation today, as well as for the work you do for Canadians in making sure that they have a strong, secure pension.

In light of those comments, obviously 15% of the current assets of the CPPIB are within Canada. Many might say that there are obviously opportunities within Canada, whether it be infrastructure or other projects.

The government came into office with a promise of a Canadian Infrastructure Bank that was oriented towards making sure that small communities across the country could have lower interest rates on their borrowing. They have instead changed that and have taken monies away from those same municipalities in order to fund this Canadian Infrastructure Bank.

Do you see the Infrastructure Bank as being a mature institution where you could put Canadians' money at this time?

Mr. Mark Machin: On the Canadian Infrastructure Bank, I think, from our perspective, one of the challenges I mentioned in my opening remarks is the huge amount of money chasing opportunities and the lack of supply of those opportunities. That's particularly acute in the field of infrastructure around the world. Valuations on infrastructure in Canada and around the world are at extremely high levels, and things are very finely priced, and we have struggled to find new investments in infrastructure.

One of the main reasons for that is the lack of a predictable pipeline of opportunities, opportunities of size. We have to keep our cost structure at a minimum, and therefore we can't have massive teams that are just on standby for when an opportunity comes along. As a result, our infrastructure team is fewer than 50 people to look at all opportunities in the world.

One of the things that we are hopeful about is that if the Infrastructure Bank gets up and running effectively, then it will increase the pipeline of sized opportunities that are available for investors like us, institutional investors. If that happens, then we'd welcome looking at those and looking at those through our risk return requirements.

Mr. Dan Albas: The question was, though, is this an institution mature enough for you to do business with? I think it will take at least five years before this crown corporation is up and running with policies and deals. As well, much infrastructure is owned or managed provincially, so to have a pipeline may be a bit of a challenge.

The question was whether you feel this institution is mature enough for the investment board's attention.

Mr. Mark Machin: Again, our job is to assess the pipeline of opportunity. We are hopeful a significant pipeline of opportunity will come over time as the bank gets up and running.

Mr. Dan Albas: The last time we had you we asked the Minister of Finance about whether or not he would stay at arm's length from trying to influence the CPPIB from making particular investments that would be politically advantageous in regard to the Canada Infrastructure Bank. Has that been the case?

Mr. Mark Machin: Yes, that's been the case.

Mr. Dan Albas: Has there been any pressure to invest in the Kinder Morgan Trans Mountain pipeline?

Mr. Mark Machin: No, there has been no pressure.

Mr. Dan Albas: Okay. Thank you.

My riding has a lot of seniors, and they depend on the CPPIB to make sure there are good returns, but next year with the additional CPP opening up, many millennials have asked me whether we're going to have a strong, stable CPP for them in the future.

Could you tell us a little about the reason for the separation of the CPP base and the additional CPP fund and what measures you have to ensure millennials understand that when they put that money away, it will be there when they need it?

● (1320)

Mr. Mark Machin: Yes, certainly. We expect the first funds from the additional CPP to arrive in January of next year. A huge amount of work has gone on internally to make sure we're totally ready for those funds to arrive.

Given the nature of the funding of the additional CPP versus the base CPP, we will need to run them at a lower risk level than the base CPP funds. We are also required by the act to report on the funds separately, so we'll be ready to do that and we'll be ready to invest that additional money responsibly within the risk parameters that are appropriate for that money and to make sure it is there for people who are contributing from January 1.

The Chair: You have time for one short question.

Mr. Dan Albas: Last time I asked specifically about the transition from a passively managed fund to an actively managed fund. You said there had been great strides with that. I believe the reference portfolio allows people to be able to understand the opportunity costs, or in some cases, gains. Could you explain that so that the public can know how their monies are being invested?

Mr. Mark Machin: Yes, certainly.

One of the ways we test how we are performing relative to what we could have done if we had stayed passively invested back in 2006 is, as you said, by measuring our performance versus the reference portfolio, which is a simple portfolio of equities and bonds. As of the fiscal year-end, our performance was about $19.3 billion, so that's $19.3 billion of extra money in a fund that wouldn't have been there if we hadn't gone into an active management organization.

The Chair: Okay. Thank you both.

I have one clarification, Mr. Machin. You talked about size opportunities. What did you mean? Was that over $500 million? The question was on infrastructure.

Mr. Mark Machin: Yes, Mr. Chair, that would be correct. We typically look for opportunities over about $500 million around the world.

The Chair: That's on infrastructure. Okay.

Thank you very much.

Mr. Dusseault is next.

[*Translation*]

Mr. Pierre-Luc Dusseault (Sherbrooke, NDP): Thank you, Mr. Chair.

I'd like to thank the witnesses for being here today.

My first question has to do with the principles that inform your investment decisions.

In our briefing package, it says that the CPPIB's key engagement focus areas include climate change, water management, and human rights.

Do your investment decisions also take into account fiscal responsibility? Do you ensure compliance with the tax laws of the countries you invest in?

Mr. Mark Machin: Thank you for your question.

[*English*]

I think there were two parts to the question, if I understood correctly. The first part was on the areas that we look at for our ESG areas. There are four, and we're introducing a fifth area this year, so you're correct to cite climate change, which we've been focused on for about 10 years. As well, there are water and water conservation, human rights, and executive compensation. This year, we're also introducing board effectiveness.

The second part of your question was related to taxes and how we comply with tax around the world.

We comply with all of the tax requirements in the jurisdictions that we invest in. We are focused on doing that. Obviously, in Canada, we have a tax-exempt status, and that applies in several other countries around the world where there are tax exemption agreements in place or the country applies a specific exemption on organizations like ours, like CPPIB. They are often available to public pensions in countries around the world, and it protects the pensions from double taxation.

It's our fiduciary duty to the beneficiaries and contributors to build a diversified portfolio with minimal transaction costs, including taxes on investment returns. For sound public policy purposes, the investment income earned on behalf of beneficiaries by pension funds, such as CPPIB, is exempt from Canadian tax to ensure that CPP beneficiaries are not double-taxed, which is what would happen if the investment income were taxed when it was earned and then again as income in the hands of the beneficiaries.

● (1325)

[*Translation*]

Mr. Pierre-Luc Dusseault: I wasn't so much asking about your 8% or 10% rate of return on investments in Canada, as I was about the practices of the companies in which you make major investments.

When you are considering making an investment, does fiscal responsibility factor into your assessment criteria? It is all well and good to say that the companies you have an interest in comply with tax laws, but some companies are clearly less responsible than others when it comes to taxes.

I am asking because CPPIB investments showed up in the Paradise Papers. For instance, you bought a 40% stake in Highway 407 and you routed funds through Bermuda. The board routed investments in London's high-speed rail line through Jersey Island, and it purchased its stake in one of Chile's largest electricity companies in a transaction routed through Bermuda.

Those are the kinds of investments Canadians see as fiscally irresponsible. I'm talking not about investments the board makes in Canada, but about those it makes in other jurisdictions. It is contributing to the problem of tax evasion and aggressive tax avoidance. It was with that in mind that I asked the question.

[*English*]

Mr. Mark Machin: Thank you. I better understand the question now.

We have a fiduciary duty to our beneficiaries and contributors to build a portfolio with minimal transaction costs, including taxes on investment returns. We honour our tax obligations around the world. We pay taxes due in the countries where we invest and operate.

We don't employ artificial structures that don't have a commercial basis to avoid tax, and the companies we invest in pay corporate income tax on the profits they earn. In jurisdictions where tax agreements don't exist, we do look at using investment structures that limit the tax cost to CPPIB, thereby limiting the double taxation on CPPIB beneficiaries.

[*Translation*]

Mr. Pierre-Luc Dusseault: As the protector of Canadians' pensions, you seem to have no qualms taking advantage of tax structures or investing in countries with low to no taxes. You have no qualms using taxpayer money to get around tax rules, do you?

You said that you don't bypass tax laws and that you honour all your tax obligations. You also said, however, that you try to minimize the tax consequences of your investments, and to do that, you use jurisdictions with very low tax rates.

How can you justify that practice to Canadians, who are the shareholders of the investments you make?

Mr. Michel Leduc (Senior Managing Director and Global Head of Public Affairs and Communications, Canada Pension Plan Investment Board): Mr. Dusseault, I'd like to jump in, if I may.

[*English*]

On some of the transactions that you've indicated, we'd be more than happy, through the office of the clerk and the office of the chair, to share more specificity around those investments.

To answer your question specifically around representing Canadians, one thing to consider is that as we compete around the world for these assets, in many of those instances—and we'll get those specifics—when we invest in those transactions, a lot of the structures are already in place. For CPPIB to unwind them it could lead to a much higher cost of capital for the organization, and therefore we would be hampering and injuring the best interests of the CPP fund.

In a lot of the instances when we're investing and where we're competing against a lot of other institutional investors, we want to make sure that we have the same even, equal cost of capital as other institutional investors; otherwise, as we look to deploy capital internationally, we would be doing so with part of our hands tied behind our back. I think most Canadians would expect us to structure things in such a way that we would not be embarrassed, and at a minimum follow all of the laws and rules.

The Chair: Okay. Thank you all.

Ms. O'Connell is next.

Ms. Jennifer O'Connell (Pickering—Uxbridge, Lib.): Thank you, Mr. Chair.

Thank you both for being here again.

I want to touch more on sustainable finance. Obviously Canada recently announced moving forward with the Expert Panel on Sustainable Finance. As well, I notice that Ontario moved forward in terms of signing on to disclosures of investments.

In terms of the CPP and CPPIB specifically, I'm curious about what you're doing in that regard.

I was part of Chatham House's Waddeson Club, and it really focused on sustainable finance. Europe is light years ahead of us in this area, and their investment boards are moving ahead significantly to ensure that investors, and in this case Canadians, know that their funds are being invested in sustainable finance and that it's being disclosed in that fashion.

Can you elaborate on what specifically you're doing to move ahead in this area?

● (1330)

Mr. Mark Machin: Certainly. It's a terrific question.

I'll address some aspects, and Mr. Leduc may want to add.

With respect to what we call “sustainable investing”, I referenced that we have four, and now five, areas we're particularly focused on. Climate change has been one that we've been focused on for the last 10 years.

Most recently our head of sustainable investment was a member of the FSB's task force on climate-related financial disclosures. That work was completed last summer and announced at the G20 last summer by Governor Carney. We have committed to implementing that ourselves by fiscal 2021. One of the reasons is that we need sufficient disclosure from all of our portfolio companies to build up so that we understand what we have and the risks we have. We need more and more of those companies to adopt those disclosure mechanisms.

In the meantime we're very focused on continuing to implement stronger understanding of the risks that we're taking on in climate change, first from the bottom up, so we're developing a tool kit. We go into a lot of detail on it in the annual report. There is a tool kit that we're developing for each investment team so that they can address and understand the risk they're taking on in the investments they're making.

We're also doing a top-down assessment of all the risks we're taking on. We have a carbon footprinting tool that we're developing. There is no perfect tool in the world to do that today, but we are working with best practices around the world to develop our own proprietary tool. We're developing our own model for energy transition and the speed of that transition, which is critical to understanding the risks we're taking on, and beyond I would highlight that we now have a dedicated team investing in renewable energy. We have made a number of renewable investments here in Canada, in Europe, in India, and in Brazil in the last year, and we continue to commit to growing that investment. We mentioned a $3-billion number for where we expect that portfolio to grow.

Today we announced that we're issuing a green bond. I think we're the first pension fund in the world to issue a green bond, which we'll use to partially finance those investments.

Ms. Jennifer O'Connell: Thank you. I think China is doing a green bond. They are looking at it, but you are probably right that you're the first investment fund.

Just before you jump in, Mr. Leduc, do you have targets for investment? I realize that on the investments you currently have and the disclosures and the climate risks, it will take some time to gather that information, but moving forward on anything new that you invest in, do you have a target in terms of percentages for how much risk can be associated in any new portfolio based on climate?

Mr. Mark Machin: First of all, we're believers in climate change. We think climate change is happening. Second, it's a very complicated risk, which affects many aspects, and one of the challenges is understanding all the risks. Whether it's the physical and geographical changes or regulatory changes or consumer behaviour changes, there are a whole variety of changes we have to assess for every investment we take on, so we look at every investment we make through that lens to understand all the risks. Our investment mandate is to maximize returns without undue risk of loss.

Everything we look at, we look at through that lens of risk and return. We have to make sure we're being sufficiently compensated for all of those risks we're taking on, that we have an adequate return on the investments.

● (1335)

Ms. Jennifer O'Connell: Thank you.

I don't know—

The Chair: Mr. Leduc, would you comment?

Mr. Michel Leduc: Mr. Machin has been comprehensive, so I wasn't planning on adding anything.

Ms. Jennifer O'Connell: Okay. Thank you.

The Chair: Thank you.

Mr. Poilievre is next.

Hon. Pierre Poilievre (Carleton, CPC): Thank you, Mr. Machin, for your service to the country. Based on my reading of your bio, there's no one who would be more qualified to shoulder this enormous task. Thank you as well for being here today.

My first question relates to the Trans Mountain pipeline. Have you ever discussed this pipeline with the Minister of Finance or any member of the government?

Mr. Mark Machin: No, I have not. I've not discussed it. What I can say is that Greenhill, which is the financial adviser to the federal government, has approached us, but we have not taken on any confidential information. I believe they have approached a lot of funds domestically and internationally, but we have not taken on any confidential information and we have not had any detailed discussions.

Hon. Pierre Poilievre: Pardon me; I had my earpiece out. Who did you say approached you?

Mr. Mark Machin: It was Greenhill, the investment bank.

Hon. Pierre Poilievre: Is your fund doing any analysis on value of the assets that are for sale?

Mr. Mark Machin: At this stage, we haven't done any analysis. We're still evaluating the situation. Obviously we have an obligation to investigate and assess any major investment opportunity that comes along and to fully understand all the risks, fully understand the potential returns, and to understand the fit for our portfolio as well. We'll decide whether to evaluate it further.

Hon. Pierre Poilievre: Neither you nor any member of your management or board has discussed the Trans Mountain pipeline with any member of the government?

Mr. Mark Machin: No.

Hon. Pierre Poilievre: Okay.

Obviously you're going to receive more contributions based on the schedule of increased payroll taxes that the government has set on track.

The Fraser Institute reports that 83% of your holdings are outside of Canada. We understand you need to diversify internationally, given your mandate to maximize returns without undue risk of loss; however, an increase in CPP contributions will necessarily reduce private savings, and private savings are typically affected by home bias, which is that when people are investing their own money, they tend to invest in their own country. What do you think about the suggestion that if Canadians are diverted away from their own private savings and into CPP, more of those savings will translate into investments outside of Canada rather than being invested here at home?

Mr. Mark Machin: Thank you. That's an interesting question.

From our point of view, our mandate is very clear: it is to invest the funds that are not immediately needed and to make sure that we are maximizing returns without undue risk of loss. As you said, diversification is a really key element of that, from both a return point of view but particularly from a risk point of view. It's to make sure that we don't have all our eggs in one basket, and one of the—

Hon. Pierre Poilievre: Right, and I'm not criticizing you for that at all. I think you are carrying out your mandate properly. I am asking whether the decision by the government to increase CPP contributions could have the effect of diverting savings that would otherwise have been invested by Canadians in Canada to, say, investments of which 83% will go abroad. Do you have any response to that?

Mr. Mark Machin: Mr. Leduc could comment.

Mr. Michel Leduc: I think that's a terrific question.

We don't have in our possession any studies that would demonstrate whether “long-term savings”—if I can use the word—increasing into the CPP will cannibalize private savings.

We're very interested in financial literacy in Canada, and what we see that Canada has as one of its biggest strengths is these three pillars to combat what is arguably one of the biggest financial challenges that any Canadian faces, which is lifelong retirement security. Our view is that all three pillars have to function and fire on all cylinders, whether it's saving at home, saving through CPP, or saving at work.

● (1340)

Hon. Pierre Poilievre: Thank you very much for that.

I see on page 16 of the report you provided the following quote:

> Because of the pressures and different objectives of prevalent shorter-term investing, we believe that individual security prices and current valuations often do not represent their long-term intrinsic value.

You're not alone in making this observation. It does seem as if the text written here would have been written by someone who is a value investor. Often when Canadians go to hire an investment adviser, they want to know the investment philosophy.

Would you describe yourself, Mr. Machin, as a Benjamin Graham–style value investor, or what investment philosophy do you bring to this role?

Mr. Mark Machin: I think that as an institution we do tend to be value investors, so we are looking for companies and opportunities and assets that are lower than their long-term intrinsic value. We try to take advantage of dislocations in markets or situations where things are not fully valued and invest in them so that we can make money for the fund over the long term, so yes, we absolutely look out for those opportunities, and a number of our strategies are more value-focused.

Hon. Pierre Poilievre: You're a bargain-hunter.

Mr. Mark Machin: We certainly love to find bargains. There are not many in the world these days, but we certainly are looking for them.

Hon. Pierre Poilievre: And do you—

The Chair: We'll have to leave it there before we find out how valuable this bargain is that Mr. Poilievre is onto.

Mr. Fergus is next.

[*Translation*]

Mr. Greg Fergus (Hull—Aylmer, Lib.): Thank you, Mr. Chair.

Thank you, Mr. Machin and Mr. Leduc. On behalf of all Canadians, I want to say how much we appreciate all your efforts to secure the Canada Pension Plan through your investment decisions.

In your 2018 annual report, you indicate that, as of March 31, the geographic breakdown of the CPP portfolio was as follows: roughly 38% in the U.S., nearly 20% in Europe, 15% in Canada, and 20% in Asia.

I'm curious as to whether that geographic mix is optimal in your eyes. Do you anticipate a change in the short term, and if so, why?

[*English*]

Mr. Mark Machin: We gradually will evolve the portfolio over time. I would say with respect to the U.S. that because it's the biggest economy in the world, the biggest capital market in the world, and one of the most developed investment markets in the world, it's likely to continue to be a large portion of our investments.

I'd say that gradually, over time, we'll increase our emerging market exposure. That's approximately 15% of the portfolio today. We published, on page 31 of the annual report, the strategic portfolio, which represents where we anticipate heading toward by 2022. We increase the emerging market weight toward 22% and we'd anticipate it to increase after that toward one-third of the fund. By 2025, we anticipate emerging markets will be 47% of global GDP, and by 2026 China could overtake the U.S. as the largest economy in the world, so we anticipate more of the money, being more responsible, to be more diversified into emerging markets over time.

[*Translation*]

Mr. Greg Fergus: That's great. Thank you.

You answered Mr. Albas's question on this, but there's something I'd like you to clarify. It has to do with the regular or, rather, base CPP and the additional CPP. I'd like to know how those strategies differ.

● (1345)

[*English*]

Mr. Mark Machin: Thank you very much for the question.

There is a lot of detail on pages 21 and 22 of the annual report. Since you have the annual report, it is probably too much detail to go into today, but essentially the additional CPP is more of a fully funded pool of capital versus the base CPP, which grows into its liabilities over the long term. It's a sustainable fund but it is not fully funded. That means that for the additional CPP, the investment returns and the funds available for paying the benefits are much more tightly correlated, so we should run a lower risk for that piece of the portfolio.

Therefore, we're going to run a lower risk for the additional CPP and we'll continue with the base CPP at the current risk levels.

[*Translation*]

Mr. Greg Fergus: I assume that, at some point, that will change or be adjusted. How many years will it take for the base CPP and additional CPP to even up or for the conditions to be more or less the same, in terms of the duty to clients.

[*English*]

Mr. Mark Machin: Over the long term, over many decades, gradually, there is the base CPP, which again is fully sustainable but is not fully funded. That gradually will converge over time as it becomes more funded over the decades ahead, and the risks that we'll be running for the two streams, the additional and the base CPP, will converge many decades in the future. They will converge toward each other in the future, yes.

[*Translation*]

Mr. Greg Fergus: You said that you planned to invest responsibly in new technology and data capabilities in order to be more competitive internationally.

Could you tell us how that kind of investment will improve your competitiveness? Also, what percentage of the entire investment portfolio will it represent?

[*English*]

Mr. Mark Machin: What I referred to in those remarks was some of the internal investment we'll be making to lift our capabilities. We, along with every asset manager in the world, understand that we have a lot of data, and data is valuable. If we can use that data effectively, then we should be able to enhance our capabilities as an investor, whether it's simply being more efficient operationally, whether it's sharing ideas more efficiently across the different investment teams, or whether it's using data to provide better insights for the investment teams.

It is something that we and all of our peers around the world are moving toward, and we expect to make sure we are doing that and investing in that in a responsible and prudent way, making sure we are keeping up with them and maintaining our competitiveness as other investors around the world invest in all of those areas.

The Chair: Thank you both.

Mr. Kmiec is next.

Mr. Tom Kmiec (Calgary Shepard, CPC): I noticed online that CPPIB has shares in Kinder Morgan that predated the government's announcement. Can you tell us more about that deal? The purchase was 50 million dollars' worth of shares.

I'd also like to know if pipelines are a good investment.

Mr. Mark Machin: I will double-check and we'll come back to the clerk with the information, but I'm guessing that $50 million is in a passive or balancing portfolio. That's what those shares would be, so it would be part of an index that we are investing in as part of the balancing part of the portfolio. I don't think it's an active investment.

With respect to pipelines, we are invested in pipelines here in Canada and elsewhere in the world. We have had positive experiences and we have had negative experiences, and it really depends on the regulatory risks and—

Mr. Tom Kmiec: Could you talk more about the negative experiences? What were those?

● (1350)

Mr. Mark Machin: We invested several years ago in a pipeline from Norway into Europe called Gassled. We invested alongside a number of our peers. Soon after we made the investment, we were surprised by a very significant change in the tariff regime for that pipeline by the Norwegian government. This is something we've been in legal proceedings on for a number of years. It was quite a surprise to us at the time.

Mr. Tom Kmiec: That was part of the regulatory risk of investing in it?

Mr. Mark Machin: Yes, that's part of the regulatory risk. It is a really critical part of due diligence to understand regulatory risk for any infrastructure investments, which are by nature long-term and very sensitive to various types of risk.

Mr. Tom Kmiec: In this case you are still litigating with the governments?

Mr. Mark Machin: I believe that's the case.

Mr. Tom Kmiec: Compare that to Canada. How do you find the regulatory risk here?

Mr. Mark Machin: It's very difficult to generalize. We have pipeline investments here. We're very comfortable with the pipeline investments that we have here today, but I could answer specifically only about particular situations.

Mr. Tom Kmiec: How about the Trans Mountain pipeline?

Mr. Mark Machin: As I said earlier, we haven't looked at that yet. We have been approached by the federal government's adviser, but we haven't taken on any confidential information and we haven't had any detailed discussions.

Mr. Tom Kmiec: Is that because of the regulatory risk?

Mr. Mark Machin: No, it's purely because it's at an early stage and we don't have any confidential information or any of the information we need to assess the situation.

Mr. Tom Kmiec: Is it something you would consider investing in?

Mr. Mark Machin: We haven't decided yet. We're still evaluating the situation. We have an obligation to assess every major investment opportunity that comes along, fully understanding the risks, potential returns, and how it might fit into our portfolio.

Mr. Tom Kmiec: What are the kinds of risks that would make investing in the pipeline unacceptable to the CPPIB? What is too much risk when it comes to an asset like a pipeline?

Mr. Mark Machin: As I said, with any investment you're measuring the risks versus the potential returns, and that's the equation we look at in any investment. That's the equation we need to thoroughly understand on both sides of every single investment we make.

Mr. Tom Kmiec: CPPIB has invested in Wolf Midstream Inc., which earlier this year acquired Access Pipeline, the entire ownership. You're also invested in Star Capital Partners, which acquired TotalFinaElf Pipelines, or TPL, and the TotalFinaElf Connect pipeline between the United Kingdom and Scotland. In those cases, it had to be part of the portfolio you assessed.

Is it just diversifying, making sure you're diversified across the board in that particular sector, or is it looking at things like how much risk you're taking on? Is there too much regulatory government risk, political risk?

Mr. Mark Machin: Certainly the risks you mention are two or three of the many risks we need to look at when we make any investment. I'd say pipelines and infrastructure are very long-term investments. Always critical to our assessment, however, is thoroughly understanding every one of the risks we're taking on and making sure we're sufficiently compensated by making sufficient returns. As you said, we do have pipeline investments around the world, those you mentioned and others in other places.

Mr. Tom Kmiec: Thank you. I'm done.

The Chair: Go ahead, Mr. Sorbara.

Mr. Francesco Sorbara (Vaughan—Woodbridge, Lib.): Thank you, Mr. Chair, and good afternoon, gentlemen.

To elaborate a little bit more, it's great to see my colleagues on the other side asking about pipelines. We're going to build that Trans Mountain pipeline from Alberta to B.C. and make sure that we diversify our export markets for Canadian resources. That $12 billion to $15 billion we're not getting for those Canadian resources needs to be captured. That will pay for more schools, more hospitals, more services for Canadians, and we'll get to narrow the discount between WTI and WCS, which will be great.

I take it once there is a data room set up for the Kinder Morgan pipeline, whenever that may happen, most likely there will be a number of institutional buyers that, I can conjecture, would be ready to take a look at such a great asset and something of significant value.

Am I off on that, or am I on the right track?

Mr. Mark Machin: We and many of our peers will have an obligation to assess precise investment opportunities in infrastructure. I mentioned before that the pipeline—with a small *p*, if you will—opportunities around the world are a real challenge for people. It's the same here in Canada and most countries in the world, and when a sizable opportunity comes along, we have a responsibility to evaluate it and understand the risk/return along with the fit in our portfolio.

● (1355)

Mr. Francesco Sorbara: Absolutely.

One of the attractions, and one of the difficulties, for CPPIB is size, the size of investment. Your folks' investment fund requires liquidity. It requires a sizeable investment. Making a $100-million investment for some funds is not a lot, but something like a $4.5- or $5-billion investment is attractive not only to yourselves, but also to other Canadian investment funds, be it teachers', OMERS, HOOPP, or bcIMC, and so forth. The size thing will be attractive, I think, to a lot of funds.

Mr. Mark Machin: I'd say, again, that in infrastructure we do look at investments, typically, of about $500 million around the world. We have only a limited capacity to evaluate opportunities here in Canada and also around the world, so size opportunities are welcome.

Mr. Francesco Sorbara: Absolutely, especially, in particular, with regard to your opening remarks, when you talked about the glut of capital and what that means in the world, and about how capital is chasing what we call “real assets” in the investment world: not brownfield opportunities, because they need to be in a different vein, but green field—sorry, brownfield assets, not green field assets.

On that front, for us, the pipeline would diversify our exports markets of Canadian oil away and to markets where demand for oil, frankly, is still increasing. Asia's demand for oil is going to be increasing today. It's going to be increasing tomorrow and for the foreseeable future. It will be great to have those markets served with Canadian resources.

On that front, I just want to pivot and ask how competitive it is. There's a lot of capital out there. That means yields are low and prices are being bid up. How is CPPIB finding that area?

Mr. Mark Machin: I think your question refers generally to the—

Mr. Francesco Sorbara: Investment climate.

Mr. Mark Machin: —investment climate around the world.

It is a challenge around the world now. With regard to markets, there is volatility that increased in the fourth quarter of our fiscal year, so evaluations have come off a little bit in certain areas around the world. However, it's still a challenge, given the wall of money. For example, in private equity, about $1.7 trillion is chasing private equity opportunities around the world, which is by far the largest pool of uninvested capital we've ever seen. It's a similar story in infrastructure and real estate and across most markets. It's a challenge for us. We need to be patient. We need to be selective. We need to find the right opportunities.

Mr. Francesco Sorbara: For the most part, CPPIB's long-short strategy and the other investment measures you've taken.... As someone who's worked on the street and follows the investment industry quite closely, I applaud your returns. I applaud your sustainability. Sustainability is difficult. The typewriter was sustainable for a period of time, but we don't use the typewriter anymore. Even on the renewable energy front, there are a lot of renewable energy companies that were first movers but are no longer in existence, so in terms of your returns, I applaud the team down there and the strides that you have made, and so forth.

With regard to the enhanced CPP that we put in place that will benefit literally millions of Canadians starting in 2019, will it be difficult to place those funds for investment purposes?

Mr. Mark Machin: With regard to the additional CPP, it gradually builds up over a number of years. I think the office of the chief actuary anticipates about $1.5 billion of additional money in that first year, and it gradually increases after that.

We don't think it's going to be a challenge to diversify appropriately and invest that money prudently and carefully. I think that while today, as I said on the specific private assets, markets are fully priced in many cases, over time we'll be able to find sufficient value and appropriate destinations for that capital.

● (1400)

Mr. Francesco Sorbara: Thank you, Chair.

The Chair: We have a quick question from Mr. Dusseault and a quick question from Mr. Poilievre, and then we'll close.

I did have one question. It relates to the Canada Pension Plan Investment Board Act. Are there any changes needed in that act to make it more effective, or are we okay with where we're at?

Mr. Michel Leduc: The act has stood the test of time. It's a really strong, sound piece of legislation. It was recently amended to ensure the differences between base and additional CPP.

We continue to evolve our approach within the framework that's provided, particularly on our disclosure. Disclosure doesn't stand still, so we continue to work hard to exceed those requirements, but the framework itself is solid and sound.

The Chair: Okay. Thank you.

Go ahead, Mr. Dusseault.

[*Translation*]

Mr. Pierre-Luc Dusseault: I'd like to quickly come back to one of your governance factors. I mentioned it earlier, as did you—executive compensation.

What criteria do you use to assess the executive compensation policies of the companies you have a stake in? There is increasing discussion around the ratio between what a company's executives earn and what its workers earn. Some argue that the CEO should earn no more than 30 times what the average worker at the company does.

Is that the sort of thing you take into account? If not, what criteria do you use?

[*English*]

Mr. Mark Machin: Thank you for the question.

Executive compensation is a focus area for us for our sustainable investments. We think there need to be clear and appropriate links between executive pay and company performance so that it contributes to an alignment of interests between management and long-term investors. We think that when interests are aligned, long-term shareholder value is more likely to be created, so we look for a clear link between executive pay and company performance. We look for appropriately structured executive compensation programs that emphasize long-term sustainable growth of shareholder value. We look for full disclosure in corporate reporting of compensation information and a clear rationale for the compensation decisions. Those are some of the areas that we are focused on and engage on with the companies we invest in.

The Chair: Mr. Poilievre, you have the last question.

Hon. Pierre Poilievre: You said that CPPIB was approached on a project by the government selling agent for the Trans Mountain pipeline. What date was CPPIB approached?

Mr. Mark Machin: I will have to get back to the clerk on the exact date. It was very recent.

Hon. Pierre Poilievre: Was it in the last 10 days?

Mr. Mark Machin: Yes.

The Chair: Is that adequate, or do you want the exact date?

Hon. Pierre Poilievre: Mr. Machin indicated that he could get back to the committee with the exact date. That would be helpful.

The Chair: There are a couple of points that you can get back to the committee on and send to the clerk, and that will be fine.

I know we had a pretty quick hearing this time around, but I think it was very productive. Thank you for the annual report as well. There is a lot of information in there. Thank you for the good job that you do. I think when you're getting 12% average return, or a little better than that, over the last five years, it's pretty impressive.

Thank you.

The meeting is adjourned.