Opening statement

Thank you for inviting us.

We would like to talk to you about pension savings, how they are invested and the major transformations that have occurred over the last 30 years. Many changes have been unintended, and several have been quite damaging for both individual pensioners and the Canadian economy.

The negative effects include a substantial decline in private sector employees covered by pension plans, a rise in much less efficient defined contribution plans at the expense of defined benefit plans, an increased reliance on subjective, opaque, and illiquid private markets, disinvestment from transparent, liquid public markets, increased investment in low return bonds, increased herding to the detriment of independent fundamental analysis resulting in a decrease of vitality.

But the negative effect that seems to attract the most attention has been the dramatic drop of Canadian public equities held by Canadian pension funds from 80% of their total equities in 1990 to probably less than 10% now representing less than 4% of their total assets.

The argument most often used to justify this behaviour is the expectation of higher returns in foreign markets.

In fact, returns in Canada have historically exceeded most other world markets and by comparison, current valuation metrics are quite favourable.

But let us assume for a moment that returns in Canada will be lower. The question remains whether maximizing single portfolio returns to the exclusion of other factors is the correct global strategy for the country as a whole?

If pension funds siphon away Canadian savings under the guise of higher expected returns without considering the effect this may have on the ability of their contributors to earn incomes, the return calculations are incomplete from the point of view of the Canadian economy.

A $100 invested outside the country may generate an extra dollar in returns, but the impact of the absence of the $100 invested in the local economy may be much greater. The loss in domestic investment, sales, salaries, and profits because of a lack of local investment by committed domestic investors can easily overshadow any pickup in income that may have come from a higher return elsewhere.

We may have already started to see the effects of this dynamic. GDP per capita in Canada in 1980 was 92% of US GDP per capita. This had fallen to 73% by 2020.

Consider these two cases:

1. A Canadian investor takes $100 of savings and invests it abroad. After one year, they repatriate the $100 and $10 of profit. Their return is 10%.
2. A Canadian investor takes $100 of savings and invests it in a machine that produces $205 of product in the year. The costs are $100 of labour salaries and $100 of wear on the machine, leaving $5 of profit. Their return is 5%.

In case 1 Canada's GDP would rise by $10, the profit. In case 2, GDP in Canada would rise by $205, the salaries, the machine, and the profit.

From the Canadian investor's point of view, the foreign investment gives a higher return but from a GDP perspective, from a GDP per capita perspective, from the perspective of Canada's ability to save, the domestic investment is by far the better one. In addition to these considerations, foreign investments can also present governance, political, legal, currency, supply, and other risks which can sometimes be better managed domestically.

It is unreasonable to think that Canadian pension funds will see the opportunity cost of the loss of investments to the Canadian economy, to the ability of their contributors to earn good incomes and save. They cannot consider what they cannot see. As a result, moral suasion cannot correct for these negative effects. Only a national policy reflected in appropriate regulation can constructively deal with the problem.

In 2021, investment in Canada accounted for 20.2% of GDP compared to 18.2% in the United States. What these statistics hide is that investment in residential real-estate in Canada was 9.7% versus 4.9% in the United States. Which left 10.4% for non-residential investment in Canada and 13.3% in the United States, close to 30% more. On a per capita basis the United States invests 75% more!

There is room in Canada for more non-residential investments. Given that Canada is a less developed economy than the United States, it may need even more again.

We have prepared a series of reports that examine these unintended and undesirable effects resulting from the changes that have occurred in pension management over the last 30 years. Evidently none of this can be corrected overnight but some relatively simple solutions can be implemented which can incentivise the proper behaviours without imposing strict constraints.

It is incumbent on government to regulate these behaviours.

Thank you again.