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President and Chief Executive Officer

December 7, 2007

BY EMAIL: CFIUS@do.treas.gov

U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220
Attention: Office of International Investment

Dear Sirs/Mesdames:

Re: Forthcoming FINSA Regulations

We are writing in response to the Treasury Department's invitation to comment on issues relating to the existing national security review process, as well as issues raised by the *Foreign Investment and National Security Act of 2007* (FINSA).

Introduction to CPPIB

The Canada Pension Plan Investment Board (CPPIB) is an asset management organization that was created by Act of Parliament in December 1997 as an independent entity to invest and maximize the return on the assets of the Canada Pension Plan (the Plan) without undue risk of loss. The Plan is a mandatory contributory defined benefit pension plan operated for the benefit of 17 million Canadians. All Canadian employers and employees, except for those in the Province of Québec, make mandatory contributions to the Plan. CPPIB's assets were valued at C\$121.3 billion as of September 30, 2007, and are projected to grow to C\$312 billion in 2019.

CPPIB is created and owned by the Canadian federal government, CPPIB's board of directors is appointed by the Canadian federal government (following consultation with nine out of ten of Canada's provincial governments), and CPPIB exists solely to invest and maximize the return on the Plan to fund old age pensions pursuant to Canadian federal legislation.¹ However, CPPIB's governance structure was designed to prevent political interference. We operate in accordance with a legislated investment-only mandate. CPPIB's investment decisions are not influenced by government direction, regional, social or economic development considerations, or any other non-investment objectives. Directors are appointed for a three year term and can only be removed for cause. We demonstrate our observance of these features through a high degree of transparency, including reporting to the public like a Canadian public company. CPPIB is not a sovereign wealth fund, and instead is internationally recognized for its independence from government influence.²

¹ Those pensions are provided under the *Canada Pension Plan*.

² See Directorate for Financial and Enterprise Affairs, Insurance and Private Pensions Committee, Working Party on Private Pensions, *OECD Seminar on Sovereign and Public Pension Reserve Funds -- Sovereign Wealth & Pension Reserve Fund Issues*, copy of draft (subject to further revision) attached, at paras. 5.2(i) and 40. See also the notes for remarks by Gail Cook-Bennett, Chair of CPPIB, copy attached.

CPPIB is an active investor outside of Canada. As of September 30, 2007, more than 44.6% of our asset value was invested outside of the country and this percentage is projected to steadily increase over time. Almost half (approximately C\$26 billion) of this foreign investment is in the United States, including investments in publicly traded stocks, private companies, infrastructure and real estate. Consequently, CPPIB has a keen interest in the opportunities for foreign investment and, more specifically, any negative effect that FINSA will have on our ability to invest in the United States.

Foreign Investment and National Security

We applaud the desire of the United States to seek the appropriate balance between, on the one hand, the clear benefits from foreign investment in creating jobs and raising productivity and the standard of living and, on the other, the unquestionable need for the United States to fully perform its national security mandate. We are concerned, however, that some aspects of FINSA could negatively affect the ability of foreign persons like CPPIB to complete U.S. investments without any countervailing national security benefit. We believe that these concerns can and should be addressed in the forthcoming regulations.

Our Concerns

We have two areas of concern. First, we believe that foreign persons like CPPIB should not be considered foreign government-controlled for FINSA purposes. Second, we believe that the definition of “critical infrastructure” should be clarified and narrowed. These concerns are addressed below.

1. Foreign Government-Controlled Transactions

Foreign government-controlled transactions receive heightened scrutiny under FINSA. We take an interest in this framework because we cannot rule out the possibility that the Committee on Foreign Investment in the United States (CFIUS) could determine that entities like CPPIB are foreign government-controlled within the meaning of FINSA. We submit that such a determination would be incorrect and that CPPIB and others like us should not be seen as foreign government-controlled within the meaning of FINSA and that the forthcoming regulations should provide a means for making this clear.

Heightened Scrutiny

Foreign government-controlled transactions are subject to mandatory second stage, 45-day national security investigations.³ Such transactions, therefore, face the prospect of the first stage 30-day review and mandated second stage investigation for a total period under CFIUS examination of 75 days. While the Secretary of the Treasury and the head of the lead agency are empowered to exempt such a transaction from the second stage investigation if they jointly determine that it will not impair the security of the United States,⁴ the starting point for foreign government-controlled transactions is a mandated 75-day examination period. This can be contrasted to all other covered transactions which are subject to a 30-day review and only move to the second stage investigation on a discretionary basis.

³ 50 U.S.C. App. § 2170(b)(1)(B).

⁴ 50 U.S.C. App. § 2170(b)(2)(D)(i).

In addition to the longer mandatory examination period, the fact of being a foreign government-controlled transaction is identified as a specific factor for consideration by the President when taking into account the requirements of national security.⁵

If entities like CPPIB are subjected to this framework, we could be at a significant disadvantage relative to other bidders in a competitive auction for a covered transaction. Depending on the circumstances, the prospect of enhanced scrutiny (in particular, the mandatory second stage investigation) could significantly reduce the interest of a seller in a bid by CPPIB or the interest of a bidding syndicate in having CPPIB join as a participant -- it may be the difference between CPPIB succeeding in a particular investment or not. The potential chilling effect on foreign investment of this competitive disadvantage may be an appropriate price for the United States to pay in the interests of national security for foreign government-controlled investors but not, in our view, for foreign persons like CPPIB.

Foreign Independent Public Pension Fund Investors

CPPIB believes that we, and others like us, should not be considered to be foreign government-controlled within the meaning of FINSAs because, although created and owned by the Canadian federal government as described earlier in this letter, our investment decisions are not subject to government influence or control, our assets are not available for any purposes other than paying defined benefits under the Plan, and we maintain a high degree of transparency, including into our investment policies. CFIUS could readily distinguish such entities from foreign government-controlled investors within the meaning of FINSAs by applying the following criteria:

(a) **The entity is constrained by an investment-only mandate.** In describing a foreign government-controlled transaction, FINSAs refers to “an entity controlled by or acting on behalf of a foreign government.”⁶ This phrase implies some level of government or political influence over the decisions and operations of the entity and it is this concern about foreign government influence that gives rise to a national security concern requiring heightened scrutiny by CFIUS. In contrast, where an investment body, even one created and owned by a foreign government, is protected from governmental or political interference and is mandated to make investment decisions not based on furthering governmental aims but purely in terms of traditional investment goals such as maximizing returns while minimizing the risk of loss, the national security concerns arising from foreign government influence are absent. In recent testimony, Under Secretary McCormick identified some of the risks of foreign government-controlled investors, such as sovereign wealth funds:

“... through inefficient allocation of capital, perceived unfair competition with private firms, or the pursuit of broader strategic rather than strictly economic return-oriented investments, sovereign wealth funds could potentially distort markets.”⁷

An entity mandated to invest solely on the basis of traditional investment goals will not raise any of the concerns cited by Mr. McCormick.

⁵ 50 U.S.C. App. § 2170(f)(8).

⁶ 50 U.S.C. App. § 2170(a)(4) .

⁷ U.S. Treasury Under Secretary for International Affairs David H. McCormick, Testimony before the Senate Committee on Banking, Housing and Urban Affairs (Nov. 14, 2007).

In the case of CPPIB, the *Canada Pension Plan Investment Board Act* (the CPPIB Act) limits our objects to assisting the Plan to meet its obligations to contributors and beneficiaries under the *Canada Pension Plan* (the CPP Act), managing the federal pension plan contributions transferred to CPPIB in the best interests of the contributors and beneficiaries, and investing CPPIB's assets with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the funding of the Plan and its ability to meet its financial obligations on any given business day.⁸ The CPPIB Act prohibits CPPIB from "directly or indirectly, carry[ing] on any business or activity or exercis[ing] any power that is inconsistent with [CPPIB's] objects."⁹ The board of directors of CPPIB has a fiduciary obligation to adhere to these objects.

Plainly stated, CPPIB has an investment-only mandate.

(b) Government does not have access to the entity's assets to fund general government purposes. Government access to investment funds gives rise to the very type of concerns emphasized by Under Secretary McCormick, because there is a high risk that governmental or political considerations could influence investment decisions. In contrast, those concerns do not arise where the funds held for investment are available for only a specific and limited purpose, and the government cannot access those funds to support general government purposes.

In the case of CPPIB, no federal or provincial government has any right to access CPPIB's assets to support general government purposes. Instead, contributions made to the Canada Pension Plan and CPPIB's assets are segregated from government assets, and those contributions and CPPIB's assets can be withdrawn only to pay benefits under the Plan.

CPPIB's assets are isolated even further because no Canadian federal or provincial government contributes amounts to the Plan or to the operations of CPPIB, or pays any benefits under the Plan. Instead, Plan contributions are collected from every covered employee and employer in Canada -- including all private sector employers and employees outside the Province of Québec -- and are credited to an account called the Canada Pension Plan Account established for the sole purpose of receiving contributions and paying benefits under the Plan.¹⁰ This account is a separate account within, but segregated from the rest of, the federal Consolidated Revenue Fund into which taxes and other amounts owing to the federal government are paid and from which federal government obligations are discharged. Amounts received on account of contributions under the CPP Act are required to be credited to the Canada Pension Plan Account,¹¹ and all amounts paid on account of benefits under the CPP Act are charged to that Account.¹² In addition, all amounts credited to the Canada Pension Plan Account in excess of the immediate obligations of that Account are required to be transferred to CPPIB for investment by it in accordance with its objects.¹³ By agreement between the federal government and CPPIB, this is done on a weekly basis.

⁸ Section 5 of the CPPIB Act.

⁹ See Section 6(2) of the CPPIB Act.

¹⁰ Section 108(2) of the CPP Act. The Canada Pension Plan Account is established under section 108(1) of the CPP Act. The Province of Québec requires that employers and employees in that province contribute to the Québec Pension Plan, which is separate from the Canada Pension Plan and not managed by CPPIB.

¹¹ Section 108(2)(a) of the CPP Act.

¹² Section 108(3)(a) of the CPP Act.

¹³ Section 108.1(1) of the CPP Act.

While CPPIB is required to pay to the credit of the Canada Pension Plan Account any amount required to pay benefits under the Plan if so requested by the federal Minister of Finance,¹⁴ no federal or provincial government has any other access to the Canada Pension Plan Account or to CPPIB's assets. Since no federal or provincial government pays, or has any obligation to pay, the benefits under the Plan, those transfers by CPPIB to the Canada Pension Plan Account do not indirectly fund any government spending.

In summary, the manner in which the Plan and CPPIB are funded, and the limited purpose for which CPPIB's assets can be withdrawn (*i.e.* only to pay benefits under the Plan), when considered in light of CPPIB's investment-only mandate (described above) and the transparency of CPPIB (described below), eliminates the risk of governmental or political influence.

(c) **The entity maintains a high degree of transparency.** Even where national legislation creates what appears to be an independent entity with an investment-only mandate for managing specific, limited purpose and segregated funds, it is important to be able to ensure that these features are being respected in practice. For that reason, in distinguishing foreign government-created but not controlled entities under FINSA from those that are foreign government-controlled, it is appropriate to expect a high degree of transparency from the former.

CPPIB is a highly transparent organization. It must cause annual financial statements to be prepared in accordance with Canadian GAAP and containing prescribed information.¹⁵ An annual auditor's report must be prepared in respect of the annual financial statements.¹⁶ CPPIB must prepare quarterly financial statements as well.¹⁷ The quarterly financial statements must be made available to the public,¹⁸ and the annual financial statements must be included in CPPIB's annual report,¹⁹ which must also be made available to the public and tabled before Parliament.²⁰ In addition to the annual financial statements, the annual report must include a certificate, signed by a director on behalf of the board of directors, stating that CPPIB's investments held during that year were in accordance with the CPPIB Act and CPPIB's investment policies, standards and procedures, a statement of CPPIB's objectives for that year and the extent to which they were met, a statement of CPPIB's objectives for the next year and the foreseeable future, and a statement of CPPIB's investment policies, standards and procedures.²¹

In addition, the federal Minister of Finance must cause a special examination to be carried out in respect of CPPIB at least once every six years in respect of the financial and management controls and information systems maintained by CPPIB to determine whether CPPIB's assets were safeguarded and controlled and whether its financial, human and physical resources were managed economically and efficiently and that its

¹⁴ Section 56 of the CPPIB Act and sections 108.1(2) and 108(3)(a) of the CPP Act.

¹⁵ Sections 39(4) and (5) of the CPPIB Act.

¹⁶ Section 40(1) and (2) of the CPPIB Act.

¹⁷ Section 39(6) of the CPPIB Act.

¹⁸ Section 50(2) of the CPPIB Act.

¹⁹ Section 51(3)(a) of the CPPIB Act.

²⁰ Section 51(1) and (2) of the CPPIB Act.

²¹ Section 51(3)(a) - (f) of the CPPIB Act.

operations were carried out effectively.²² Moreover, CPPIB is required to hold a public meeting once every two years in each participating province to discuss its most recent annual report and to give interested persons an opportunity to comment on it.²³ A notice of each such meeting must be published in a newspaper of general circulation identifying the time and place of the meeting and indicating where copies of the annual report can be obtained.²⁴ One or more directors or officers of CPPIB must be present at each such meeting to answer questions from the public.²⁵

In short, CPPIB is a transparent organization, subject to scrutiny with respect to its financial performance and investment activities by its key beneficiaries -- the Canadian public.

We do not believe that any national security purpose is served by treating the covered transactions of foreign persons that satisfy the foregoing criteria as foreign government-controlled transactions. We believe further that the United States should want to make this clear lest the prospect of enhanced scrutiny (in particular, the mandatory second stage investigation) significantly impedes desirable foreign investment. Finally, as Congress noted, one of FINSA's goals is to allow "CFIUS to focus its resources and efforts on those cases involving foreign governments that truly raise national security concerns."²⁶ We submit that such cases do not include covered transactions involving foreign persons that satisfy the foregoing criteria.

Implementation

If the Treasury Department is in agreement with the foregoing, implementation could take any number of forms. We submit that there are two obvious and desirable forms -- first, a definition of "foreign government-controlled" for the purposes of FINSA that expressly exempts foreign government-created entities meeting specified criteria such as those described above; or second, a process to allow entities to apply for an advisory opinion that they should not be considered to be foreign government-controlled for the purposes of FINSA.

As to the first form, the forthcoming regulations could exclude from foreign government-controlled transactions any covered transactions effected by foreign persons that satisfy the following criteria:

- (i) The entity is constrained by an investment-only mandate;
- (ii) No foreign government has access to the entity's assets to fund general government purposes; and
- (iii) The entity maintains a high degree of transparency.

As to the second form, the regulations could empower CFIUS to make a determination upon the application of a foreign person satisfying the foregoing criteria (on a blanket basis, whether or not in the context of a specific transaction) that the foreign person would not be considered to be foreign government-controlled for the purposes of FINSA. Any such determination would not, of course, limit the discretion of CFIUS to undertake a second stage investigation of a covered transaction on account of other national security concerns.

²² Sections 47(1), 39(1)(b) and 39(2)(a) and (c) of the CPPIB Act.

²³ Section 52(1) of the CPPIB Act.

²⁴ Section 52(2) of the CPPIB Act.

²⁵ Section 52(3) of the CPPIB Act.

²⁶ S. Rep. No. 110-80, at 9 (2007).

2. Definition of “Critical Infrastructure”

For the first time, FINSA introduces the concept of “critical infrastructure” into the CFIUS review process. The interpretation of this term will be important to foreign entities seeking to invest in U.S. infrastructure. We believe that the definition of “critical infrastructure” in FINSA suggests that it should have a narrower application for purposes of CFIUS national security reviews than it has been given in other U.S. homeland security contexts.

The *USA Patriot Act of 2001* and the *Homeland Security Act of 2002* define “critical infrastructure” as “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters” (emphasis added).²⁷ FINSA’s definition of critical infrastructure omits any reference to “national economic security, national public health or safety, or any combination of those matters” and is only concerned with infrastructure the “incapacity or destruction of [which] would have a debilitating impact on national security.”²⁸ While elsewhere FINSA expands the definition of “national security” to include “those issues relating to ‘homeland security’”,²⁹ it clearly did not intend for CFIUS to import the extremely broad definition of the homeland security statutes. If it had, there would be no need for FINSA to provide a special definition of “critical infrastructure” for purposes of CFIUS review.

While the Treasury Department is in a much better position than CPPIB to determine an appropriate framework for clarifying and narrowing the definition of critical infrastructure, we submit the following are examples of the kinds of infrastructure systems and assets that should not be considered critical for purposes of CFIUS review:

(a) **Physical infrastructure systems and assets for which there are viable alternatives.** Examples would include power plants representing only a portion of a region’s generating capacity; and roads, highways, almost all bridges, railways and airports (with respect to which there will always be alternative routes).

(b) **Infrastructure systems and assets in sectors or industries where there are a number of competitors offering comparable services or products.** Examples would include almost all financial institutions, transportation companies, and large parts of the energy sector.

(c) **Health systems where there are viable public and private alternatives.**

While some determinations must of necessity be fact specific, it is important that Treasury provide as much guidance as possible on the meaning of “critical infrastructure” so that (i) foreign persons know when their transactions involve critical infrastructure and notice should be filed with CFIUS, and (ii) CFIUS is not inundated with cautionary filings for the many transactions that could fall under the broad definition but that do not raise any national security concerns.

²⁷ 42 U.S.C. § 5195c(e); and 6 U.S.C. § 101(4) (incorporating, by reference, the definition in 42 U.S.C. § 5195c(e)).

²⁸ 50 U.S.C. App. § 2170(a)(6).

²⁹ 50 U.S.C. App. § 2170(a)(5).

NAFTA Considerations

We note that Chapter 11 of the *North American Free Trade Agreement* (NAFTA) requires that the United States not discriminate against Canadian or Mexican investors establishing or acquiring an investment in the U.S. and to treat those investments fairly and equitably. Addressing the concerns set forth above would be consistent with the obligations of the United States under NAFTA.

Conclusion

Thank you for the opportunity to comment on the above areas of concern to CPPIB. We hope you consider that our comments strike an appropriate balance between the need for the United States to fully perform its national security mandate, and the objective of not unnecessarily impeding foreign investment and the benefits to the United States that flow therefrom. If you would like further elaboration on our comments, please do not hesitate to follow-up with me (416-868-6940) or Babak Abbaszadeh, Director, Stakeholder Relations (416-868-6612).

Yours very truly,

A handwritten signature in black ink, appearing to read "David F. Denison". The signature is stylized with a large, sweeping initial "D" and "F".

David F. Denison

Please see the first attachment re: OECD report on the next page

**Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development**

**DIRECTION DES AFFAIRES FINANCIERES ET DES ENTREPRISES
DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
INSURANCE AND PRIVATE PENSIONS COMMITTEE
WORKING PARTY ON PRIVATE PENSIONS**

**Room Document 1
(English)**

OECD SEMINAR ON SOVEREIGN AND PUBLIC PENSION RESERVE FUNDS

SOVEREIGN WEALTH & PENSION RESERVE FUND ISSUES

**[Draft report made public during a public OECD seminar on December 4, 2007 in Paris.
Subject to Finalization.]**

SOVEREIGN WEALTH & PENSION RESERVE FUND ISSUES

*Adrian Blundell-Wignall, Yu-Wei Hu and Juan Yermo**

I. Introduction

1. Sovereign Wealth Funds (SWFs) are pools of assets owned and managed directly or indirectly by governments to achieve national objectives. They may be funded by: (i) foreign exchange reserves; (ii) the sale of scarce resources such as oil; or (iii) from general tax and other revenue. There are a number of potential objectives of SWFs, which are not always easy to attribute to a particular fund; and some funds may have more than one of the distinguishable objectives. Some of these are: (i) to diversify assets; (ii) to get a better return on reserves; (iii) to provide for pensions in the future; (iv) to provide for future generations when natural resources run out; (v) price stabilisation schemes; (vi) to promote industrialisation; and (vii) to promote strategic and political objectives.

2. These funds have raised concerns about: (i) financial stability, (ii) corporate governance and (iii) political interference and protectionism.

3. At the same time governments have formed other large pools of capital, in particular to finance public pensions, which are generally referred to as Sovereign and Public Pension Reserve Funds (SPPRFs). There are two such types of funds: those set up and owned directly by government (Sovereign Pension Reserve Funds, or SPRFs) and those belonging to the social security system (Public Pension Reserve Funds, or PPRFs). SPRFs may be considered a type of SWF with a specific mandate to finance future public pension expenditures. On the other hand, not all PPRFs may be considered SWFs. Some are legally independent of government and their balances are not integrated for national accounting purposes into the government accounts.

4. This paper focuses primarily on the issues at the broad macro level. It also compares the possible effects of different kinds of pools of capital, depending on how they are formed and on their governance, rules and strategies.¹

II. Definition and examples of Sovereign Wealth and Pension Reserve Funds

5. There is no single, widely accepted definition of a SWF. Two broad different types can be distinguished.

1. The first, a SWF, is a fund set up to diversify and improve the return on foreign exchange reserves or commodity (typically oil) revenue, and sometimes to shield the domestic economy from (cycle inducing) fluctuations in commodity prices. As such most invest in foreign assets. This group (in order of size) includes the Abu Dhabi Investment Authority (ADIA), the Government of Singapore Investment Corporation (GIC), the Saudi Arabian Monetary Authority (SAMA), the China Investment Corporation (CIC), Temasek Holdings

* Adrian Blundell-Wignall is Deputy Director in the OECD Directorate for Financial and Enterprise Affairs, and Yu-Wei Hu and Juan Yermo are consultant and principal administrator, respectively, in the Financial Affairs Division in the same directorate. The opinions expressed and arguments employed herein are those of the authors and do not necessarily reflect the official views of the Organisation or of the governments of its member countries.

(Singapore), The Central Huijin Investment Company (China), the Kuwait Investment Corporation (KIC), the Stabilisation Fund of the Russian Federation, The Reserve Fund of Libya, the Qatar Investment Authority (QIA), and many more. Where national resource funds are earmarked for particular regions, such as Canada's Alberta Heritage Savings Trust Fund, and the USA Alaska Permanent Fund, they are included as a SWF. Some of the above funds are set up to meet industrial objectives, such as regional development, as in Temasek, and the Central Huijin Investment Company.

2. The second broad type includes Sovereign and Public Pension Reserve Funds (SPPRFs). These could be defined as funds set up by governments or social security institutions with the objective of contributing to financing the relevant pay-as-you-go pension plans. Based on this yardstick, two sub-categories of pension reserve funds can be identified:

- (i) The first, Public Pension Reserve Funds (PPRFs), are set up as part of the overall social security system, where the inflows are mainly surpluses of employee and/or employer contributions over current payouts, as well as, in some cases, top-up contributions from the government via fiscal transfers and other sources. Among others, Denmark's Social Security Fund, Japan's Government Pension Investment Fund, and USA's Social Security Trust Fund fall within this category. These funds may be managed by the social security institution itself or an independent – often public sector – fund management entity. While most of these funds, like the social security system itself, fall under the government sector, there are some exceptions. For example, the Canada Pension Plan (CPP) reserve fund is legally independent of government. The CPP has no financial guarantee from government and relies solely on mandatory pension contributions and investment income from the reserve fund to finance pension benefits for Canadian citizens. In this sense, the CPP reserve fund may not be considered a SWF.

- (ii) The second type, Sovereign Pension Reserve Funds (SPRFs), refers to those funds which are established directly by the government (completely separated from the social security system), and its financial inflows are mainly from direct fiscal transfers from the government. Unlike the first type of reserve fund, those within this category have been set up by governments to meet future deficits of the social security system. Some are not allowed to make any payouts for decades. Examples include the Australian Future Fund, the New Zealand Superannuation Fund, the Irish National Pension Reserve Fund, the Norwegian Government Pension Fund, and the French *Fonds de réserve pour les retraites*. Some of these funds are sometimes treated as SWFs and indeed a few fit both definitions. For example, Norway's Government Pension Fund, established in 2006, is the result of the amalgamation of a pension reserve fund (the National Insurance Scheme Fund) and a SWF (the Government Petroleum Fund). It has a mandate beyond financing pension expenditures and is largely invested in foreign assets.

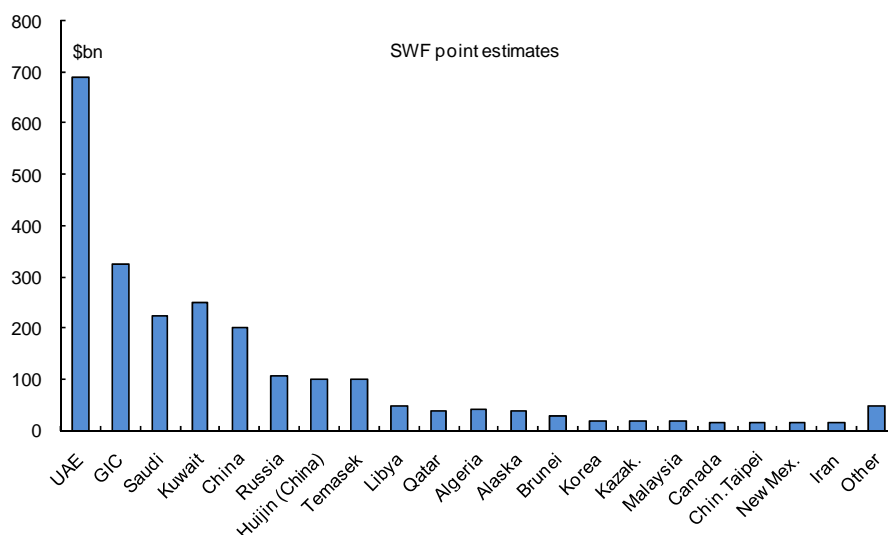
III. How large are global SWF & SPPRF markets?

SWFs

6. Some funds are a mix of SWF and pension assets which belong to individuals, as in the GIC, which manages these and foreign exchange reserves for the Monetary Authority of Singapore (MAS). Korea's investment authority has a similar mix of assets to manage. For this reason we include both as SWFs rather than SPPRFs. Norway's Government Pension Fund, on the other hand, while deriving its

funds from oil revenue, has since 2006 a specific mandate to finance future public pension expenditure and hence should be classified as a SPPRF.

Figure 1. Sovereign wealth funds by size



Source: Private sector market sources, central banks' balance sheets.

7. The size of the main SWFs are shown in Figure 1 and Table 1. At present, ADIA is the largest, at 29% of the total, followed by Singapore's 2 funds at 18%, China's 2 funds at 13%, the Saudi Arabian Monetary Authority (not foreign exchange reserves) at 10%, and the Kuwait Investment Authority at 7%.

8. Our estimate of total SWF pools is around USD 2.4 trillion, but they are getting bigger at a rate that is beginning to alarm some commentators. SWFs are likely to grow rapidly with the current configuration of foreign exchange policies, the relative weakness of the US dollar and the current oil price. For example, Chinese intervention policies are generating accelerating increases in reserves at present (a staggering USD 446 billion in the year to September 2007, versus USD 247 billion in the year to December 2006). China is beginning the process of transferring this money to SWFs and SPPRFs. So there is scope for rapid acceleration in these entities.

Table 1. Sovereign wealth funds estimates

Assets under management in USD billion, various dates

Country	Fund, year established	Estimates of assets under management (AuM) by Sovereign Wealth Funds (SWF), according to different sources				Range of estimated AuM	Foreign Exchange Reserves
		Deutsche Bank ^a	Peterson Institute ^b	Morgan Stanley ^c	Official		
UAE	Abu Dhabi Investment Authority, 1976	875	500 to 875	875		500 to 875	34.8
Singapore	Gov. of Sing. Invest. Corp. (GIC), 1981	330	100 to 330	330		100 to 330	148.4
Saudi Arabia	Saudi Arabian Monet. Auth.	300	-	300	225	225 to 300	22.4
Kuwait	Kuwait Invest. Auth. (KIA, 1953).	250	213	70		70 to 250	17.8
China	China Investment Corporation (CIC), 2007	200	-	200		200	1332.6
Russia	Stab. Fund of the Russian Fed. (SFRF),	127	122	-		32 to 127	425.4
China	Central Huijin Invest. Corp. (CHIC), 2003	100	66	100		66 to 100	above
Singapore	Temasek Holdings, 1974	108	108	100		100 to 108	148.4
Libya	Reserve Fund	50				50	na
Qatar	Qatar Investment Authority, 2000	40	50	40		40 to 50	5.7
Algeria	Revenue Regulation Fund	25	43	-		25 to 43	5.7
USA	Alaska Permanent Reserve Fund, 1976	40	40	39		39 to 40	67.0
Brunei	Brunei Investment Authority (BIA), 1983	35	30	30		30 to 35	na
Korea	Korean Invest. Corp. (KIC)	20	20			20	256.8
Kazakhstan	National Oil Fund	18	18			18	18.4
Malaysia	Khazanah Nasional	18	18	17.7		18	96.3
Canada	Alberta Heritage TF (1976)	17		13		13 to 17	34.1
Chin. Taipei	National Stab. Fund	15		15		15	2.6
USA	New Mex. SIO Trust Fund	15				15	above
Iran	FX Reserve Fund	15		8		8 to 15	38.3
Other		50				50	
TOTAL	(of above)	2,648	2,032	2,138		2,032-2648	2654.8
Memo items:			World Hedge Funds AuM	OECD Pension Funds		World Mutual Funds AUM	World Forex Reserves (approx)
			2,000	17,915		21,765	5,200

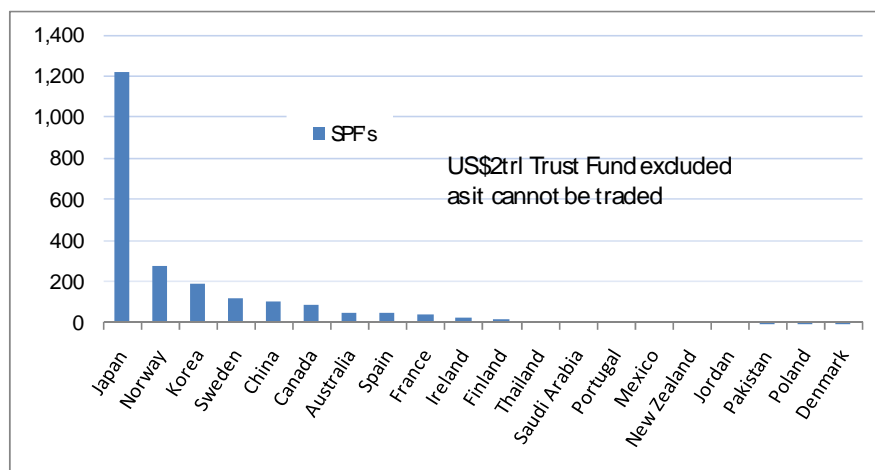
Note: This table reflects the OECD definition of a SWF – it excludes Sovereign Pension Funds, and excludes obvious overlaps (e.g. HK Monetary Authority using the GIC to invest).

Source: Peterson Institute, Deutsche Bank, OECD, national sources. Data for worldwide mutual funds is from Investment Company Institute. Total pension fund data is from OECD Global Pensions Statistics Project.

9. Transfers to oil producers are also accelerating. At a (say) USD 70 oil price and say 85 million barrels per day consumption, the world is handing over revenue of over USD 2 trillion per annum. There are costs of producing oil, and some of the surplus is consumed—but the sums are very large indeed.

10. The total amount for SPPRFs is an even larger USD 4.2 trillion as of 2006, if the US Trust Fund is included, some 49.6% of the total. This reduces to USD 2.2 trillion if we exclude the US Trust Fund, on the grounds that the amount cannot ever be traded because it is a notional accounting figure (IOU number) based on accumulated surpluses lent to the government. The USD 2.2 trillion is shown in Figure 2. USD 1.2 trillion was accumulated by Japan's National Reserve Funds – accounting for 29.5% of the total; USD 278 billion by Norway, some 6.7% of the total; and USD 191 billion by Korea, at about 4.6% of the total.

Figure 2. Sovereign and public pension reserve funds assets by country, in USD billion



Source: OECD and national sources.

11. Some of the SPPRFs, especially those of the sovereign (longer-run accumulation) kind, are relatively new. For example, Australia's Future Fund was established in 2006, New Zealand's Superannuation Fund was established in 2001 and China's National Social Security Fund in 2001. Given their short history, their assets are smaller than those in the more mature funds. However, some of these funds are growing rapidly. For example, as of 2006, the Future Fund in Australia had assets equivalent to USD 13.6 billion, while this figure increased to USD 45 billion as of August 2007.

12. In terms of total assets relative to the respective national economies (*i.e.* GDP), Table 2 shows that Norway has the biggest system, *i.e.* 83% in 2006. The other countries where pension reserve funds were significant relative to the economy include Sweden (30.6%), Japan (27.9%) and Korea (21.5%). On average, the ratio of OECD SPPRFs assets to GDP was 15.4% in 2006.

13. Table 2 also gives information on the governance of pension reserve funds, and specifically whether the fund is independent of the government, where independence is defined as having a board without government employees. For example, for the Australian Future Fund and the Irish National Pensions Reserve Fund, operation is fully independent of government. In most countries, however, the boards of reserve funds have some government employees in their boards.

Table 2. Statistical summary of Sovereign and Public Pension Reserve Funds by region and type, 2006

	Country	Name of the fund/institution	\$ bn			Ind.of govt.
			2006	% of total	% of GDP	
OECD: PPRF	Canada	Canadian Pension Plan	86.39	2.09	6.80	Yes
	Denmark	Social Security Fund	0.66	0.02	0.24	No
	Finland	The State Pension Fund	12.93	0.31	6.17	No
	Japan	National Reserve Funds	1,217.55	29.49	27.88	No
	Mexico	IMSS Reserve	7.39	0.18	0.88	No
	Spain	Fondo de reserva de la seguridad social	44.87	1.09	3.66	No
	USA	Social Security Trust Fund	2,048.11	49.60	15.53	No
	OECD: SPRF	Australia	Future Fund	45.00	1.09	5.70
	France	fond de reserve des retraites' (FRR)	39.14	0.95	1.74	No
	Ireland	National Pensions Reserve Fund	23.71	0.57	10.75	Yes
	Korea	National Pension Fund	190.84	4.62	21.49	No
	New Zealand	New Zealand Superannuation Fund	6.67	0.16	6.32	Yes
	Norway	Government Pension Fund: Global	278.12	6.74	83.04	No
	Poland	Demographic Reserve Fund (DRF)	1.76	0.04	0.60	No
	Portugal	Social Security Financial Stabilization Fund	8.33	0.20	4.28	No
	Sweden	National Pension Funds (AP1-AP4 and AP6)	117.47	2.84	30.61	No
	OECD:Total		4,128.95	100.00	15.40	
Non-OECD: PPRF	China	Pillars 1A and 1B	35.48	27.31	2.62	No
	Jordan	Social Security Corporation	6.02	4.64	46.20	No
	Pakistan	Employees' Old-Age Benefits	1.82	1.40	1.47	No
	Saudi Arabia	General Organisation for Social Insurance	8.62	6.64	2.41	No
	Thailand	Social Security Office	9.07	6.99	5.10	No
Non-OECD: SPRF	China	National Social Security Fund	68.87	53.02	1.35	No
	Non-OECD:Total		129.9	100.00	3.9	

Note: Australia is August 2007. Ind. Of govt.: independent of government. PPRF stands for Public Pension Reserve Fund. SPRF stands for Sovereign Pension Reserve Fund. For definitions see main text.

Source: OECD.

IV. SWFs and SPPRFs: similarities and differences

14. SWFs and SPPRFs share some similarities. Both are very large in terms of assets under management, and are autonomous and accountable only to governments or public sector institutions. Like SWFs, SPPRFs are also increasingly investing abroad and moving into alternative assets (property, private equity and hedge funds). Hence the financial stability concerns raised over SWFs are also applicable to SPPRFs.

15. However, there are still a number of discernable differences between SWFs and SPPRFs.

1. The objectives of these funds are different. SPPRFs serve as a long-term financing vehicle of public pensions and other related benefits, while SWFs are normally established to shield the domestic economy from fluctuations in commodity prices (e.g. oil) and to diversify foreign reserve holdings into higher return assets, among others. Hence, the investment horizon of SPPRFs tends to be longer than that of SWFs. Some SPPRFs even have specific timeframes for drawing down funds and at least one (the Canadian one) aims to meet a funding target (the ratio of public pension asset to liabilities). Clear objectives and investment timeframes shed much clarity to the mission of SPPRFs and are conducive to better governance and more efficient investment management.
2. In many countries SPPRFs face strong pressures to invest their resources domestically and conservatively. This is more the case of SPPRFs managed within the social security system. Three of the four largest SPPRFs, the US Social Security Trust Fund, the Japanese GPIF, and the Korean National Pension Fund are largely (solely in the US case) invested in domestic government securities. In emerging markets, where institutional investors and capital markets are

underdeveloped, it is sometimes felt that SPPRFs should help promote domestic investment and financial sector development. These concerns contrast with those of SWFs which are by construction mainly invested only in foreign assets.

3. As noted earlier, SWFs and SPPRFs have different sources of funding. SWFs are mainly financed by foreign exchange revenues on commodity exports and/or transfers of foreign reserves from the Central Bank. SPPRFs, on the other hand, are more often financed via social security contributions or direct fiscal transfers from the government.

16. SPPRFs may also raise issues concerning fiduciaries' responsibilities and of social ownership by pensioners of SPPRF assets. Trustees may constrain what these funds can do and require greater transparency than is the case for SWFs. For example, most SPPRFs have policies for socially responsible investments.

V. SWF and SPPRFs' asset allocation across countries

17. Consistent with this latter observation (point 4 above), we found it much easier to extract information about SPPRF governance and asset allocations than we did for SWFs. It is extremely difficult to find information on actual SWF sizes and investment allocations. One concern about SWFs is that their governance, investment objectives and asset allocations may reflect strategic objectives.

Table 3. Asset allocation information SPPRF's in 2006

		EQUITIES	BONDS	CASH	PROPERTY	ALTERNATIVE INV.
OECD	Australia					
	Canada	58.5	31.8	0.6	4.6	4.5
	Denmark	0.7	26.4	67.0		
	Finland	40.4	55.5		1.3	0.9
	France	62.1	26.4	11.5		
	Ireland	77.1	13.3	4.7	3.0	0.6
	Japan	37.3	62.7	0.0		
	Korea	8.9	89.3	0.4		1.2
	Mexico					
	New Zealand	60.0	20.1		7.2	12.7
	Norway	40.7	59.3			
	Poland					
	Portugal	20.8	70.1	2.2	3.6	
	Spain	0.0	100.0			
	Sweden	59.5	36.7	0.8		
USA	0.0	100.0				
Non-OECD	China	24.2	53.7	9.5		
	Jordan					
	Pakistan					
	Saudi Arabia					
	Thailand					

Note: "Alternative investments" refer to "private equity" for Canada, Finland and Ireland, while that for Korea and New Zealand refers to various alternative asset classes.

Source: National sources and OECD.

18. Information on objectives and asset allocations is more readily available for SPPRFs, though there are differences between funds in this respect. For most of the countries for which data are available, bonds and equities are the largest components in SPPRFs' portfolios (see Table 3). For example, as of 2006 France's FRR allocated 62.1% of its total assets to equities and 26.4% to bonds, while the remaining 11.5% was invested in other assets. At the extreme, SPPRFs in Spain and the USA, invested all assets in

short-term assets and bonds. For the US Trust Fund, such conservative investment strategy is mandated in the relevant legislation.

19. Over time, there is a trend of increased allocation to equities and declining bond allocations in some countries. For example, equities accounted for 15.6% of the Canadian Pension Plan assets, while bonds accounted for 63.0% in 2001. In 2006, these two figures were 58.5% and 31.8%, respectively. A similar trend was observed in France, Finland, and Portugal.

20. Generally speaking, because of its low returns, cash and its equivalent do not account for a significant share of the SPPRF portfolios, except for Denmark.

21. In contrast, recently there has been an increased exposure to high-yield, alternative assets, *e.g.* private equity. This trend is driven by the perceived low correlation between alternative and traditional asset classes and pressure on SPPRFs to beat market benchmarks (so-called “beta”) and seek higher “alpha” via active management. In most cases, active management is delegated to professional fund managers, though a few SPPRF’s (*e.g.* Canada’s) carry out such investments in-house. Alternative investments accounted for 1.2% of the Korean National Pension Service funds as of 2006, while this figure was 0.9% for Finland. A major increase in the alternative asset allocation was implemented by the New Zealand Superannuation Fund (12.7% in 2006, from 0.5% a year earlier). China made an investment in Blackstone in 2007.

22. Some SPPRFs are also increasing their allocation to foreign assets, though this information is not readily available for some funds. For the countries where statistics are available, the trend has been towards rapid increases in overseas investment. Examples include the 35.4% overseas investment of Irish SPPRFs², and 75.9% overseas investment of New Zealand’s Superannuation Fund in 2006. France’s FRR started to invest in foreign assets (defined as assets denominated in non-Euro currencies) in 2004, with 5.1% of total assets, and this increased to 29% by 2006. Foreign assets accounted for only 0.3% of Korea’s NPS in 2002, but this increased to 9.6% in 2006. In Japan, foreign assets accounted for a large share and were on a steady rise, from 19.4% of the total portfolio in 2001 to 25.5% in 2006. Norway’s Government Pension Fund-Global is fully invested in foreign assets, a large part of it (61%) in currencies other than euro.

VI. Global financial stability issues

23. Financial stability issues often come from two broad sources:

1. Excessive liquidity creation reflected in asset price inflation, and the encouragement of low interest rates and leverage.
2. Excessive concentrations of investments in particular securities.

(1) Liquidity

24. The creation of excessive global liquidity can cause asset bubbles. Fixed exchange rates in the face of capital inflows lead to foreign exchange accumulation and, if impossible to fully sterilize, easier domestic monetary conditions. This can contribute to local asset bubbles. The global investment of the reserves may affect prices in other financial markets.

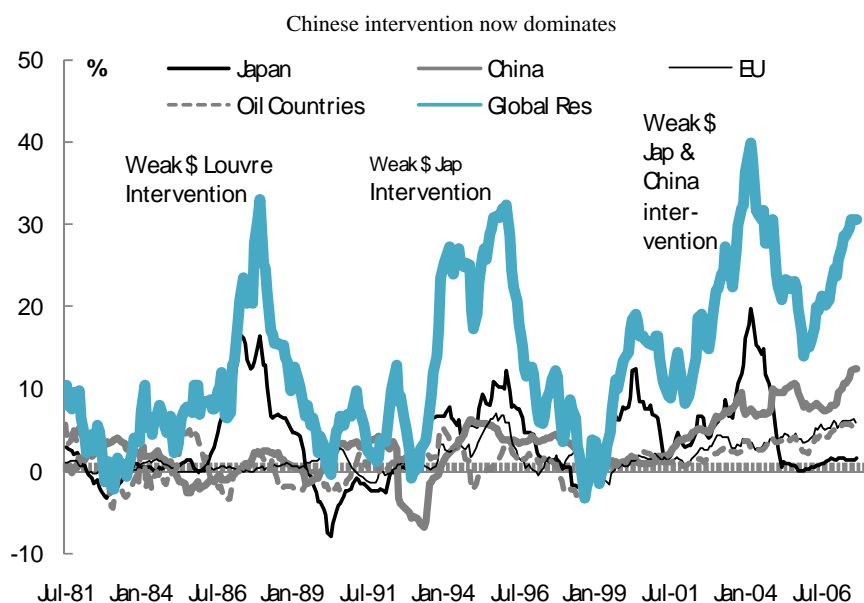
25. The staggering growth of global reserves since the late 1990’s is shown in Figure 3. Similar episodes have occurred during weak dollar periods in the past when Japan was the main driver. China has been a more consistent accumulator since the mid 1990s devaluation, and currently has USD 1.3 trillion of the (above) USD 5 trillion total. In periods of USD weakness Japan has carried out massive interventions,

as can be seen from the chart. While Japan has huge holdings of foreign reserves, it has now been eclipsed by China as the major holder.

26. Rapid reserve accumulation has contributed to asset price pressures.

27. Foreign exchange intervention by central banks is typically carried out in US dollars and invested in US Treasury securities. This has served to keep US bond yields abnormally low relative to short rates, hence influencing other rates (e.g. mortgages at the fixed rate end) and the cost of capital more generally. This, in turn, influences leverage and asset prices through that channel.

Figure 3. Global USD reserves and contributions



Source: Thomson Financial Datastream and OECD.

28. The growth of global reserves and China's stock market are shown in Figure 4. The mechanism here is that when risk taking rises, investors buy into emerging markets creating capital inflow into countries like China that fix or quasi fix their exchange rate. This eases monetary policy and contributes to stock market booms.

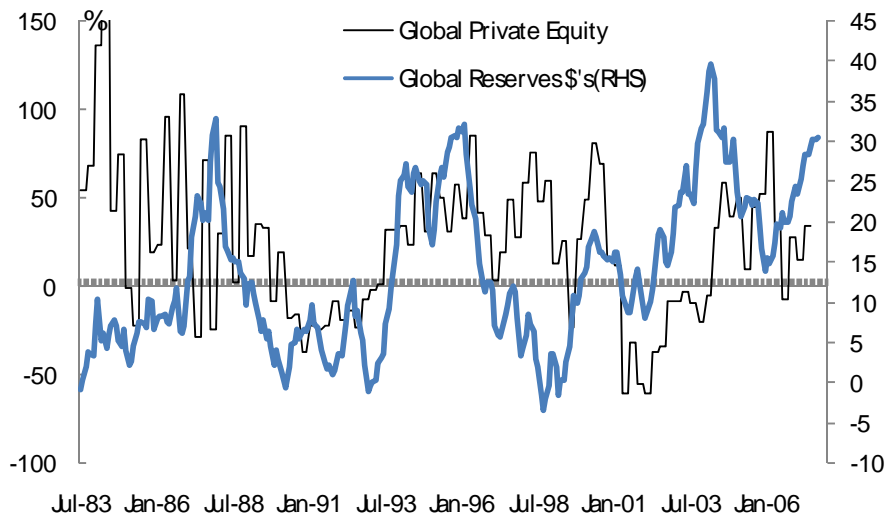
Figure 4. Global Reserves and China's Stock Market



Source: IBES, Thomson Financial Datastream.

29. The growth rates of global reserves and of private equity deals are shown in Figure 5. Private equity has been in a bubble until recently.

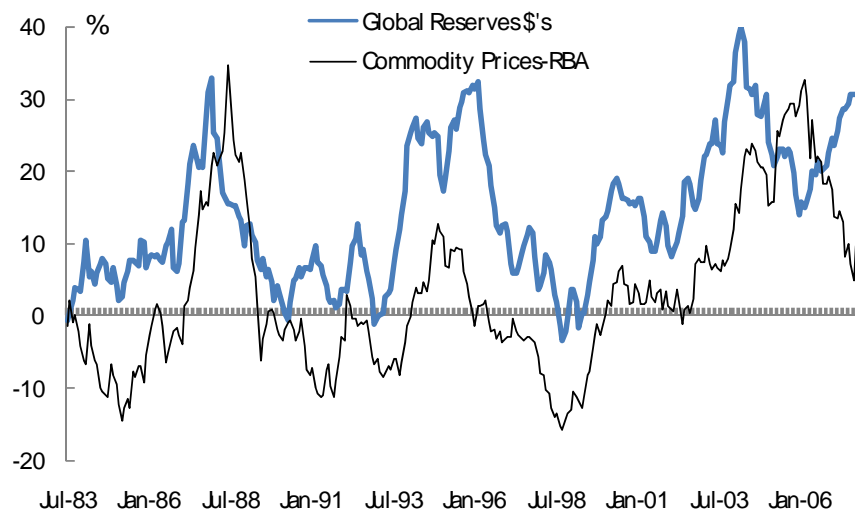
Figure 5. Global liquidity and private equity deals



Source: Thomson Financial Datastream.

30. The global reserves and a commodity price index constructed by the Reserve bank of Australia (with a heavy weighting to materials used by China – energy, base metals, bulks) is shown in Figure 6. This is one of the bubbles that commodity funds have invested in. The hedge fund Amaranth had difficulties with respect to this bubble.

Figure 6. Global liquidity and commodity prices



Source: Thomson Financial Datastream.

31. While foreign exchange reserve accumulation can create liquidity, this is not the case for SWF's. If a part of the USD foreign exchange reserves is transferred to a SWF, the central bank gets a credit and the SWF invests the reserves. There are indirect and second round effects, but no primary liquidity is created. If the SWF switches out of dollars into another currency, there will be an exchange rate impact (one reason why China can't really do this). If it switches out of one asset like a Treasury security to another one like an equity stock, there will be an asset price impact. Given the large size of some SWFs, changes in the strategic asset allocation, such as a shift from bonds to equities, could have a significant impact on the relative prices of these two asset classes. The price impact will also vary depending on whether the changes in portfolio allocation are carried out via new fund inflows (as is the case during periods of rapid asset accumulation, like the one we are going through) rather than the sale of existing assets. Stronger price effects can be expected once the growth rate of the funds slows down and changes in the investment policy can no longer be implemented solely by shifting inflows.

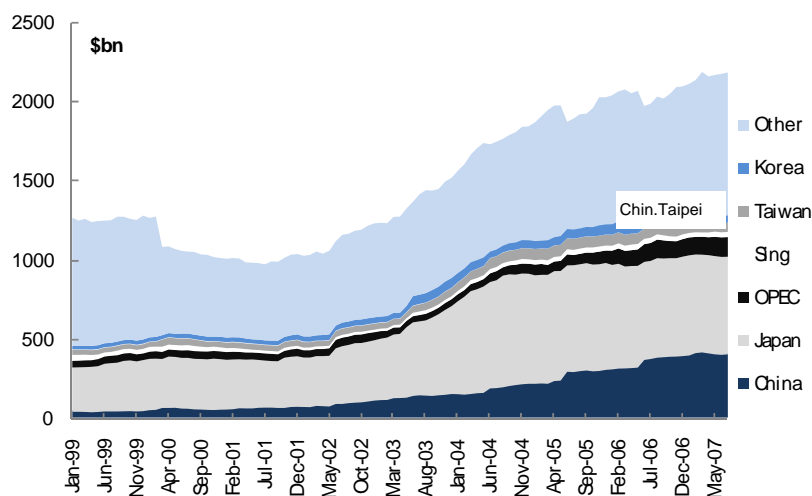
32. If a SWF provides capital to a private equity company, like Blackstone, the latter may lever this amount at the low global cost of capital (where the carry trade and other forces are at play). If they invest in smaller emerging markets which are less liquid they might increase volatility. But there are much bigger pools of capital in the West which will have exactly the same effects.

(2) Excess Concentration

33. SWFs provide mechanisms for breaking up concentrations of portfolios that increase risk.

34. USD 1.4 trillion of Chinese reserves invested mainly in the US Treasury market distorts the yield curve in the US, and sudden changes could lead to USD and yield effects that could hurt (certainly) China and possibly the USA. By shifting assets to SWFs, the foreign exchange reserve concentration is reduced.

Figure 7. Foreign holdings of US Treasury securities



Source: Thomson Financial Datastream.

35. The official holdings of US Treasury Securities by some foreign governments are shown in Figure 7. The rising trend has been driven by Japanese and Chinese foreign exchange intervention policies. In this context it is also very clear that Singapore and OPEC, both of which are associated with the largest SWFs, and by some considerable margin, have very little holdings of US Treasury Securities. In other words, SWFs invest in a much more diversified way and do not concentrate their holdings in US Treasury Securities.

36. Many SWFs also hire external managers as a part of normal style diversification. Investing in equities in Western countries requires ‘buying’ experienced in-house teams, or outsourcing to western funds management firms, private equity companies and hedge funds. Once again, these structures and strategies are diversifying.

(3) Governance

37. To the extent that commercial considerations allow, clear corporate governance and full accountability are important for all public funds. Similar issues apply to both SWFs and SPPRFs. SPPRFs appear to have better transparency in these areas, and this probably follows from the clearer mandate and the fiduciary and pensioner ownership considerations that have become a part of the generally accepted wisdom in the pension area. Where these lines should be drawn for SWFs is less clear.

38. The clearer mandate of SPPRFs stems from their founding purpose, which is to meet pension benefits. As a result, some SPPRFs have specific investment return targets and concomitant investment strategies that have been designed on purely financial grounds. In particular, SPPRFs try to achieve a rate of return that will help maintain the actuarial balance of the public pension system. In contrast, most SWFs have diffuse investment objectives, which can expose them to manipulation for political purposes.

39. Another difference with most SWFs, is that many SPPRFs, at least those of the sovereign type, are governed by boards that have been selected according to strict criteria of knowledge and professional experience in financial matters. The governing body of an SPPRF of the sovereign type is typically either an independent committee (like the National Pensions Reserve Fund Commission in Ireland) or the highest

organ of an independent legal entity that is exclusively responsible for the management of the reserve fund (like the Board of the Guardians of New Zealand Superannuation). One of the strictest eligibility requirements for board members is in place in New Zealand, where all board members must have experience and expertise in investment management, and at least four must be qualified as investment professionals.

40. Some public pension reserve funds, like the Canada Pension Plan reserve fund, are even operated by private sector management entities (the CPP Investment Board) and led by a board of professionals independent of government. The board approves investment policies and makes critical operational decisions, such as the hiring of the president and chief executive officer and the setting of executive compensation. Such governance structures ensure a high degree of protection against political interference in the management of the reserve fund.

41. While operating at arm's length from government, many SPPRFs are subject to rigorous accountability requirements. Accountability is primarily exercised via strict disclosure requirement and oversight by relevant authority. SPPRFs are required to publish an annual report, to have their accounts audited by an independent external audit firm (or in some cases the public audit office) and to provide regular and timely information on their website.

42. Disclosure is a particularly sensitive topic for both SWFs and SPPRFs. Commercial considerations argue against detailed disclosure of investments in both SWFs and SPPRFs. At the same time, there is a need to promote the transparency of the funds' investment policy. Public disclosure of asset allocation and investment performance at sufficiently long intervals (e.g. one year) and with prudent delays (a few months) can help meet the goal of transparency without jeopardising the fund's confidentiality over some aspects its investment management.

43. In conclusion, lessons can be learnt from existing SPPRFs in OECD countries for the debate on the design, operation and role of SWFs in the global financial system.

¹ A version of this paper served as background for discussion at the October 2007 meeting of the OECD Committee on Financial Markets. Other aspects related to SWFs have been addressed in other OECD Committees, in particular the Steering Group on Corporate Governance, the Working Group on Privatisation and Corporate Governance of State-Owned Assets, and the Investment Committee.

² Note that For SPPRFs in France, Ireland, Norway and Sweden, foreign investments refer to those investments in assets outside the Euro zone or denominated at non-Euro currencies.

Please see the second attachment re: OECD speech

**The Case for Clarity:
Sovereign Wealth Funds and the Canada Pension Plan Investment
Board Governance Model**

**Notes for remarks by
Gail Cook-Bennett
Chair
Canada Pension Plan Investment Board**

CHECK AGAINST DELIVERY

**“Sovereign and Public Pension Reserve Funds”
An OECD Seminar
Working Party on Private Pensions
Directorate for Financial and Enterprise Affairs
Organization for Economic Cooperation and Development
Tuesday, December 4, 2007
Paris, France**

Good afternoon. I am very pleased to have been invited to participate in this important and highly topical discussion on Sovereign and Public Pension Reserve Funds. I commend this OECD committee for its efforts to encourage best practices in pension fund governance through working sessions such as these. One of the ideas I want to share with you today is that a national pension reform model created in Canada 10 years ago may provide some relevant concepts and potential solutions to some of the public policy challenges presented by Sovereign Wealth Funds today.

Sovereign Wealth Funds, as you well know, are not new – they have been around for decades. What *is* new is that these funds have emerged in recent years as active direct investors – acquiring sizable international assets in sensitive industries, such as transportation infrastructure, telecommunications and energy. Also, they are growing at an astounding pace. Deutsche Bank has estimated that Sovereign Wealth Funds today hold \$3 trillion in assets – double the size of the global hedge fund industry – and could grow to \$10 trillion in 10 years.

Consequently, and not surprisingly, the role of Sovereign Wealth Funds in global capital markets has escalated into an international public policy issue with extensive political and economic implications, and with concerns being expressed by governments, regulators and other opinion leaders.

We have heard plenty through the media about those concerns: that Sovereign Wealth Funds are controlled by governments, are opaque and that they may use their financial clout in the pursuit of non-commercial national security, political or economic objectives.

In response, we are already seeing calls for new protectionist legislation, which could have negative consequences for the free flow of capital and access to global investment opportunities. This would penalize not just Sovereign Wealth Funds but return-driven national pension funds operating with much higher transparency.

The threat to these return-driven investors is clear. They may be mislabeled as Sovereign Wealth Funds simply because they are national funds. We believe that policymakers and opinion leaders can facilitate clarity by looking beyond the labels of Sovereign Fund, Sovereign Pension Fund and so on, to examine the underlying characteristics of these large pools of capital. They can then be better positioned to consider public policy based on facts, not labels.

As the Chair of the Canada Pension Plan Investment Board I know that we have, on occasion, been incorrectly categorized as a Sovereign Wealth Fund. While we do have the word “Canada” in our name, the CPP Fund, managed by the Canada Pension Plan Investment Board, is neither a sovereign entity nor a sovereign fund. And we are not a sovereign fund for a number of reasons:

- Our assets are not government assets. Rather they are contributed directly by employees and employers.

- We do not receive any tax revenues or fiscal top-ups.
- Assets are strictly segregated from government assets.
- And by law, we operate at arm's length from government, with very high transparency and abide by a clear and singular mandate to “maximize investment returns without undue risk of loss.”

Based on those characteristics, some observers would not even classify us as a public pension reserve fund.

But Canada's model for national pension reform can offer some lessons about managing a large and growing pool of capital – lessons that may be applicable to Sovereign Wealth Funds. These lessons centre on the twin concepts of clarity of purpose and transparency. Based on the Canadian experience, we believe that if observers had the answers to five key questions about the objectives of Sovereign Wealth Funds, the public policy debate would be better informed and would result in a more judicious response to the issue.

Those questions would be:

- Number 1: For what purpose was the Sovereign Wealth Fund or Sovereign Fund created?
- Number 2: How will the funds be used?
- Number 3: What is the governance and oversight structure?
- Number 4: How is the investment policy created?
- Number 5: Is there sufficient disclosure on all of the above?

At the CPP Investment Board, we were fortunate to have all of these questions answered for us – albeit for an entirely different reason – when we were created as part of the Canada national pension reform model in 1997 – 10 years before the current concern about Sovereign Wealth Funds.

Why Was the Fund Created?

In answer to Question 1, Why was our fund created?, Canadian policymakers answered – to help sustain the Canada Pension Plan. In 1996 the Canada Pension Plan, like many public pension plans, was facing a pension funding crisis. That year, it received C\$11 billion in contributions and paid out C\$17 billion in benefits, with an asset base of more than C\$35 billion. Unless something was done, the plan’s collapse would be only a matter of time. Today the CPP Fund has more than C\$120 billion in assets (roughly €82 billion), earned a 13.6 per cent annualized investment rate of return over the past four fiscal years and has grown by about C\$80 billion since inception – two-thirds of which derived from investment income. Canada’s Chief Actuary has estimated in his latest report that the fund will grow to more than C\$310 billion by 2019 and has projected that the CPP will be sustainable throughout the 75-year period of the report.

The model Canada created to solve its national pension crisis set the CPP on a solid financial footing. At the same time, it has been cited as a best-practice model for pension fund governance around the world because of its mutually reinforcing set of governance characteristics that include clarity of purpose and transparency.

We recognize that Canada's model was created in response to a unique set of facts and circumstances. But based on the steady stream of visitors from other national pension funds who come to study our model, we believe that some elements of Canada's blueprint for national pension reform could help address not only the governance issues of other pension plans, but also some of the problems of Sovereign Wealth Funds today.

From our advance materials you will have noted that the Canada Pension Plan is a national defined benefit pension plan operated for the benefit of 17 million Canadians. And we, as the CPP Investment Board, were created as a purely return-driven professional investment management organization to operate in the private sector and to make investment decisions at arm's length from governments.

So why did Canada devise such a different national pension plan model – a model that we at the Canada Pension Plan Investment Board did not create. The design was the fruit of an extraordinary policy reform process involving Canada's federal government and nine Canadian provinces working together in the mid-1990s to rescue the Canada Pension Plan. From the outset, their top priority was to create a governance structure that would protect the organization – including its board, its management, its assets and its investment decisions – from political interference. The fact that these politicians identified political interference as our greatest threat is remarkable in itself. The solution they devised to achieve their goal was original, bold and visionary. And it has worked.

Let me bring it alive for you with three examples of day-to-day operational life at our organization.

- First: We do not submit our investment strategy or business plans for government approval.
- Second: We do not have government officials sitting on our board.
- Third: We do not submit our compensation policies and pay levels for government approval.

How will the funds be used?

The policymakers also saw the importance of clearly answering Question 2: How will the funds be used? Their answer: to help pay pensions and nothing else.

Powerful Investment Mandate

To reinforce absolute clarity about the CPP Investment Board's objective, the reforms called for a simple, but powerful investment-only mandate. To quote from our legislation, we are mandated to achieve, "**a maximum rate of return without undue risk of loss**".

The legislation goes further. It stipulates that we must not pursue other objectives that are inconsistent with that investment mandate.

So, for example, there is no pressure or obligation for the CPP Investment Board to invest in Canada, buy government debt, make loans to state-owned firms, provide credit to governments, invest in politicians' favourite projects or invest with a view to any

particular social policy agenda other than the goal of helping to secure Canada's national pension plan.

Segregating the Assets

Segregating the pension assets from government revenues was another vital part of the framework they built to ensure that the funds would be used as intended. After all, these assets are contributed directly by working Canadians – employees and employers – as part of a defined benefit pension plan and the money belongs to the millions of Canadians who are contributors to or beneficiaries of the plan. They are not government assets funneled to the plan through the tax revenue system. Indeed the Canadian government is neither a sponsor nor a guarantor of the plan.

And what is the governance and oversight structure?

With the investment mandate articulated and the funds segregated, the policymakers also recognized the importance of answering Question 3: What is the governance and oversight structure?

Governance Structure Based on an Arm's-length Relationship with Governments

The answer was clear: a governance structure based on an arm's-length relationship with governments. Although many organizations say that they are arm's length from governments, the CPP Investment Board's legislated structure and subsequent measures adopted by the board make this claim a reality. The reforms called for management to report not to governments, but to an independent and qualified board of directors. Board

members possess strong credentials in business, finance, actuarial science, portfolio management and other relevant disciplines. Moreover, directors are appointed through a nominating process that balances governments' legitimate role in selecting directors with private sector input to identify directors with the requisite expertise and independence. To be clear, these are not political appointments or representatives of a given constituency, but rather a group of qualified professionals with a common duty to serve the best interests of the Plan's contributors and beneficiaries.

An example of the board's commitment to the arm's-length principle is embedded in its Code of Conduct. In accordance with the Code, directors, officers and employees have a positive duty to report immediately any attempted political influence if they have been subjected to pressure with respect to investment, procurement or hiring decisions. In our nine years of operation, there has never been any attempted influence. So ours is a pure investment-only mandate that meets the standard of "commercial-only".

How is the Investment Policy Created?

Which brings us to Question 4 – How is the Investment Policy Created? The board of directors, not governments, approves investment policies, determines with management the organization's strategic direction and makes critical operational decisions such as hiring the Chief Executive Officer and determining executive compensation. The CEO, in turn, hires and leads the management team, including the investment professionals who make portfolio decisions within investment policies agreed to by the board of directors.

This organizational structure ensures that investment professionals make investment decisions at arm's length from governments.

Is there Sufficient Disclosure?

And finally Question 5: Is there sufficient disclosure?

Transparency and Accountability

Policymakers ensured that our legislation required a high level of transparency and our board and management have voluntarily raised transparency to an even higher level.

Early in the life of the CPP Investment Board, the board of directors adopted a disclosure policy that states:

“Canadians have the right to know why, how and where we invest their Canada Pension Plan money, who makes the investment decisions, what assets are owned on their behalf, and how the investments are performing.”

The power and effectiveness of this disclosure policy has served us well.

We report our results on the same basis as most Canadian public companies, including the presentation of independently audited financial statements, as well as the inclusion of a Management's Discussion and Analysis and a Compensation Discussion and Analysis, in our annual report.

In addition, we post our investment policy and objectives on our website as well as a full list of our public equity holdings. The website also identifies our private investment fund partners and real estate fund partners, how much we have committed to their funds, and how much has been drawn down. We believe that it is possible to provide a very high degree of transparency without compromising our proprietary investment insights.

In addition to these voluntary measures we have adopted, our legislation imposes a duty on us to hold public meetings every two years in all nine participating provinces, to participate in a federal/provincial triennial review of the Canada Pension Plan, and to open our books for a routine special examination every six years.

Changes to the Model

The Act

There is one powerful element of our governance model that I have left until the end because it is a product of our federal/provincial system. Any changes to our Act, which enshrines our governance model, would require agreement between the federal government and two-thirds of the provinces representing two-thirds of the population in order to amend the legislation. This is the same formula required for amending Canada's constitution – a high standard indeed in Canada. It prevents unilateral and potentially ill-considered or hasty changes. Changes are possible, but only after full consideration of the potential implications. The federal and provincial governments' commitment in enacting these reforms was truly extraordinary.

All told, it amounts to a far-sighted formula that was designed with intense collaboration in response to a funding crisis.

Finally let me reflect on two things. First, our model is uniquely well-suited for our purposes and each piece of the formula is vitally important in preserving the maximum-strength quality of our governance model. We believe that if one element of the model were removed it would significantly weaken our protections. Secondly, for other pools of capital around the world that are addressing problems unique to them, it may be appropriate to adopt elements of the Canadian blueprint to help solve those problems.

For those pools of capital, it will be increasingly important to articulate the specific measures that clarify and codify their investment objectives. Transparency, while not easy, is rewarding. It imposes extraordinary accountability, to be sure, but pays for itself with the trust and confidence it enables an organization to build with others.

So to conclude, I leave you with three messages.

The CPP Investment Board is not a Sovereign Wealth Fund and should not be caught up in the fear surrounding these entities. I have detailed the power of our governance model in support of this fact.

Some Sovereign Wealth Funds might be able to respond to fears about their motives by clarifying their objectives and generally increasing their transparency.

Increased transparency by these funds would contribute to a more informed debate and would allow international policymakers to move beyond labels and offer more judicious responses to this challenge.

Thank you.