OPTRUST GLOBAL **PENSION LEADERSHIP** SUMMIT

REPORT

FOREWORD FROM THE PRESIDENT AND CEO

The world around us is changing.

Delivering plan sustainability over a long horizon is increasingly met with complex challenges – from the low-return environment and macroeconomic headwinds to the infrastructure gap and climate change. Against this backdrop, the OPTrust Global Pension Leadership Summit underscored the notion that pensions matter now more than ever.

By the very nature of our industry, pension funds are not in competition with one another. Instead we recognize the inherent value and privilege of providing retirement security for countless members and their families. It means collaboration and building trusted partnerships between institutional investors which will lead to better outcomes both today and in the future.

The most important goal any of us can have is to be fully funded at a time when our industry continues to experience an already shaken, unstable economy. We have a responsibility to strike the right balance between assets and liabilities in defining new measures of success.

This report highlights the range of themes that impact long-term asset owners and reflects the thought leadership and engagement of the world's leading pension minds, investors, policy-makers and academics in steering their assets under management through this economic period.

As investors, we cannot navigate today's challenges alone, which is why collective thought and idea-sharing will help to ensure long-term capital is applied to tomorrow's solutions.

HUGH O'REILLY
PRESIDENT AND CEO, OPTRUST

SUMMIT HIGHLIGHTS

In a rapidly transforming global economy, what is the role of long-term investors in helping to address big picture challenges like climate change, the innovation gap and aging infrastructure? And, with US$70 trillion held by global institutions, how can they collaborate to ensure long-term capital is applied to tomorrow's solutions?

The OPTrust Global Pension Leadership Summit brought together delegates from around the world to consider these questions and examine the role that collaboration can play in addressing the Summit's key themes: the low return environment, the role of innovation and disruptive technology, the infrastructure gap and climate change.

Leading asset managers, pension funds, governments and academic institutions were focused on a key topic – what makes collaboration work and how can we partner together going forward?

Based on a thought-provoking agenda designed to discuss and capture the best ideas, this report features highlights, key learnings and important themes that emerged during the two-day event.

THEME 1: COLLABORATION – THEORY AND PRACTICE

Collaboration on significant issues is how we learn and take the industry further, explained Gordon Clark, Director of the Smith School of Enterprise and the Environment at Oxford University. He was moderating the opening session of the Summit, "Collaboration in Theory and Practice," where a central theme arose: the importance of ensuring collaborators share the same interests and that their values are aligned.

Alignment is also critical from the standpoint of Christian Racicot, CEO of the Institutional Investors Roundtable, who explained that, out of the US$70 trillion in assets held by institutions globally, 60 organizations alone own 20%.

While Racicot added that this group has the "power to move mountains" when they work together, collaboration can only occur when potential partners can articulate their needs and ultimately reach consensus. Getting to that point involves creating opportunities to engage and understand the strategic impulse behind each investor at the table, no matter what size.

Reaching that level of mutual understanding is critical for Gavin Ingram, OPTrust's Global Head of Infrastructure. While partnership and collaboration are ingrained in everything OPTrust does in infrastructure, Ingram emphasized that a collective understanding of each partner's motivation behind each investment decision is critical to making it work – and "this doesn't show up in a legal agreement or decision-making framework."

Ingram also explained that collaboration isn't just about pooling capital – everyone benefits when there are a diverse set of viewpoints at the table.

One mechanism for collaboration is fiduciary management, which has emerged as a path for pension funds to pool interests, assets and costs. Panellist Dorothee Franzen, Partner with Avida International, explained that consolidation and mergers have helped some pension funds survive in challenging times, particularly in the Netherlands where consolidation has reduced the number of funds but created bigger pools of capital with more economies of scale.

Alignment is key, however, and when it comes to collaboration, Franzen points out that "size matters a lot" – if partners at the table aren't equal and aligned it can be hard for both to get value.

THEME 2: FUNDING THE INFRASTRUCTURE GAP

The sheer size of the global infrastructure gap is hard to contemplate. According to Omar Khalifa, Director, OPTrust, investment of US$3.3 trillion is needed annually from now until 2020 to meet current needs. As moderator of a panel discussion, "Infrastructure Investment – Global Opportunities for Institutional Investors," he explained that pension funds are fast becoming seasoned investors in the infrastructure asset class. But as governments and private investors come to the table to solve the infrastructure gap, alignment and shared values are again a critical part of the conversation.

Panellist Sharmila Kassam, Deputy Chief Investment Officer with the Employees Retirement System of Texas, discussed the 4% infrastructure allocation that acts as a liability match for her mature plan and can also help meet its return needs. Emerging markets infrastructure is the focus at her plan. "We can be more opportunistic with returns," she explained, adding that they use co-investments to generate the best returns.

Emerging markets are clearly becoming leaders in some types of infrastructure, particularly climate-related projects – Andrew Chung, Founder of 1955 Capital, explained that the lion's share of investment in solar power technology has come from China, a country seeking energy independence. While technologies are being developed in the U.S., the major infrastructure investment is coming from emerging markets in countries with the deep pockets and desire to scale up nascent technologies.

Whether you're investing in developed or developing markets, however, political risk is always a reality when one of your partners is the government – the Brexit vote made this abundantly clear according to panellist Thierry Deau, Meridiam Founding Partner and CEO. He discussed his firm's $5 billion Euro public infrastructure portfolio which is focused on greenfield projects – often the only infrastructure opportunities available in emerging markets.

We asked delegates:

What factors make collaboration work for infrastructure projects?

Diverse models for public/private collaboration….risk management… an ecosystem that fosters idea sharing and collaboration…. alignment…globalization…better deal structures…more cost effective… opportunities for deal sharing.

Ensuring that the interests of government and investors are aligned is tricky – but essential.

Panellist John Fitzgerald is CEO of Infrastructure Australia, which has instituted a new governance structure that puts local needs over political interference as it develops a private investor market. In addition to governance, deal structure can also help mitigate political risks.

According to Panellist Victor Traverso, Special Advisor to the Executive President of the CAF Development Bank of Latin America, his organization works to bridge the gap between pension funds and the infrastructure needs of Latin America, using special purpose vehicles (funds) managed under CAF practices. In addition CAF is exploring the use of A/B loan model in special purpose vehicles to structure deals to provide de facto political risk mitigation to foreign institutional investors.

THEME 3: FOSTERING INNOVATION

Terry Stuart, Chief Innovation Officer at Deloitte kicked off his keynote speech by boldly stating that we're living in a "fourth industrial revolution" – an era when business models in every industry are being transformed by new and emerging technologies. Blockchain, artificial intelligence, advanced manufacturing and robotics are what Stuart calls the "change enablers" reshaping the global economy.

Change enablers could represent a threat to future productivity for some countries – but can engender future prosperity for those countries able to foster innovation on the home front.

In that context, Canada is falling behind said Stuart. The issue stems from financing. "We don't have a start-up problem – we have a scale-up problem." While he asserts that it can be fixed, doing so will take focus and investment from Canada's leaders.

Failure to act and change, however, will mean our children will be less well off than we are today.

That frustrating gap between start-up and scale-up arose during a panel discussion, "Investing in Innovation," which was moderated by Sandra Bosela, OPTrust's Global Head of Private Equity. When it comes to venture capital as a percentage of GDP, she noted Canada ranks low - just over 0.10% of GDP - compared to leaders like the U.S. and even Israel.

Notably, Canada is experiencing an upswing in the number of early stage financings – the trouble is many aren't moving to the next level.

Which begs the question – why?

Panellist Thomas Birch, Managing Director, Funds and Technology with the Caisse de dépôt et placement du Québec, explained. "Our tech companies frequently get sold too early," as their founders and early stage VC's look to realize quick returns on their initial investment. At the same time, there simply aren't enough companies in Canada with the financial support to get from early stage financing to that critical point where large investors can get involved.

We asked delegates:

What factors make collaboration work in addressing the innovation gap?

Continuity…trust… diversity of views… idea sharing…innovation hubs… models that foster successful economic outcomes for both governments and asset owners.

OMERS Ventures' John Ruffolo, also a panellist, agreed that more consistent financing is needed across the spectrum and that there are gaps at just about every stage of the venture cap lifecycle, from early to late stage.

That might just be changing – Salil Munjal was recently appointed Chair of the newly-launched TMX Advancing Innovation Roundtable. In this new role, he is overseeing an independent working group which will examine ways to increase access to growth capital for companies in Canada's innovation economy. "Canada is outperforming our peers at the startup stage, it's the next growth stage where we're facing a capital gap," he said. "The Roundtable will explore new strategies to increase the supply of growth capital to develop large, next generation companies in Canada."

Change must happen soon, however, 1955 Capital's Andrew Chung, cautioned, "if Canada doesn't address its innovation gap, other economies will outpace it – and they're catching up fast."

THEME 4: DEALING WITH A LOW RETURN ENVIRONMENT

Speaking a week after the U.S. election, keynote speaker Anatole Kaletsky, Founder of GaveKal Research, discussed its impact on a world already marred by poor economic growth, low interest rates and growing political unrest.

"For the first time since the 1930s, there is an administration in Washington that doesn't believe trade is positive," he explained.

How will this impact the global economy in future? Kaletsky explained that the U.S. election has clearly blown off course a global economy that was at last in an expansionary cycle after years of contraction. As bond yields move higher and the U.S. dollar strengthens rapidly against other world currencies, it creates new risks and uncertainty for investors who must now reassess their strategy and outlook.

Whether the outcome of the U.S. election alters the reality of today's low return investment environment remains to be seen. James C. Davis, OPTrust's Chief Investment Officer, who moderated the panel, "Investing in a Challenging Environment," equated investors' efforts to extract the real returns required from assets to ensure pension sustainability to "squeezing blood from a stone."

One cannot expect to earn returns without taking risk. However, many investors have been forced into taking excessive levels of risk to achieve their investment objectives.

The question is, how can large institutional investors' best position their portfolios to get the returns they need in such an environment?

For OPTrust, risk is considered a scarce resource that must be managed purposefully and efficiently. Explained Davis, this requires a total fund approach where silos are broken down and collaboration is encouraged, both internally and externally.

Panellist Keisuke Kawasaki, President and CEO of Nippon Life Global Investors explained how his organization moved to decrease its standard guarantee rate in tandem with falling interest rates. Nippon Life also reduces risk and enhances yield through currency hedged forward bonds, global credit investments and alternatives. So far, it's been a successful mix at a time when other big insurers in Japan have not been able to survive.

We asked delegates:

How can collaboration help asset owners thrive in a low return environment?

Transparency… alignment… continuity…knowledge-sharing… access to local markets…efficiency and cost effectiveness...governments and asset owners.

THEME 4: DEALING WITH A LOW RETURN ENVIRONMENT

"Our core role as an investor is harvesting risk premia over time, with diversification being the only free lunch," explained panellist David George, Head of Debt and Alternatives with the A$142.8 billion Future Fund. "We, like everyone, need to bridge the gap between a reasonable estimate of the market's offered return and what is required to achieve our mandates." The Future Fund is doing this by adding new risk premia, layering on value-added strategies (i.e., real estate, venture and emerging growth), and by managing total portfolio risk over time.

All have been critical differentiators in this low return and low growth world.

Similarly, panellist Leslie Teo, Chief Economist with GIC, said his fund is focused on minimizing and managing drawdown risk – and by taking on more risk within acceptable levels. He said GIC's portfolio is carefully calibrated between the need for returns on one side – and the resultant risk – and the potential for drawdown risk.

THEME 5: TACKLING CLIMATE CHANGE

The new U.S. president's desire to "cancel" the Paris Agreement on climate change does not change the physics of climate change risk, said keynote speaker Cameron Hepburn, Director, Economics of Sustainability at the Institute for New Economic Thinking at Oxford University.

"Climate value at risk (VaR) is now arguably material – and fiduciaries should be managing climate risk," Hepburn explained. In fact, the investment opportunity involved in eliminating carbon emissions is massive. Some US$6 trillion p.a. is required to fund low-carbon infrastructure projects, through to 2030, with most of it needed in emerging markets transit and energy."[1]

We asked delegates to tell us:

What factors will make it easier for institutions to collaborate on climate solutions?

Consistency of standards and performance metrics....global alignment of efforts and interests....better understanding of the time horizon... long-term engagement on the part of all stakeholders.

The good news is that sources of capital are growing – US$26 billion was raised last year from carbon pricing, up 60% from the year before. However, to ensure the financing exists in the future, policy-makers must maintain a model that encourages institutions to invest.

Institutional investors represent just 1% of all private sector investment on climate-related projects explained Reid Capilano, Principal with Aligned Intermediary during a panel discussion, "Climate Change – An Investor's Perspective," moderated by Katharine Preston, OPTrust's Director of Responsible Investing. Aligned Intermediary is dedicated to bringing long-term investors together to fund climate infrastructure projects but, he admitted, more access points are needed to attract institutional capital.

Panellist Jaap van Dam, PGGM's Principal Director of Investment Strategy said it is PGGM's social responsibility to contribute tangibly to a sustainable and viable world – but sustainability is also necessary to generate returns. PGGM's approach has been a mix of divestment to decrease the CO_2 footprint of the portfolio and seek out private and public opportunities in four focus areas: health, food security, water, and climate and environmental sustainability.

Panellist Jackie Forrest, Vice President, ARC Financial Corp., a private equity investor in the oil and gas sector argued that divestment alone won't solve the climate change problem. She explained that the act of pumping out oil and gas generates just 10% of carbon emissions. The real problem is with consumption, where more than 80% of emissions are generated– policy-makers instead need to change the demand side among consumers.

As policy-makers become part of the climate change solution, India is making some bold moves according to Uday Khemka, Vice-Chairman of Sun Group. Climate risk affects the 200 million people living in India's low lying coastal regions – and it's also tied to the country's ongoing quest for energy security. India's reliance on imported fuel is now being addressed by Indian Prime Minister Modhi. As Khemka explained achieving grid parity through alternative energy sources like wind and solar power will help it catch up to China economically. To that end, the Government of India has worked to create an effective and transparent place for infrastructure investors.

[1] http://www.nature.com/nclimate/journal/v6/n12/full/nclimate3142.html?WT.feed_name=subjects_economics

Warren (Smokey) Thomas, President, OPSEU

Wrapping up the Summit, President of the Ontario Public Service Employees Union (OPSEU), Warren (Smokey) Thomas talked about the role pension plans have as stewards not just of their local communities, but of the world. "Pension plans can help make the world a better place," he explained, adding they can contribute to job creation and infrastructure development and also address climate change. As he concluded, "If we don't deal with these issues, we will leave the world a worse place for our children."

The Honourable Kathleen Wynne, Premier of Ontario

When it comes to investing, governments and pension funds have one thing in common: a long-term vision that involves planting seeds meant to bear fruit decades into the future. Kathleen Wynne, Premier of Ontario, outlined the province's own infrastructure milestones and strategic imperatives. Wynne's message revolved around the concept of sustainability, not just from a climate stability and clean technology perspective but from a social standpoint as well.

Social cohesion should be the goal of both governments and business – there should be no distinction between economic and business success and the broader society.

The focus for investors and governments, then, must be on a creating "a society where everyone can thrive and benefit from growth, without borrowing from future generations what we cannot pay back."

The Honourable Amarjeet Sohi, Minister of Infrastructure and Communities, Canada

We know a strong economy can't run without solid infrastructure – but what is the Canadian government doing to ensure that the country remains competitive? Canada's Minister of Infrastructure and Communities, Amarjeet Sohi, expanded on a recently announced plan to enhance infrastructure across Canada by creating the Canada Infrastructure Bank to supplement existing infrastructure projects and initiate new ones.

"It is the government's intention to keep Canada a great place to work and invest," he said, noting that the government will contribute C$35 billion through the new Bank to finance projects in energy transmission, cities, bridges and ports.

The idea is to attract private sector investment and act as a "centre of excellence" to other investors, contributing knowledge, ideas and expertise for projects that don't require funding help.

Infrastructure spending is now a key priority for the federal government – new Bank aside, Sohi explained that the government has already approved 750 projects for C$12 billion to build sustainable communities, boost prosperity and foster a low carbon economy.

CONTACT US

HEADQUARTERS

1 Adelaide Street East, Suite 1200
Toronto, ON M5C 3A7

optrust.com

Phone: (416) 681-6161
Toll-free within Canada: 1 800 906-7738

Fax: (416) 681-6175
email@optrust.com

LONDON

33 Cavendish Square, 15th Floor
London, UK W1G OPW

Phone: 011 44 207 009 1100
Fax: 011 44 207 009 1101

SYDNEY

Level 29 Chifley Tower
2 Chifley Square
Sydney, Australia NSW 2000

Phone: 011 61 9238 8050
Fax: 011 61 9238 8040

CONNECT WITH US