CPP INVESTMENT BOARD

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BUILDING THE CASE FOR A LONG-TERM PERSPECTIVE

Address to the Canadian Australian Chamber of Commerce

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President and Chief Executive Officer
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CHECK AGAINST DELIVERY

Thank you, Dominic for your warm welcome. I'm very happy to return to the Canadian Australian Chamber of Commerce after a 2 ½ year absence.

Since my last visit in March 2013, the Canada Pension Plan Fund has grown to A$280 billion[1] in assets, and I am proud to say that, since we started investing in 1999, well in excess of half of the Fund's value is comprised of investment returns, as opposed to contributions. In fact, in our last fiscal year (ended March 31st), we generated over $40 billion in investment income, in addition to the nearly $5 billion of net inflows from Canadian workers and employers.

In addition, we've increased the size of our international footprint, opening an office in New York in 2013, São Paulo in 2014, Luxembourg in 2015, and Mumbai opening next month.

And today, more than 75% of the Fund is invested outside of Canada.

As we build our international presence, Asia Pacific remains a key focus…and Australia a gateway to promising long-term growth in this region.

We have almost A$7 billion invested here in Australia, or about A$1.5 billion more than the last time I spoke here.

In 2014, we significantly expanded our office real estate portfolio by acquiring 100% of the units of Commonwealth Property Office Fund alongside DEXUS Property Group. This past February, we made an A$525 million investment in the motorway tunnel NorthConnex. These and other transactions, including a 25% interest in the Westlink M7 toll road, and a 100% interest in Broadcast Australia, underscore our long-term commitment to this market.

I should remind you that we are, first and foremost, a long-term investor.

Our investment strategy is built on our comparative advantages: our size, our certainty of assets - and perhaps most importantly in this current market environment - our exceptionally long investment horizon.

To illustrate this last point, unlike many other pension funds, CPPIB generally does not hedge our foreign currency exposure. To be sure doing so might smooth out our results year to year, but hedging comes at a financial cost with no expected benefit over the long term.

We lost $10.1 billion in fiscal 2010 by accounting for our foreign holdings in Canadian dollars, but in the years since, we have realized currency **gains** of $15.1 billion. Undoubtedly, this trend will reverse again at some point in the future. But, with long-dated liabilities, essentially hedging for accounting reasons only would result in a significant cost without any tangible economic benefit.

We view risks and returns over decades rather than quarters. In fact, as I have said in the past a quarter for CPPIB is 25 years, not 90 days.

[1] The CPP Fund was C$268.6 billion at June 30, 2015.

Yet we remain a long-term investor navigating an ocean with short-term undercurrents. The sweeping reaction to the slowing of China's economy is merely the latest example of how capital markets…and the players that operate in them…are influenced by short-term sentiment.

Just over 2 years have passed since I last spoke here - that is long enough for 30% of the Fortune 500 CEOs to leave their jobs and the average stock on the NYSE to have been turned over three times. But it is only a fifth of the lifespan of the average fixed assets in a corporation, or a tenth of the time it takes to bring the average new drug from research to market.

Researchers at Stanford University have found that pressure to meet quarterly earnings targets is reducing spending on R&D. They estimate that this is cutting US growth by 0.1% annually. Others have found that private companies, not beholden to short-term pressure, invest at nearly two-and-a-half times the rate of publicly-held counterparts in the same industries.[2]

Andrew Haldane, Chief Economist of the Bank of England, said in an interview this past July that business leaders are serving the short-term interest of shareholders at the expenses of the wider economy. As evidence, Haldane said that in the 1970s, only 10% per cent of company profits were returned to shareholders. Today, this figure is now in the 60-70% range[3].

We are robbing the future to pay the present.

Two months after I appeared on this podium last, CPPIB along with McKinsey, launched *Focusing Capital on the Long Term*, a collaborative global effort to develop practical ideas and approaches to combat short-termism.

But the spark that lit this fire had happened two years earlier.

In 2011, the Harvard Business Review published a ground-breaking article by Dominic Barton, McKinsey's Global Managing Director, entitled "Capitalism for the Long Term".

Dominic is a friend of mine, and when I congratulated him on the piece a few months later, I said, "You know, Dom, you've written this great piece about the perils of short-termism, but you're a typical consultant. You've pointed out all the problems, you've suggested a few solutions, but what are you actually going to do about it?"

His response was, "Mark, what you really mean is, what are CPPIB and McKinsey going to do about it?"

Today, I'm going to give you a report card on our progress thus far, and summarize our thinking and recommendations.

[2] As discussed in the *Financial Times*, "The cost of confusing shareholder value and short-term profit" by Dominic Barton and Mark Wiseman, March 31, 2015.

[3] *Financial Times* "BoE's Haldane says corporations putting shareholders before economy", July 25, 2015. http://www.ft.com/intl/cms/s/0/7d347016-32f4-11e5-b05b-b01debd57852.html#axzz3jkZ6b700

In order to combat this trend *Focusing Capital on the Long Term*, or FCLT as we call it, has three main goals:

The first is to mobilize leaders from both the investment and corporate worlds to focus on action.

Some of the world's foremost economists, academics and central bankers have been sounding alarm bells for years on the harm being done by short-termism – from the lack of long-term capital to meet worldwide demand for infrastructure renewal, to the abandoning of profitable, job-creating projects by corporate managers because the investment might mean missing quarterly earnings targets by even 1 penny.

In a survey of 400 CFOs, 78 percent said they would **destroy** economic value in exchange for smooth earnings. 55 percent said they would forgo a NPV positive investment to avoid missing EPS consensus.[4]

Yet there has been little offered to remedy the problem.

We wanted to change this. In just two years, FCLT has grown to be a global effort with more than 20 different organizations from all parts of the investment value chain…including BlackRock, Tata, GIC and the New Zealand Superannuation Fund.

The second goal is to develop practical structures, approaches and ideas that we and others can implement today to encourage, measure and reward long-term strategies and actions throughout capital markets.

To expedite the process, we deliberately targeted institutional investors and corporate boards. These groups are bound by their fiduciary duty to consider the long term, and have the power and influence to change in the near term. They are the linchpins in the value chain that I just described.

The third goal is to generate broad awareness and debate around our ideas in the business and investment community through a strong advocacy and communications platform. We've been very active on this front, publishing a series of white papers and holding hundreds of working sessions. I encourage you to review our thinking at www.fclt.org.

As I said earlier, FCLT was born out of a need to find practical solutions to combat value-destroying short-term behaviours by investors and companies.

The culmination of the first phase of this multi-year effort was the release of our *Roadmap for focusing capital on the long term* which includes detailed recommendations under four areas for action[5]:

1. Reorienting the portfolio strategy and management of institutional investors
2. Unlocking value through engagement and active ownership
3. Improving the two-way dialogue between investors and corporations
4. Shifting the board's focus to support long-term strategy and sustainable growth

[4] Graham, Harvey, Rajgopal "Value destruction and Financial Reporting decisions", 2006.
[5] See a '*Roadmap for focusing capital on the long term*' and other FCLT publications at: http://www.fclt.org/en/ourthinking/publications.html.

This March we hosted the Long-Term Value Summit in New York City, bringing together more than 120 leaders from 18 countries to identify how these ideas can be put into action.

Some of the world's largest asset owners sat next to the leaders of some of the world's largest corporations.

Participants agreed that a **fundamental breakdown** at several points along the investment value chain has resulted in a system where markets fail to convert capital into long-term value for all.

So what does a fundamental breakdown along this value chain look like?

I heard this best described at our Summit by an S&P 500 CEO. He said at the end of the day…because of short-term metrics and incentive systems…he could remove **all R&D**, **all capital expenditures** and be considered a phenomenal CEO for a year or two by the markets and enrich himself personally in the process.

Yet doing so would clearly be to the long-term detriment of the company. In fact, he claimed that if his company cut R&D to appease the market, it would cease to exist after a few years.

A fundamental change in mindsets and behaviours in our markets will only be realized through a shift amongst the entire value chain - from asset owners, to asset managers, to CEOs and through to the board - to adopt practices that **reward** longer-term capital investment, longer-term business practices, and longer-term value creation for all stakeholders.

So to conclude I'm going to discuss what we have argued *should be* the roles of these various actors, and address these thoughts directly to you.

First - If you are a CEO, your role is to build a long-term strategy, and that in turn means building a supportive board of directors, a long-term culture within your organization, and a strong investor base that understands and buys into long-term goals.

Former US Treasury Secretary Larry Summers addressed this last point – the need for investor support – in a recent column in the Financial Times. He said:

> "The real need is for a cadre of trusted, tough-minded investors in any given company who can credibly commit to support strong management teams and to provide assurances to a broader investment community so that productive investments are made."

Throughout our work I've heard many CEOs express that 'you get the shareholders you deserve'.

CEOs must seize every opportunity to immerse your board, your employees and your investors in your long-term strategy. This requires having **the right short-, medium- and long-tem metrics** to track progress along the way.

Next - If you are an institutional investor, your role is to align the goals of your constituents towards long-term value creation.

Asset owners and asset managers must set appropriate benchmarks for measuring longer-term performance; create the right incentives for investment professionals; understand what drives long-term value among the companies they invest in; and crucially they must engage more closely with companies to support their long-term strategy.

Activist investors who own just one or two percent of a company's stock would simply not be able to advance short-term agendas, if long-term investors were doing a better job engaging with the company as an owner and the company was doing a better job engaging with the owners. In short, institutional investors must start acting like owners. They must engage. They must vote their proxies. They must set benchmarks and incentives that are aligned with the interests of the beneficiaries that they represent.

If you are a board member, you have a central role to play, given that you sit at the juncture between the company and its external stakeholders.

Your role starts with selecting the right directors. Directors who bring a diversity of perspectives and proven experience in building relevant businesses, as well as deep functional knowledge.

Next, directors must spend more time focusing on long-term strategy and the business context in which it is unfolding. This means not only spending more days on board work but understanding the business, meeting with customers and clients, visiting R&D labs and so on.

It also means spending more time supporting management by being active in dialogues with investors, helping to ensure they understand the long-term strategy.

And finally…for serving such a role…directors must be compensated for the increased demands on their time and skills, tying their long-term pay to the long-term performance of the enterprise.

And finally if you are a regulator, your role is to understand how policies and rules provide incentives or disincentive to a long-term focus.

And one of the best examples of such thinking in action is the $5 billion Australian Asset Recycling Initiative - a key element of the Australian government's Infrastructure Growth Package - to offer incentives to states and territories to sell assets to fund new investment in productive infrastructure. With growing infrastructure deficits worldwide… we often reference this model with our own government and others as one to follow to incent and attract long-term capital.

CEOs…board members…investors…and regulators…all players in capital markets have a role to play in instilling longer-term mindsets and fostering long-term productive growth for all of society.

Since we set out on this journey two years ago I am encouraged by the progress I've seen…including a CEO who told me recently he had instructed his management team to re-write their objectives for the year to reflect longer-term goals.

We are also taking action on CPPIB's part…including an internal working group looking at how our portfolio analysts and managers can better engage with companies to more deeply understand their long-term strategy.

Progress on the issue is crucial for pension fund investors like us that are seeking to maximize value for generations of beneficiaries. It is also a crucial issue for anyone concerned about generating global prosperity for the long term, because that is precisely what this discussion is about.

I welcome all of you here today to engage us on this issue… and there is no better time to get started than right now, with your questions and comments.

Thank you very much.