Can AIMCo Be Fixed?

PARKLAND INSTITUTE | Robert L. (Bob) Ascah

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Tables and Figures

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Robert L. (Bob) Ascah was born in Lachine, Québec. He holds degrees in Commerce and Public Administration from Carleton University. He completed his Ph.D. in political science at the University of Alberta in 1984. He then joined the Alberta public service in 1984 (Federal and Intergovernmental Affairs) and moved to Alberta Treasury in 1986. At Treasury he was responsible for financial sector policy, foreign borrowing, and liaison with credit rating agencies. In 1996, he joined Alberta Treasury Branches (ATB), becoming responsible for government relations, strategic planning, and economic research. In August 2009 he was appointed Director of the Institute for Public Economics at the University of Alberta where he served for four years. In 1999, Ascah's Ph.D. dissertation *Politics and Public Debt: The Dominion, the Banks and Alberta's Social Credit* was published by the University of Alberta Press. His current research interests include Alberta fiscal history, the history of ATB, and appointments to Alberta agencies. He is the editor and a contributor to the forthcoming book, *A Sales Tax for Alberta: Why and How* (Athabasca University Press). His blog is abpolecon.ca.

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List of Acronyms

Alberta Federation of Labour	AFL
Alberta Investment Management Corporation	AIMCo
Alberta Investment Management Corporation Act	*AIMCo Act*
Alberta Health Services	AHS
Alberta Heritage Savings Trust Fund	AHSTF
Alberta Teachers' Retirement Fund	ATRF
Alberta Teachers' Association	ATA
Alberta Union of Provincial Employees	AUPE
British Columbia Investment Management Corporation	BCI
Caisse de dépôt et placement du Québec	*Caisse*
Canada Pension Plan	CPP
Canada Pension Plan Investment Board	CPPIB
Canadian Union of Public Employees	CUPE
Joint Governance of Public Sector Pension Plans Act	*JGPSPPA*
Local Authorities Pension Plan	LAPP
Management Employees Pension Plan	MEPP
Ministerial Orders	MO
New Democratic Party	NDP
Public Service Pension Plan	PSPP
Public Sector Pension Plan Act	*PSPPA*
Ontario Teachers' Federation	OTF
Ontario Teachers' Pension Plan	OTPP
Ontario Municipal Employees Retirement System	OMERS
Reform of Agencies, Boards and Commissions and Government Enterprises Act	*RABCGEA*
Special Forces Pension Plan	SFPP
Teachers' Pension Plans Act	*TPPA*
United Conservative Party	UCP
Volatility Trading Strategy	VOLTS
Workers' Compensation Board	WCB
Workers' Compensation Act	*WCA*

Executive Summary

The pension security of over 460,000 Alberta workers and retirees depends on the investment management performance of a provincial agency called the Alberta Investment Management Corporation (AIMCo).

AIMCo is one of the most significant agencies of the Alberta government, managing the investments of the Alberta Heritage Savings Trust Fund (AHSTF), various government accounts, and five major public sector pension funds—Local Authorities Pension Plan (LAPP), Management Employees Pension Plan (MEPP), Public Service Pension Plan (PSPP), Special Forces Pension Plan (SFPP), and Alberta Teachers' Retirement Fund (ATRF). These five plans account for 74 per cent—a whopping $97.5 billion—of the $131.4 billion in funds under AIMCo's management.

Trust in the governance of pension plans and in the investment management done on behalf of pension plan members and beneficiaries is critical to the pension bargain. Unfortunately, this trust has been seriously eroded through legislative and regulatory actions taken by the United Conservative Party (UCP) government. In late 2019, the UCP government swept Alberta teachers' pensions under AIMCo's management without consultation and removed the right of public sector pension plans to withdraw their funds from AIMCo. Neither of these actions were mentioned in the UCP's spring 2019 election platform. In late 2020, AIMCo—acting through the UCP government—attempted to remove the discretion of pension boards in setting investment policies.

On top of these unusual moves, in April 2020 it was disclosed that AIMCo had lost over $2 billion due to a risky investment strategy known as volatility trading strategy (VOLTS). This large financial loss and the manner in which it occurred added to teachers' and other public sector workers' concerns about the competence of AIMCo's board and management.

This report shows that AIMCo's investment management performance overall has been less than satisfactory for its clients and when compared with most of its peers. Key research findings include:

- Over a period of four to 20 years, AIMCo's main job of beating its clients' return objectives by consistently adding value was met in only six of 15 data points available.
- AIMCo's five-year performance against its own benchmarks was minus 0.7 per cent, meaning AIMCo as the investment manager failed to meet its own performance expectations.
- A review of 10 years of performance data of AIMCo's investment management for the Alberta Heritage Savings Trust Fund (AHSTF) shows volatile investment performance that should concern all Albertans and the government.

- The formerly independent Alberta Teachers' Retirement Fund (ATRF) had a four-year performance that is over one percentage point above that of AIMCo, and AIMCo has not outperformed ATRF since 2017. An ATRF report to the Alberta Teachers' Association found that had AIMCo managed ATRF's investments over the past seven years, $1.3 billion of value would have been lost.
- In recent years, AIMCo was not a top performer compared to other major public pension fund managers based in British Columbia, Ontario, and Québec. Over a 10-year period, AIMCo once outperformed its four main peers, but that was nine years ago in 2012/13, when AIMCo's value-add equalled that produced by the Ontario Teachers' Pension Plan.
- AIMCo's long-term performance has only been better than one of its peers, the Ontario Municipal Employees' Retirement System.

A thorough rethink of AIMCo's board of directors and ownership structure is required in light of the troubling actions by the UCP government, AIMCo's poor performance as an investment manager in recent years, and the serious structural weaknesses of AIMCo. Trust is central to the pension bargain, but the current relationship between pension plan members, including retirees, and the Alberta government is one of mistrust.

Actions, not words, are required from AIMCo and the government to repair the damaged trust of the past two years. This report makes five policy recommendations to improve the damaged relationship between AIMCo and plan members and Albertans:

1. **Eliminate the Crown's sole ownership of AIMCo**
2. **Representation on AIMCo's board should be broadly apportioned on the percentage of investments contributed.**
3. **Qualifications or skills required should be defined in a refurbished *AIMCo Act* to make it difficult for the government to change these details for political reasons.**
4. **Give plan participants and owners the option to give two-years notice of departing after AIMCo has managed its funds for eight years.**
5. **Implement a new ownership structure with the government holding a *minority* position to prevent governments using AIMCo funds for their own political purposes.**

1. Introduction

The Alberta Investment Management Corporation (AIMCo) is one of the most significant agencies of the Alberta government. AIMCo manages the investments of the Alberta Heritage Savings Trust Fund (AHSTF), various government accounts, and five major public sector pension funds. These five pension funds—Local Authorities Pension Plan (LAPP), Management Employees Pension Plan (MEPP), Public Service Pension Plan (PSPP), Special Forces Pension Plan (SFPP), and Alberta Teachers' Retirement Fund (ATRF's investments fully transition to AIMCo management on December 31, 2021)—are responsible for overseeing the retirement financial security of over 460,000 workers, pensioners, and beneficiaries.

AIMCo was established as a provincial Crown corporation in 2007 to act as an arms-length investment manager for government funds and public sector pension plans. Until recently AIMCo operated in relative obscurity, without much political or public scrutiny. That obscurity ended when the United Conservative Party (UCP) government decided to sweep the investment funds of the Alberta Teachers' Retirement Fund (ATRF), the Workers' Compensation Board (WCB), and Alberta Health Services (AHS) under AIMCo's management in the fall of 2019. Further worries emerged about the management and direction of AIMCo in April 2020 when the agency admitted that it lost $2.1 billion on an investment strategy known as VOLTS (volatility trading strategy).

Section 2 of this report provides background information on the investments managed by AIMCo on behalf of its 30 clients, explains the roles of pension boards and of AIMCo, and provides a brief primer on investment management, which is expanded upon in an appendix.

Section 3 contextualizes the current concerns of pension boards and many of their members by examining the recent history of AIMCo. This section provides an overview of the establishment of AIMCo, changes introduced by the former NDP government's 2018 Bill 27, and the consolidation of investment management under AIMCo subsequently made by the UCP government through the introduction of the omnibus Bill 22. The section concludes with a discussion of the March 2020 VOLTS losses and the December 2020 imposition of investment management agreement (IMAs) on four public sector pension plans.

Section 4 takes a deep dive into the relative investment performance of AIMCo against benchmarks or performance expectations set by its clients, including the pension funds. AIMCo's performance is also compared against other large Canadian public pension fund investment managers. AIMCo's mediocre investment performance means that its credibility with pension board clients has suffered serious damage.

In order to fix the current situation of mistrust in Alberta, Section 5 examines the fundamental governance issues at AIMCo. The section explains the importance of establishing and maintaining trust in the relationship between pension plans and investment managers. Four critical questions that must be addressed in fixing AIMCo are:

1) Who owns AIMCo?
2) Is AIMCo's board representative of its clients?
3) How does AIMCo's monopolistic position vis-à-vis pension boards serve the interests of employers and employees?
4) How can investment decisions be made independently of the government?

In response to these critical questions, the section concludes by offering five practical recommendations for reform to rebuild the trust that pensioners and plan members have lost in AIMCo.

2. Background[1]

AIMCo is a provincial agency[2] that manages investments of 30 clients, including public sector pension plans, government endowments, government agencies, and the Alberta Heritage Savings Trust Fund (AHSTF). Table 1 presents key features of the funds that AIMCo manages, including the size of the investments AIMCo manages, the membership size of the various pension plans, and other AIMCo clients. In addition, the table highlights the percentage of total AIMCo managed funds represented by each plan or fund. ATRF is included in Table 1, though the ATRF's transfer to being a client of AIMCo will not be fully complete until December 31, 2021.

Table 1: AIMCo's Clients

Name of fund or pension plan	Members, pensioners, and/or beneficiaries	Number of clients, employers, or funds	Funds managed ($ billions)	Percentage of total funds managed(2)
Local Authorities Pension Plan	275,863	433	53.6	41%
Management Employees Pension Plan	12,354	1	5.6	4%
Public Service Pension Plan	87,863	28	15.6	12%
Special Forces Pension Plan	7,506	7	3.4	3%
Alberta Teachers' Retirement Fund(1)	83,233	93	19.3	15%
Endowment Funds	N/A	5	4.7	4%
Alberta Heritage Savings Trust Fund	Alberta citizens	1	17.8	14%
Workers' Compensation Board	N/A	1	11.4	9%

Sources: Annual Reports. December 31, 2020 for LAPP, MEPP, PSPP, WCB, and AIMCo; August 31, 2020 for ATRF; December 31, 2019 for SFPP.
Note: (1) AIMCo will fully take over the investment management of ATRF on December 31, 2021. (2) Total is more than 100% due to rounding.

Table 1 shows that AIMCo has $131.4 billion under its management. About three quarters (74%) of this money—a whopping $97.5 billion—is owned by pension plan members, pensioners, and plan beneficiaries of the LAPP (41%), MEPP (4%), PSPP (12%), SFPP (3%), and ATRF (15%). AIMCo's success is critical to over 460,000 Alberta public sector workers—including some that are now pensioners as well as pension beneficiaries—whose retirement financial security can be affected by AIMCo's long-term investment performance. The assets of these clients do not reside on AIMCo's balance sheet, rather AIMCo has "assets under administration" and operates to recover all of its expenses from its various clients.[3]

Roles of Pension Boards and AIMCo

Changes made in 2018 by the Alberta New Democratic Party (NDP) government to the structure of public sector pension plan boards created two separate entities responsible for two aspects of a plan's governance. The first board is known as the sponsor board. These boards are composed equally of employee and employer representatives. The sponsor board of each pension

1 This section follows Ascah 2016, pp. 10–14.

2 Note 1 to AIMCo's March 31, 2021 financial statements reads: "Alberta Investment Management Corporation (the corporation) is an agent of the Crown in right of Alberta and operates under the authority of the Alberta Investment Management Corporation Act, Chapter A-26.5. Under the Act, the Corporation is established as a Crown Corporation governed by a Board of Directors appointed by the Lieutenant Governor in Council. The issued share of the Corporation is owned by the Crown, and accordingly the Corporation is exempt from federal and provincial income taxes under the Income Tax Act."

3 Note 12 to AIMCo's 2021 financial statements states: "These assets are invested in segregated investments owned by clients or aggregated in one or more pooled investment portfolios managed by the Corporation. Some of these assets are managed by third-party investment managers selected and monitored by the Corporation in order to achieve greater diversification, as well as to access external expertise and specialized knowledge. The segregated assets and the assets within the pooled investment portfolios are not consolidated in the financial statements of the Corporation. The Corporation makes investments on behalf of its clients and may also establish companies in which the Corporation is the registered owner of the shares for the purpose of managing specific investments. As the Corporation has no share in the expected benefits or the risk of loss in the entities, they are not consolidated in the Corporation's financial statements."

plan is responsible for the provisions of the plan, including contribution rates and benefits. The second board for each plan, known as the corporate board, is responsible for setting investment strategies and liaising with the investment manager, in this case AIMCo.

For instance, section 17.1 of the *Teachers' Pension Plan Act* (*TPPA*) declares "the Board shall establish a statement of investment policies and goals having regard to any restrictions on investment set out in the regulations." In the case of the Local Authorities Pension Plan (LAPP), its corporate board establishes the mix of investments ("asset mix") through a Statement of Investment Policies and Procedures (see Table 2 for details). LAPP's statement identifies about a dozen investment categories and sub-categories and sets minimum and maximum investments as a percentage of the total portfolio or a specific target.[4] In the case of the Alberta Heritage Savings Trust Fund (AHSTF), the minister of finance approves a Statement of Policies and Guidelines.[5]

The setting of the overall ranges by pension boards significantly influences overall investment performance. For example, a higher allocation in U.S. equities relative to Canadian or global equities would have improved overall performance due to the increase in U.S. equity markets over the past decade (Milstead 2021). The strategic asset mix is believed to affect upwards of 90 per cent of investment performance (Larrabee 2012).

Table 2: Summary of Investment Mix Policy Ranges (%) of Alberta Public Sector Pension Plans

Fund manager	Public Equities (%)	Fixed Income (%)	Private Equity (%)	Infrastructure (%)	Real Estate (%)	Absolute Return (%)
Local Authorities Pension Plan	25–50	20–40	3–9	5–25	10–25	
Public Service Pension Plan	37–65	11–33	0–6	5–12	10–18	
Management Employees Pension Plan	40–62	10–30	2.5–7.5	7–20	7.5–20	
Alberta Heritage Savings Trust Fund Policy Asset Mix	35–70	15–45	0–10	5–15	10–20	15–40(1)
Alberta Teachers' Retirement Fund Policy	36	21	10	8	15	10(2)
Workers' Compensation Board	35–45	20–50		12–17	13–18	8–15(3)

Sources: LAPP Annual Report 2020; PSPP, Statement of Investment Policies & Procedures, 2020; MEPP Annual Report 2019; AHSTF Annual Report 2021; ATRF https://www.atrf.com/investments/policy-asset-mix/; WCB, Investment Policy 01–04, part II, May 4, 2021.
Notes: (1) Defined as "inflation sensitive and alternatives." (2) Defined by ATRF as "managed futures, hedge funds, and other multi-asset strategies." (3) Real return bonds

While investment policy remains the domain of the pension boards, in practice overall returns also depend on the execution of these strategies. AIMCo is responsible for managing discrete pools or funds, such as money market, mortgages, long-bonds, and private equity. While AIMCo does not have any formal discretion over the asset allocation of the investments they manage, these investment policy statements do give AIMCo wide latitude to add value, or in the parlance of investment management, "add alpha." For

4 For example, see LAPP's policy on asset mix: https://www.lapp.ca/assets/lapp/files/publications/funding/long%20term%20asset%20mix.pdf

5 Alberta Heritage Savings Fund. Statement of Investment Policy and Goals. Approved 1 April 2011 by Deputy Minister of Finance and Enterprise Tim Wiles. https://open.alberta.ca/dataset/e22f96c4-e162-4366-9cac-e75764cad12c/resource/eed4438b-0f59-4663-ad4b-069c3c9a6aa1/download/5328327-2011-04-alberta-heritage-savings-trust-fund-statement-of-investment-policy-and-goals.pdf

example, LAPP's asset mix (see Table 2) allows a minimum of 25 per cent in "short horizon" public equities and a maximum of 50 per cent in this class. AIMCo portfolio managers can still beat the individual benchmarks through stock or asset selection or by accepting risk that differs from benchmark risk within the given investment class (see below and Appendix A). This function is known as "portfolio construction" and is a crucial activity of AIMCo.

A key metric in evaluating the performance of the investment manager is to compare the performance of a portfolio with a suitable benchmark. Benchmarks are chosen by AIMCo's clients to assess performance and by AIMCo to assess its performance and for compensation purposes (Ascah, 2016, pp. 15–17). Benchmarks normally refer to a specific market index, such as the TSX S&P, which most closely approximates the assets held in that portfolio. Benchmarks can be beaten by strategically selecting investments in that investment category that perform better than the overall index or benchmark. For example, a heavy allocation to energy stocks in the Canadian equity market over the past decade would have been a losing strategy (until recently) compared to the TSX S&P index benchmark.

Thus, while investment policy and portfolio allocation theoretically remain the domain of the boards, in practice achievement of overall returns is impacted by AIMCo's security selection, use of various strategies within the specified ranges, and decisions to take more or less risk.

AIMCo, like all other public or private investment managers, establishes funds or "pools" of similar assets such as public equities. Each pool is overseen by portfolio managers who have expertise in managing certain classes of assets. The compensation of AIMCo's portfolio managers typically depends on how investment returns compare with benchmarks established in advance through negotiations between executive management, AIMCo's board, and individual portfolio managers. As discussed below, the determination of suitable benchmarks can be difficult and controversial.

Investment Management[6]

Investment management is a complex process combining a wide range of skills including accounting, legal, finance, economics, communications, marketing, risk management, human resource management, compliance reporting, and information technology. The investment management industry is highly profitable and also highly competitive. As a consequence, each private corporate fund manager must design investment products to be sold to retail clients and to institutions. AIMCo does not currently compete with other fund managers because it is the sole provider of investment management services to entities designated by the responsible minister (currently Treasury Board and Finance).[7]

6 Interested readers are directed to Appendix A for more information on the basics of investment management. The LAPP provides a useful primer about investment here: https://www.lapp.ca/page/investments.

7 There are exceptions, such as the City of Medicine Hat and the Universities Academic Pension Plan, which are not locked into using AIMCo.

Private and public fund managers face similar challenges. For example, AIMCo competes for skilled personnel to join its staff. In addition, information technology and communications infrastructure must be updated constantly to address cybersecurity concerns and new investment vehicles. AIMCo's information technology infrastructure must be capable of handling mountains of data that feed discrete databases to enable trading on a global basis, to develop new investment tactics, and to manage financial, client, and regulatory reporting and compliance. These costs are considerable and are regarded as prerequisite conditions to compete for clients and gain access to profitable investment opportunities.

AIMCo, like other sophisticated investment managers, is experimenting with artificial intelligence as a means of discovering profit-making opportunities. AIMCo must also take into account investor and public concerns about responsible investing, notably environmental, social, and governance issues. In practice this means that fund managers are under growing pressure to divest their fossil fuel corporation holdings. Divestment is obviously of interest to AIMCo's sole shareholder, the Government of Alberta, as one of AIMCo's peers (*Caisse de dépôt et placement du Québec,* or *Caisse*) recently announced it is beginning the process of divesting its oil and gas company holdings (Jones, 2021a). Funds must also have policies to determine how to vote on slates of directors and on shareholder resolutions, including climate change resolutions.

3. Context: Establishment and Recent History of AIMCo[8]

The creation of an investment manager operating outside some of the restrictions of the Alberta public service (e.g., salaries and salary disclosure) began in 2005 with a call for proposals for an arms-length investment manager for government funds and public sector pension plans. There were two main concerns identified with the existing structure, then located inside Alberta Finance. Firstly, there was the difficulty faced by a government organization attracting strong investment professionals because of below-market wages. Secondly, there was the unwillingness of politicians to spend money to modernize Alberta Finance's investment management and investment administration systems, which was seen as impairing the organization's ability to keep pace with developments in an increasingly complex investment environment.

Bill 12, the *Alberta Investment Management Corporation Act* was passed by the legislative assembly in April 2007. Two main reasons were given by the minister of finance for creating this standalone entity: (1) the new entity's managers would outperform their predecessors' investment returns; and (2) AIMCo would serve as a local centre of investment specialization, creating well-paying local jobs instead of sending money outside the province.

AIMCo's first board of directors was composed of "blue chip" corporate executives, as required in the regulation,[9] with one-third of directors residing outside Alberta. This structure was designed to minimize real or perceived political influence over investment decisions. The premise of this structure was that current and former corporate executives would resist political interference. While there is no direct evidence that AIMCo has ever been told how to invest, the fact that many past Alberta-based directors made large donations to the Progressive Conservative Association of Alberta raises doubts about the actual independence of the board (see Table 3 on page 10).

8 Taken from Ascah, 2016, 10–14.

9 "Individuals … must have proven and demonstrable experience and expertise in investment management, finance, accounting or law or experience as an executive or a director in a senior publicly traded issuer." Section 5 of the *Alberta Investment Management Corporation Regulation*, A/R 225/2007. This provision was eliminated in 2017 (see Ascah 2017). This provision was reinstated by the UCP government in 2019.

Table 3: Past AIMCo Directors' Donations to Progressive Conservative Association of Alberta, 2004–2015

Name	Corporate affiliation	Leadership races	Personal constituency and party donations	Company donations
George Gosbee	Tristone Capital	$5,000 (Redford)	$21,680	$9,400
Clive Beddoe	Westjet	$2,000 (Redford)		$17,720
David A. Bissett	Bissett & Associates (now owned by Franklin Templeton Investment Corp.)	$10–$4,999 (Dinning) $30,000 (Prentice)	$6,995	
Darryl Katz	Katz Group Edmonton Oilers	$5,000–$30,000 (Rexall – Dinning) $5,000–$30,000 (Medicine Shoppe – Dinning) $10–$4,999 (WAM – Dinning) $101–$500 (WAM – Hancock) $10,001–$15,000 (Medicine Shoppe – Stelmach) $15,000 (Katz Group – Prentice) $10,000 (Medicine Shoppe – Redford)	$30,000	$227,275
Frank Layton	Bennett Jones LLP		$4,438	
Mac Van Wielingen	ARC Financial	$5,000–$30,000 (Dinning) $5,000 (ARC Financial – Prentice) $10,000 (Prentice)	$18,500	$91,180
Ross Grieve	PCL Construction	$5,000–$30,000 (PCL – Dinning) $501–$1,000 (Stelmach) $10,000 (Prentice) $5,000 (PCL – Redford)	$1,500	$185,471
Harold A. Roozen	CCI Thermal Technologies	$1,001–$5,000 (Stelmach) Over $10,001 (Hancock)		$5,750
John Ferguson	Princeton Developments	$501–$1,000 (Stelmach)	$3,550	$8,275
Totals	N/A	N/A	$86,663	$545,071

Sources: Elections Alberta. https://efpublic.elections.ab.ca/efCTACSSearch.cfm?MID=CT_ACS

The individuals listed in Table 3 are no longer on AIMCo's board of directors (changes to the board began in 2015). No members of AIMCo's current board have been donors to the UCP, NDP, or the Progressive Conservative Association of Alberta. However, without the ownership changes recommended below (see Section 5), there is nothing to prevent any government from making partisan appointments.[10] The power of appointment includes the power to fire a director perceived to act in ways that might conflict with the financial interests of the province's dominant industry.

10 Section 4.1 of the Mandate and Roles document between the Minister of Finance and AIMCo provides a process to recruit and nominate directors that attempts to de-politicize director selection. Nevertheless, the minister and provincial Cabinet have the final say.

The NDP's Bill 27: Joint Governance of Public Sector Pension Plans[11]

In 2018, after discussions with pension fund boards, the Alberta NDP government announced significant structural changes to pension fund boards and to investment management.[12] Bill 27, the *Joint Governance of Public Sector Pension Plans Act (JGPSPPA)* was introduced by then minister of finance Joe Ceci, who stated:

> This structure will give employees and employers an equal say in how their pension plans are managed. By giving equal voice to employees and employers, pension decisions will no longer happen to the owners of the plan; they will be made by the owners of the plan (*Alberta Hansard*, 29th Legislature, 4th Session, p. 1995).

The changes mirrored joint governance structures in other provinces, such as British Columbia and Ontario. The fundamental principle was expressed by MLA Jessica Littlewood:

> Given the plans are funded by participating employees and employers and the assets held in the plan belong to the members, it follows that employees and employers should be able to make decisions that will impact these plans (*Alberta Hansard*, 29th Legislature, 4th Session, p. 2027).

According to Ceci, this measure would take "the politics out of pensions" (*Alberta Hansard*, 29th Legislature, 4th Session, p. 2373).

Elements of the amendments in Bill 27 included:

- The responsible minister would no longer be a trustee and administrator of these funds;
- Regulation of the pension plans would fall under the *Employment Pensions Plan Act*, an act of general application to public and private sector pension plans;
- Creation of two boards for each of the affected plans: a "sponsor" board and a "corporate" board. (While there are additional costs with this arrangement, the debate over plan cost and benefits is an employee-employer negotiation, which makes imperative union and large employer representation.) The sponsor boards and the corporate boards would consist of equal number of employer and employee representatives[13,14] (*Alberta Hansard*, 29th Legislature, 4th Session, pp. 2027–8); and
- Use of the services of AIMCo and the Alberta Pension Services Corporation would continue for five years, after which pension boards would be free to move investments to other investment managers.

11 Section 10 of the Ontario Teachers' Pension Act is a good summary of this concept of joint management. The minister of education and the executive of the Ontario Teachers' Federation (OTF) may enter into an agreement that provides for the following matters: (1) The joint management of the pension plan by the minister and the executive of the OTF. (2) The composition of the board, the appointment of the members of the Board and the delineation of the powers and duties of the board. (3) The sharing of entitlement to gains or surplus under the plan and of liability for deficiencies in the pension fund by the minister, the employers who contribute under the plan and the active plan members.

12 The governance structure of the Management Employees Pension Plan was not changed.

13 For example, under the Local Authorities Pension Plan, six employee representatives would be appointed by the Alberta Federation of Labour (1), Alberta Union of Provincial Employees (2), Canadian Union of Public Employees (1), Health Sciences Association of Alberta (1), and United Nurses of Alberta (1). Employers' representatives were appointed by Alberta Health Services (3), the Alberta School Boards Association (1), the Council of Post-secondary Presidents of Alberta, or another organization representing post-secondary institutions participating in the Plan (1); and either the Alberta Urban Municipalities Association or the Alberta Association of Municipal Districts and Counties (also known as Rural Municipalities of Alberta) (1). Section 4, *JGPSPPA*. Section 5 provided for rotational appointments.

14 Section 7 of the *JGPSPPA* spells out the roles, responsibilities, and authorities of the LAPP sponsor board.

The changes meant that changes to benefits or to the structure of the plans (changing the plan from a defined benefit plan to a defined contribution plan, for example) would have to be negotiated jointly between employers and employees' representative. This would make it virtually impossible for employers to unilaterally change the existing defined benefit plan to defined contribution.

The UCP's Bill 22: Consolidation of Investment Management

During the 2019 provincial election, the UCP released a detailed platform called Alberta Strong & Free: Getting Alberta Back to Work (UCP 2019). The only mention of pensions concerned opposition to the federal government's increase in Canada Pension Plan (CPP) premiums (UCP 2019, p. 99). While the platform did not mention AIMCo, with the election of the UCP government in April 2019, AIMCo suddenly became a key policy instrument for the government.

By the time Minister of Finance Travis Toews tabled his first budget, he had been convinced that consolidation of investment management under AIMCo was sound financial policy. Toews described the thinking behind centralizing investments at AIMCo, achieved by adding ATRF, WCB, and AHS investments to AIMCo's responsibilities:

> To build a "made in Alberta" portfolio for healthy public investment, the volume of funds invested must be big enough to support optimum earnings and minimize costs. To maximize the funds under investment, government intends to reverse the option of public sector pension plans leaving AIMCo as a fund manager. Moreover, the Alberta Teachers' Retirement Fund, Workers' Compensation Board and Alberta Health Services will be expected to transfer funds to AIMCo for management, reducing redundant administration. AIMCo is expected to provide maximum returns to its clients, and processes will be expanded to support broader agency involvement. (Alberta Treasury Board and Finance, 2019, p. 120)

What a "'made in Alberta' portfolio for healthy public investment" means is disturbingly vague. Over the following weeks and months, members and pensioners grew fearful about the real agenda of the new government. "How could the government do this?" was a common question of teachers. Similarly, "why is this change necessary?" was also voiced. It was abundantly clear that the UCP government felt little need to consult with the membership or boards of these entities.

Opposition to the changes was predictable and particularly fierce from the Alberta Teachers' Association (ATA). Two days after Budget 2019 was tabled, ATA President Jason Schilling stated:

> Why didn't they talk to us? Individual teachers contribute half of the money that funds the plan and now will have no say over the management of those funds. Making this decision without consulting teachers at all makes this feel like a hijacking (ATA, 2019).

This lack of consultation would prove to be a serious barrier in facilitating a smooth transition to AIMCo management. Trust had been eroded.

A few weeks after the budget announcement, Bill 22, the *Reform of Agencies, Boards and Commissions and Government Enterprises Act* (*RABCGEA*) was introduced. The legislation—introduced nearly one year to the day after Ceci's introduction of the *JGPSPPA*—effectively overturned many of the NDP's changes. According to Toews:

> A larger pool of investments would allow AIMCo to realize greater economies of scale, increasing the returns and lowering administrative costs on a range of public investments. Ultimately, consolidating pensions, funds, and endowments under AIMCo's management reflects our commitment to make government more efficient. Bill 22 also proposes changes to the LAPP, PSPP, and SFPP to ensure that these pension plans follow industry best practices. These changes include requiring board appointments based on competency as well as representation and reinstates the Auditor General as the auditor for these pension plans. (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2341).

Government House Leader Jason Nixon added that savings of 25 per cent, or $41 million, on administrative fees would be achieved when these changes with ATRF were fully implemented (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2449).

The 172-page omnibus Bill 22 did not change or cancel contribution levels or benefits of members and pensioners. Toews pledged to "deliver even better results on behalf of all Albertans … This is public money. It includes Alberta government funds and endowments as well as most of Alberta's public-sector plans (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2340). However, the only sums of money that could be considered "public money," as defined by the *Financial Administration Act*, were the AHSTF, and the endowment and agency funds. Pension funds are not public money, so Minister Toews' statement is highly misleading and it likely further undermined trust in the government's intentions with pension funds.

Toews also informed the legislative assembly that the ATRF board would still "set investment policy and guidelines" (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2341). However, the *AIMCo Act* was amended to give the minister responsible authority to impose an investment management agreement (IMA) with a "designated entity" (e.g. LAPP, ATRF) if an IMA had not been agreed upon between AIMCo and the entity (*RABCGEA*, section 25(2)(f)).

Bill 22 also removed the ability of these pension funds to seek out alternative investment managers after the five-year period (*RABCGEA*, section 25(2)(f)) and removed equality of representation for unionized employees by the appointment of a non-unionized employee (*RABCGEA*, sections 25(2)(a)(iii)). Appointments required "skilled candidates" to be nominated (*RABCGEA*, section 25(2)(h)).[15] Sponsor boards could nominate directors for Cabinet approval; however, Cabinet retained the power to decide if a nominee was qualified.

Perhaps as a concession to pension funds, the minister could, upon request, direct the pension boards to exclude up to 10 per cent of a pension funds' assets for a fixed or indefinite period of time, *if* the minister agreed (*RABCGEA*, section 25(2)(f)).

There was immediate and fierce opposition to the legislation from the ATA and other labour groups (ATA, 2019). On November 20, 2019, union leaders issued a joint media release asserting that the money in the various plans belongs to members and pensioners, not the government (AFL, 2019).[16]

The NDP opposed the pension changes contained in Bill 22, resulting in the UCP government limiting debate (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2440). The NDP's concerns with Bill 22 centered on the fact that the pension funds are not the government's money (that is, they are not public money[17]) and that the money would not be safe in the hands of a UCP-government-controlled AIMCo (*Alberta Hansard*, 30th Legislature, 1st Session, pp. 2351–2).

MLA Kathleen Ganley challenged the government taking away members' right to representation on the basis of an individual not meeting the government's standard of competence (*Alberta Hansard*, 30th Legislature, 1st Session, pp. 2359, 2365, 2451–52). MLA Christina Gray expressed concern about AIMCo's independence from the government and about the Alberta Union of Provincial Employees (AUPE) losing one seat at the LAPP corporate and sponsor board tables. She rhetorically asked, which members of pension boards are not "competent?"

Another point raised was the damage to trust of teachers this legislation had wrought (*Alberta Hansard*, 30th Legislature, 1st Session, pp. 2365–66). Another question raised was the absence of a business case or analysis

15 In making an appointment, the "Lieutenant Governor in Council shall have regard to the desirability of having a board of directors that is comprised of individuals who, in the aggregate, have the full range of skills, knowledge and experience necessary to be able to effectively lead the Corporation in carrying out its roles, responsibilities and authorities under this Schedule." This would appear to give the provincial Cabinet discretion to say no to nominees submitted by public sector unions.

16 The joint statement was signed by the presidents of the Alberta Teachers' Association, United Nurses of Alberta, Alberta Union of Provincial Employees, Health Sciences Association of Alberta, and the Alberta Federation of Labour.

17 Under the Financial Administration Act, "public money" is defined to include money owned by the Crown or held by the Crown for the benefit of or in trust for any other person, but excludes money owned or held by ATB Financial.

to justify moving ATRF's investment management function to AIMCo (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2365; see the business case subsection below).

MLA Lori Sigurdson expressed surprise that conservatives would want to change a system that was operating effectively by itself and to use legislation to move teachers' pension investments to AIMCo (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2456).

Absent from the legislative debate was discussion of the new provision giving the responsible minister the power to impose an IMA for teachers (*Teachers' Pension Plans Act*, section 17) and other pension plans if an IMA could not be reached by the end of 2020 (see the IMAs subsection below).

Bill 22 received royal assent on November 22, 2019, outside of the legislative sitting. This speed demonstrated the government's determination to limit debate and to not listen to the representative bodies of public sector workers. The NDP raised the spectre of potential damage to pensions and dangers to democratic decision-making while the government vaguely accused the NDP of "misinformation and fearmongering" (*Alberta Hansard*, 30th Legislature, 1st Session, p. 2438).

Business Case

The business rationale for bulking up AIMCo's assets was provided by an internal document based on input from AIMCo and from a former British Columbia deputy minister of finance. The document was never released publicly but leaked to the media and various pension boards. The core of the advice to the minister was:

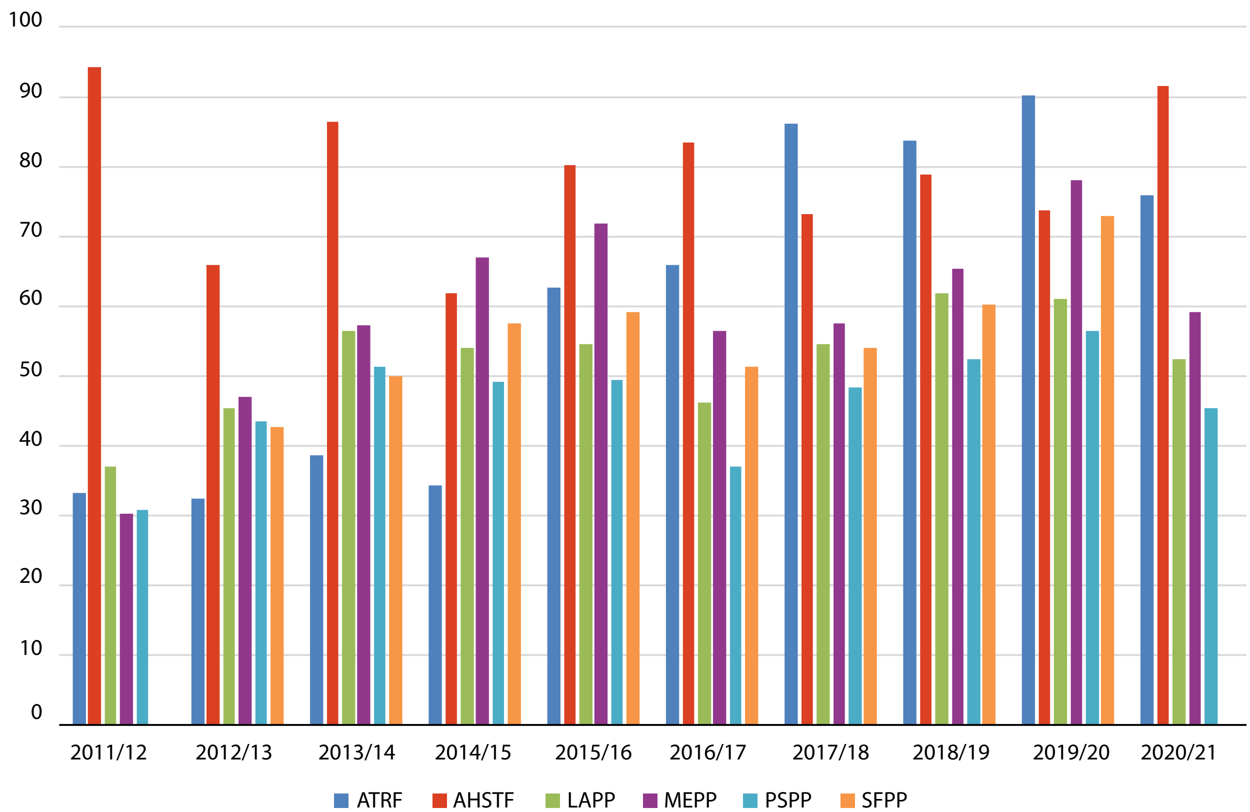
> All of these features—above average investment performance in the past, lower investment management and administration costs and access to a wider range of investment opportunities—give AIMCo a stronger base from which to produce superior investment returns for its clients *in the future* (Alberta Treasury Board and Finance, undated, p. 5, emphasis added).

The report summary came with the caveat, "the scope of the analysis and the recommendation was limited to the provision of investment management services only," and not intended to take away how strategic investment policies are determined or to alter benefits received by teachers. The document included an eight-page attachment by AIMCo setting out the consolidation rationale: benefits from scale; "an arms-length professional board and world-class governance"; improved portfolio construction; "a robust risk management environment"; and a "'Clients First' orientation." These claims, written before the significant March 2020 investment losses, further reduced credibility in AIMCo's policy advice given the VOLTS (volatility trading strategy) debacle discussed below.

Another key argument—compelling to provincial politicians—was that a strong, locally based investment manager would employ Alberta finance graduates as well as reduce the fees paid to external managers located in global financial centres, like London and New York. However, it was unclear how the $41 million in annual savings would be achieved without cutting any local employment through consolidation.

Central to AIMCo's argument of putting ATRF's investments under its management was lower investment management expenses. Figure 1 shows investment expenses as a percentage of net assets of six Alberta investment and pension funds over the past decade.

Figure 1: Investment Expenses of Alberta Funds as a Percentage of Net Assets, 2011/12–2020/21 (BPS)



Sources: Annual reports of funds, 2011–2020
Notes: BPS means basis points. One basis point is equal to 1/100 of 1 per cent.
SFPP data are not available for 2011/12 and 2020/21.

AIMCo's analysis emphasized ATRF's August 2018 expense of 84 basis points, a figure that was at the highest level in recent years, though using one year's investment expenses is selective and misleading. Figure 1 illustrates that ATRF's expenses were higher than the four pension plans and the AHSTF managed by AIMCo, but the data also show that expenses for the four pension plans and the AHSTF had increased over the decade. The expenses of the Management Employees Pension Plan (MEPP) as a percentage of net assets more than doubled over the decade. Based on Figure 1, there is little basis to believe AIMCo will deliver significantly lower costs than ATRF in the future. Furthermore, the focus on costs misses the most important metric in pension fund management: the net investment returns after costs. If costs are higher but net investment income is proportionally higher, costs are relatively insignificant.

Appended to AIMCo's memorandum was an October 2012 report written by Bill Morneau (Morneau Shepell pension consultants) to Ontario's minister of finance recommending consolidation of nearly a hundred Ontario pension and agency funds (Morneau, 2012, pp. 8–10). However, the AIMCo and ATRF/WCB/AHS situation is markedly different than in Ontario's case, which comprises smaller, more-numerous pension and agency funds. Morneau established that economies of scale would require about $50 billion in funds managed. Significantly, Morneau did not find a compelling case for economies of scale above $50 billion in managed assets (ibid, pp. 10–12).

In theory, $30 billion more in assets should allow AIMCo to bring in-house more fund management and reduce fees, especially for private equity. However, even $150 billion in assets pales in comparison to other Canadian public sector managers like Ontario Teachers' Pension Plan (OTPP) and the *Caisse de dépôt et placement du Québec (Caisse)*. The proof of the wisdom of this aspect of the UCP's policy decision won't be known for years. In the interim, there will be significant transition costs borne by the ATRF in the short-term (e.g., termination payouts, and lawyers' fees).

March 2020 Losses[18]

In March 2020, when global equity markets dropped precipitously due to the onset of the COVID-19 pandemic, market volatility (rapid up-and-down movements in stock and equity indices) exposed a serious weakness in AIMCo's risk management and governance systems. On April 21, 2020 *Institutional Investor's* Leanna Orr broke the story entitled "AIMCo's $3 Billion Volatility Trading Blunder." The story contained damaging details of how highly complex investment strategies might have a "minus-infinity potential," according to one quantitative hedge fund manager. Orr reported that "AIMCo's derivative-based 'portable alpha' overlays—may have exacerbated the bleeding, according to one of the sources" (Orr, 2020).[19]

18 This borrows from Ascah, 2020.

19 The New York-based investment media outlet also noted that only a handful of institutional investors run their own "volatility trading strategies in house," with the vast majority of them Canadian. Orr added that David Triska, a portfolio manager at AIMCo, claimed credit in a LinkedIn profile for the complex trading program. Subsequent reports from the Globe and Mail's Andrew Willis and Progress Alberta indicated a potential $5 billion hit to the AHSTF and pension fund asset values occurring over the past several months and years (see Willis, 2020; Storrie, Kinney, and Boychuk, 2020).

Under such a strategy, when equity markets are volatile AIMCo would pay the counterparty; if equity market conditions were placid, AIMCo would receive payments. Market conditions in February and March 2020 were extremely volatile and caused the derivative contract to move into an extreme payment ("out-of-the money") position.

In a message 10 days later, AIMCo CEO Kevin Uebelein stated he was "accountable for the performance" of AIMCo and felt "responsible for setting the record straight." Uebelein explained that the extent of losses on the volatility trading strategy (VOLTS) "to date are approximately $2.1 billion of the $118.8 billion of assets managed on behalf of our clients." The tally of losses "will not be finalized until the strategy is completely wound down, which should occur by mid-June." Uebelein went on to say, "AIMCo takes full responsibility for the investment losses incurred by this strategy." To reassure Albertans, beneficiaries and clients, Uebelein announced that AIMCo's Board had initiated a "thorough review of the situation" using "AIMCo's internal audit capabilities … and outside, third party experts" (AIMCo, 2020). Minister of Finance Travis Toews said nothing publicly.

As a consequence of the VOLTS, the AHSTF returned a negative 5.1 per cent return, its first negative return since the 2008/09 global financial crisis. The value of the fund was reduced by $1.9 billion (AHSTF Annual Report, 2020, pp. 1, 22).[20] In the case of the LAPP, its investment returns were ameliorated somewhat by a de-risking strategy (LAPP, 2020, p. 5) put in place by the LAPP board and executed by AIMCo. The 2020 annual reports of the LAPP and Public Service Pension Plan (PSPP) highlighted losses of $0.9 billion for LAPP (LAPP Annual Report, 2020, p. 5) and $0.34 billion for PSPP (PSPP Annual Report, 2020, p. 26). In the case of MEPP, the investment income dropped from $673 million in 2019 to $232 million (MEPP Audited Financial Statements, 2019, Note 8).[21] (Without a 2020 annual report, it is as yet unknown what portion of the MEPP's lower income was due to general market declines as opposed to the VOLTS.)

AIMCo's board hired experts to advise them on how to ensure such an event would not be repeated. The review into the VOLTS would involve a plan to "limit the damage" in exiting the trading positions entailed in the VOLTS (AIMCo Board, 2020a). On June 30, 2020, the board released a seven-page summary of its review (AIMCo Board, 2020b). The board relied heavily on the "input" of AIMCo's internal auditor and chief legal officer. The results found that the "degree of challenge from the first and second line[s] of defence (investment and risk management, respectively) regarding the VOLTS strategy" was "unsatisfactory." In addition, the board learned that existing risk governance controls, involving "collaboration and risk culture" were still "unsatisfactory." Finally, the board found that "escalation of analytics" to senior management and the board on "extreme tail risk" was

20 "A volatility strategy (VOLTS) was also a major factor in the underperformance. This strategy caused the Fund to lose $411 million and reduced Fund returns by 2.2%." AHSTF, Annual Report, 2019-20, p. 12.

21 As of October 25, MEPP had still not released its Annual Report to members. (The audited financial statements of MEPP are found in Alberta Treasury Board and Finance, 2021, 603-626). MEPP's funding surplus fell to $810 million from $1 billion in 2019.

"incomplete" and tardy. Several executive officers departed AIMCo, but not the chief investment officer. The CEO's departure before his contract expired was announced in November 2020. With a new CEO installed, it is possible several more AIMCo executives will leave. In January 2021 AIMCo's board established a risk management committee.

Investment Management Agreements (IMAs)[22]

Until the end of December 2020 the corporate boards of Alberta's public pension plans had the sole authority to set investment policy. This meant that the board would provide a framework to AIMCo setting the various parameters AIMCo must operate within (see Table 2 on page 6). The statement of investment policy specifies a range of holdings or targets for public equities, fixed income securities, real estate, private equity, and so on. A key document governing the relationship between pension boards and AIMCo is known as an investment management agreement (IMA).

AIMCo and the boards of the ATRF, PSPP, LAPP, and the Special Forces Pension Plan (SFPP) were unable to agree on the IMA for each pension plan in the fourth quarter of 2020, so on December 23, 2020 Minister of Finance Toews signed four ministerial orders (MO) imposing IMAs for the four pension plans (Ministerial Order, 2020).[23] The ATRF was not notified of its MO until January 4, 2021. This unilateral move added to plan members' unease about the security of their pensions. A week later the ATRF reassured its members that the government's action "does not impact member's pension benefits" and that the pension "remains secure" (ATRF, 2021a). The full transition of investment management of teachers' pensions to AIMCo will occur by December 31, 2021.

The imposed IMA claimed to simplify AIMCo's administrative and investment processes and to respond to clients' desire for flexibility and choice. Yet, the IMA appended to the ministerial order gave AIMCo the power to effectively veto an investment policy if it "would threaten to compromise AIMCo's economies of scale or operational efficiencies" (Ministerial Order, 2020). Crucially, "economies of scale" and "operational efficiencies" were not defined in the MO, and it is unclear what criteria would be used to judge these subjective matters. AIMCo's decision would not be subject to any appeal or arbitration.

Alberta union presidents issued a joint statement condemning the unilateral nature of the government's move (AFL, 2021). On February 2, 2021 the ATA launched a legal challenge to the constitutionality of the ministerial order (ATA, 2021a). On March 12, the ATA filed an application with the Court of Queen's Bench against the Alberta Crown asserting that the imposition of the MO was "unreasonable and should be declared invalid" by the court

22 This borrows from Ascah, 2021b.

23 AIMCo ceased negotiations with the ATRF about a month prior to the imposition of the IMAs via Minister Toews' MOs. Regarding the MOs, see also the LAPP's January 14, 2021 "Update to Members: Ministerial Order for LAPP & AIMCo": https://www.lapp.ca/page/whats-new/5bd94b52-64fa-4157-2bec-08d8b802170a?title=Update%20to%20Members:%20Ministerial%20Order%20for%20LAPP%20%26%20AIMCo

(ATA, 2021b). In an affidavit filed with the court, ATA President Jason Schilling identified the disconnection between what the minister of finance stated in the legislative assembly—that the ATRF board would remain in control of investment strategy—and the IMA imposed by ministerial order (Schilling, 2021). On September 2 and 3 the case was heard and, according to the ATA, "the judge remarked at one point that she was not buying the Government of Alberta's arguments related to certain sections of the IMA" (ATA, 2021c).

The matter was soon settled out of court, and a new IMA between the ATRF and AIMCo was agreed upon (ATA, 2021c). Schilling attributed the settlement to the arrival of a new CEO at AIMCo, Evan Siddall, who, according to Schilling, "appears to realize that [AIMCo needs] to be responsive to clients and that they will be held accountable for their duty to teachers as the investment manager" (ATA, 2021c). The renegotiated IMA has not been released publicly, nor it is customary to be disclosed. At the time of writing, AIMCo is negotiating changes to the ministerial-imposed IMAs affecting the MEPP, LAPP, SFPP, and PSPP.

4. Investment Performance Compared

The following analysis first compares the 10 years of investment performance of four of AIMCo's pension clients (LAPP, MEPP, PSPP, and SFPP) and the AHSTF. These five funds collectively constitute 75 per cent of the assets managed by AIMCo. (We exclude other clients of AIMCo such as the liquidity pools and funds for provincial agencies whose purpose is mainly to provide liquidity through short-term investments.) Secondly, AIMCo's performance is compared against the ATRF and then against major Canadian public pension funds (BCI, Caisse, OMERS, and OTPP). These comparators were used in my 2016 study and are comparators that AIMCo uses when designing compensation policies. Each of these large funds are different but they all share the ethic of maximizing returns to their beneficiaries.

Qualifications

Comparing investment performance is difficult. The main difficulty is finding appropriate comparators so that an "apples-to-apples" comparison can be achieved. Appendix B contains more information about other qualifications related to comparing investment performance.[24]

Performance of AIMCo's Major Clients

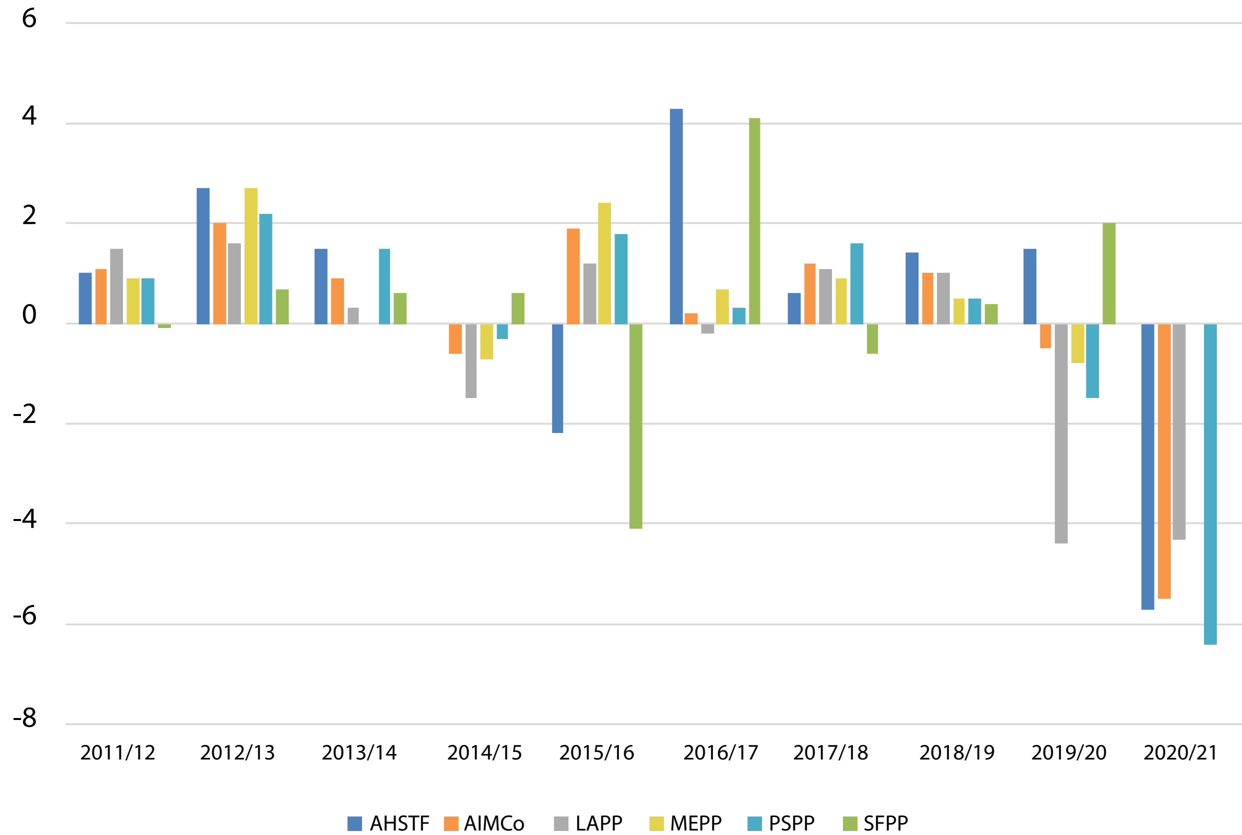
Figure 2 illustrates the overall performance of AIMCo relative to its own benchmarks and its performance against benchmarks set by the various pension boards over the past 10 years. Several observations about Figure 2 stand out. First, the AHSTF and SFPP appear to exhibit more erratic performances against benchmarks than the other funds.

AIMCo's own performance is predictably in the middle of the pack given that 75 per cent of the achievement of its own benchmarks relate to managing the five large funds. AIMCo's investment performance for the major pension funds was generally strong—that is, above benchmarks—in 2011/12, 2012/13, 2014/15, 2016/17, 2016/17, and 2018/19, but since then performance has been poor.

While this report focusses mainly on pension fund investment management, the volatility of the AHSTF's investment performance should concern all Alberta taxpayers. This erratic performance suggests that, at the very least, the minister of finance should have his deputy sitting at the AIMCo board table. This measure was taken in the 2007 *AIMCo Act* but the deputy was later removed from the board, which suggests they were appointed only for the transition of AIMCo into a provincial corporation. Issues related to the ownership and board representation of AIMCo are analyzed further in Section 5.

24 See Ascah, 2016, 21–23.

Figure 2: Overall Performance of Alberta Funds Against Benchmarks, 2011/12–2020/21 (%)



Sources: Annual reports of AHSTF, LAPP, MEPP, PSPP, and SFPP.
Notes: 2020-21 performance data are still not available for MEPP or SFPP.

In Table 4, AIMCo's long-term investment track record is presented (4, 5, 8, 10, and 20-year where available).

AIMCo's 4-year performance has been poor largely due to the effects of the VOLTS. Over a period of four to 20 years AIMCo's main job of beating their clients' return objectives by consistently adding value was met in only six of the 15 data points available. AIMCo's 5-year performance against its own benchmarks was minus 0.7 per cent; that means AIMCo, as the investment manager, failed to meet its own performance expectations.

Table 4: Long-Term Performance of Alberta Funds Against Benchmarks, 2019, 2020, 2021

Entity (fiscal year end)	4-year	5-year	8-year	10-year	20-year
LAPP (2020)	-0.7			0	-0.1
MEPP (2019)	0.4		0.7		
PSPP (2020)	-1.44	-1.08		0.06	
AHSTF (2021)		-0.6		0.3	
AIMCo (2020)	-1	-0.7			
SFPP (2019)	0.3			0.8	0.5

Sources: Annual Reports, 2019, 2020, 2021. PSPP figures from PSPP staff.

Longer term (8, 10, and 20 year), where reported, AIMCo's performance has actually been decent. However, the table's reporting gaps demonstrate that pension fund boards cannot agree on common reporting for longer terms. Why the four major boards do not agree on common long-term reporting requirements is a puzzle. At a minimum, 5-year and 10-year reporting would give members and analysts a better sense of how AIMCo is performing overall and would form the basis for improved accountability for long-term results.

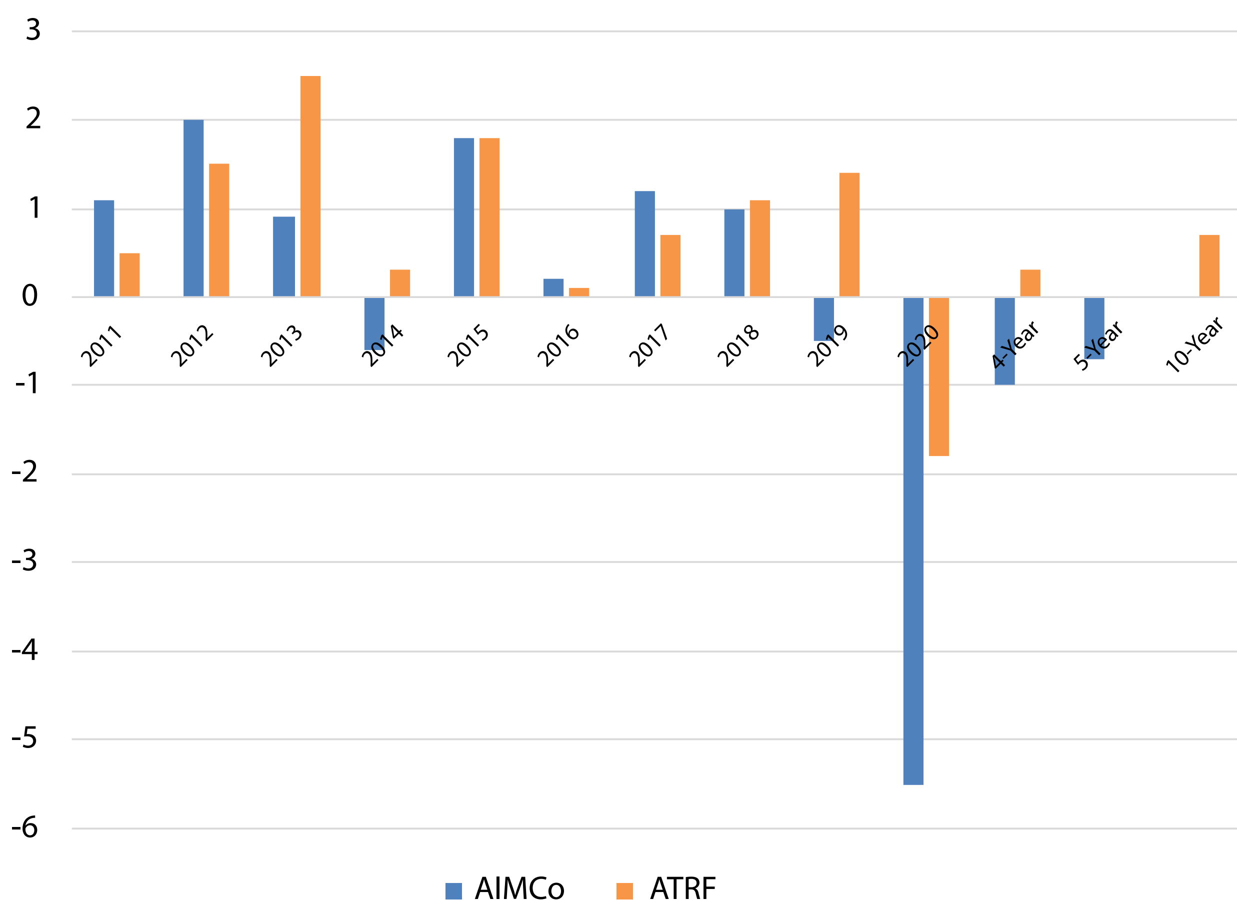
Comparing the Performance of AIMCo and ATRF

In Figure 3 we explore the performances of AIMCo and of ATRF against benchmarks.

Looking at longer-term returns, ATRF returns a superior performance against benchmarks set, including a respectable 70 basis points added over the benchmark in the most recent 10-year period. ATRF's 4-year performance is over one percentage point above that of AIMCo. AIMCo's performance relative to the ATRF was superior only in 2011, 2012, 2016 2017, but AIMCo's record has worsened over the past three years. The VOLTS damaged AIMCo's returns in 2020 (discussed above in Section 3).

In May 2020, in the wake of revelations about the VOLTS, ATA President Jason Schilling wrote to the chair of the ATRF asking ATRF to compare ATRF's actual performance against a hypothetical scenario where AIMCo was managing ATRF's investments (Schilling, 2020). The ATA released the study undertaken by the ATRF in June (see ATA, 2020). The study found that teachers' pension plan assets would have been $1.3 billion less under AIMCo stewardship.[25] The difference was due to three main factors: 1) private equity returns would have been significantly poorer under AIMCo; 2) infrastructure returns were materially less at AIMCo; and 3) real estate returns were marginally better at ATRF. ATRF's analysis was not challenged by AIMCo or the minister of finance.

Figure 3: AIMCo and ATRF Performance Against Benchmarks, 2011–2020 (%)



Sources: Annual reports, 2011–2020.
Notes: AIMCo's fiscal year is the calendar year, while ATRF's fiscal year ends August 31.

25 "ATRF's analysis was done by using the actual returns earned by various asset classes within the Local Authorities Pension Plan, AIMCo's largest and most comparable client. Those return rates were applied to ATRF's actual asset mix and data was compared with a common Dec. 31 year-end" (ATA, 2020).

Comparing the Performance of AIMCo, BCI, Caisse, OMERS, and OTPP

Table 5 provides some basic information about AIMCo and its peers, including size of investments, number of members, and client organizations.

Table 5: Overview of AIMCo and Peer Investment Managers

Investment manager at December 31, 2020 except where noted	Members, pensioners, beneficiaries	Number of clients	Funds managed ($ billions)
AIMCo	463,514[1]	30	129.4[2]
BCI	630,000	31	171.3
Caisse[3]	6,000,000+	40+	365.5
OMERS[4]	525,981	1,000[5]	105.6
OTPP[6]	331,000	1	221.2

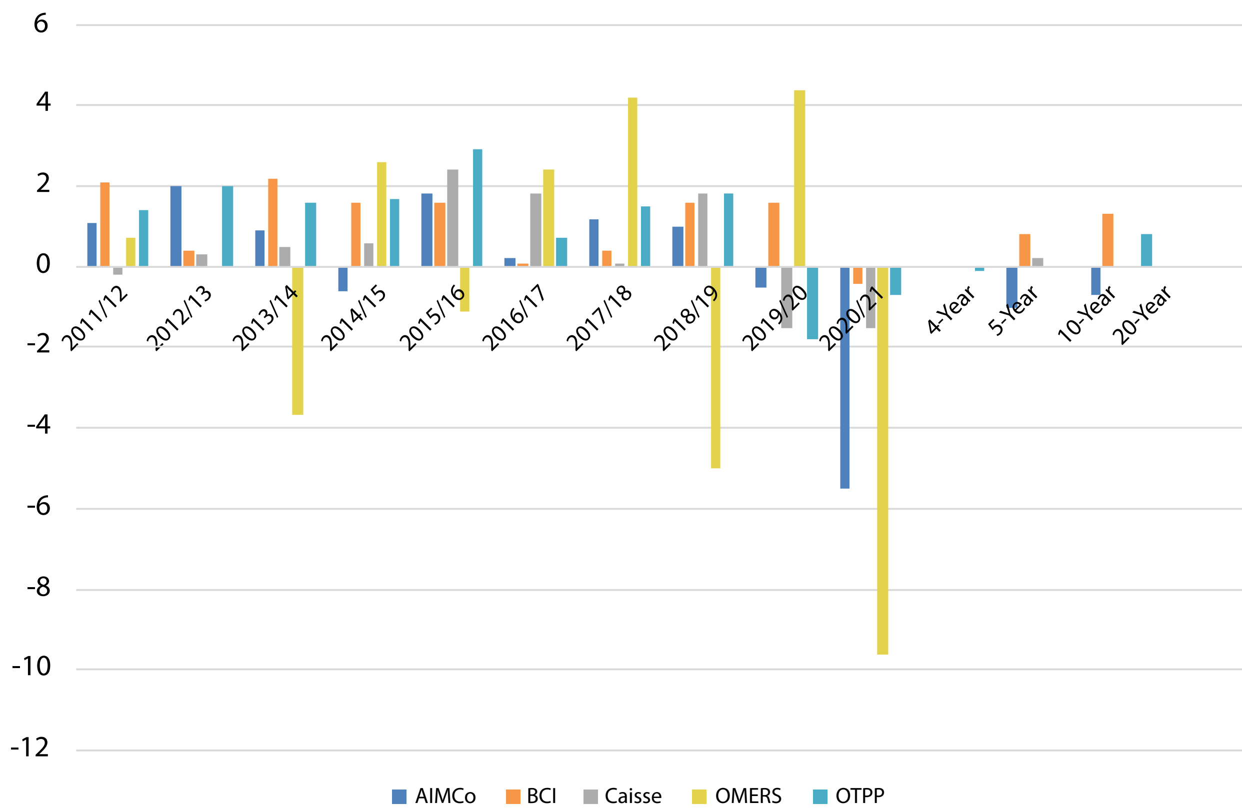
Sources: Annual reports.
Notes: (1) AIMCo has no direct relationship with pension fund members. (2) At December 31, 2020, and includes transition assets from WCB and ATRF. (3) Caisse's gross assets were $412.1 billion at December 31, 2020. (4) OMERS gross assets were $122.5 billion. (5) Number of employers. (6) Ontario teachers' gross assets were $270.9 billion at December 31, 2020.

AIMCo most closely resembles British Columbia Investment Management Corporation (BCI), which is a multi-client investment manager that manages both government funds and public sector pension funds. Québec's Caisse is also similar to the multi-client structure of AIMCo and BCI, but it also manages the large Québec Pension Plan, which contains some elements of an economic development mandate. AIMCo's executive compensation disclosure (AIMCo, 2020 Annual Report, p. 72) includes these managers as well as other large single-client pension fund managers like OTPP and Ontario Municipal Employees Retirement System (OMERS).

Figure 4 shows the overall performance of these funds against their benchmarks for the decade 2011 to 2020.

OMERS has the weakest performance over the 10-year period. AIMCo had superior performance than all of its peers in 2012/13, and it did worse than all its peers in 2014/15. AIMCo's poor performance in 2020/21 caused its performance to slip relative to its peers except for OMERS. AIMCo's long-term performance (5-year and 10-year) is poor when measured against its closest comparator, BCI.

Figure 4: Overall Returns of Canadian Pension Plans Against Benchmarks, 2011/12–2020/21 (%)



Sources: Annual Reports of AIMCo, BCI, Caisse, OMERS, and OTPP, 2011–2020.

The performance of *Caisse*, which uses leverage—a financial technique that expands the balance sheet through borrowing to increase investment income (see Appendix A for further details)—was strong in the first half of the decade, but its performance has since deteriorated. The best that could be said of AIMCo's performance is that its track record is better than OMERS while lagging the rest. AIMCo's lack of leverage might explain the weaker performance against benchmarks; however, BCI does not use leverage and it has captured more value added. Leverage is used by AIMCo to some extent in its real estate investments where ownership stakes are partly financed by mortgage debt. Inadequate public reporting by AIMCo in this area means we cannot fully evaluate its performance.[26]

25 The only reference to leverage in AIMCo's 2020 report is that AIMCo has "avoided leveraged lending in commodity sectors, in general, and was highly selective in cyclical and energy sectors" (AIMCo, 2020, p. 29, emphasis added). This suggests that AIMCo is doing leveraged lending to the energy sector. Leveraged lending is a form of finance used in mergers and acquisitions, business recapitalization, and equity buyouts to enhance the purchaser returns. The use of leverage is mentioned in note 14 to LAPP's 2020 financial statements: "the use of derivatives and leverage are based on an asset mix and risk policies and procedures that are designed to enable the Plan to meet or exceed its long-term funding requirement within an acceptable level of risk, consistent with the Plan's SIPP approved by the Board." However, there is no quantification of this practice.

5. Issues and Recommendations

Reforming AIMCo's ownership and governance structure is central to protecting the financial security of pension plan members in retirement. This report has identified serious weaknesses of AIMCo. These weaknesses include poor investment performance relative to clients' expectations, including large losses from the VOLTS. The VOLTS also undermined confidence in the board of directors' role in supervising risk management activities. Actions taken by AIMCo and by the UCP government to undermine the authority of pension boards to set their own investment policy have left pension plan members and pensioners worried about what the government could do with their pension funds. Additionally, the ability of boards to look elsewhere for investment management services, a measure implemented by the NDP in 2018, was reversed by the UCP.

AIMCo is too important to the well-being of almost a half-million Alberta workers and pensioners to be left exclusively to fiat by the government of the day. The recent settlement between AIMCo and ATRF regarding an IMA, and recent media featuring AIMCo's new CEO, Evan Siddall, suggest that the status quo will not continue (Jones, 2021b; Siddall, 2021). This bodes well for the future, but execution must back up the stated desire to become a client-centred, world-class organization.

Actions, not words, are required from AIMCo and the government to repair the damaged trust of the past two years. Below are outlined the critical issues facing AIMCo and five practical recommendations that will help improve the damaged relationship between AIMCo and plan members and Albertans.

Trust is Central to the Pension Bargain

The current relationship between pension plan members, including retirees, and the Alberta government is one of mistrust. As discussed in Section 3, this mistrust began in late 2019 with the UCP government using its majority in the Legislative Assembly to introduce and swiftly adopt Bill 22, which swept ATRF, WCB, and AHS funds under AIMCo's investment management without consultation. Then followed the Christmas 2020 surprise imposition of IMAs by the minister of finance (see Section 3).

Numerous public statements from leaders of the UCP government also raised suspicions—not proven—that the government might use AIMCo as a vehicle to financially support the ailing oil and gas industry. These included the persistent trumpeting of the benefits of oil and gas investment from Premier Kenney and the Minister of Energy Sonya Savage, while attacking the Trudeau government for supposedly not providing enough support to Alberta's biggest industry.

AIMCo's investment in two pipelines after the 2019 Alberta election suggested an alignment of UCP government policy and AIMCo's investment thrust. On May 28, 2019, AIMCo acquired 85 per cent of the Northern Courier Pipeline from TC Energy. The pipeline transports bitumen and diluent between the Fort Hills mine (majority-owned by Suncor Energy) and Suncor's terminal located north of Fort McMurray. This represents a $1.15 billion investment of mainly Alberta public sector workers' retirement funds. AIMCo's news release emphasized the "low-risk" nature of the investment (AIMCo, 2019a).

On December 26, 2019, AIMCo invested in a substantial share of TC Energy's Coastal GasLink Pipeline. AIMCo's news release stated, "The Coastal GasLink pipeline represents a critical component of Western Canada's ability to meaningfully realize the value of its vast natural gas resources, while supporting the coal-to-gas energy transition currently underway globally." The news release also stated, "AIMCo is committed to meeting the long-term return objectives of our clients, and by partnering with TC Energy, we are meeting those aims alongside a great Canadian company" (AIMCo, 2019b).

There is no evidence that the UCP government is in fact using AIMCo to fund pipelines or other large fossil fuel projects. However, the continued appointment of AIMCo directors by the UCP and questions about AIMCo's independence from government should still be of concern to all Albertans, especially public sector workers and pensioners. Pensioners' funds are best protected by government diminishing its role as the owner of AIMCo and restricting its function principally to regulating public and private sector funds (these issues are discussed further in the following sub-sections). While one would hope that AIMCo's executive and board would never go along with using the AHSTF and pension money for large fossil fuel bets, Albertans should remain vigilant about the subtle ways governments—of any political stripe—might try to influence how AIMCo invests tens of billions of dollars.

Ownership of AIMCo

Recall from Section 3 that AIMCo was established in 2007 as a provincial agency with one share held by the Crown. However, as shown in Table 1 (page 5), 76% of the money that AIMCo is responsible for as an investment manager is owned by pension plan members (members of LAPP, MEPP, PSPP, SFPP, and ATRF as of December 31, 2021). The $98.3 billion in these five pension plans is not owned by the government. Given the mistrust between pension boards and AIMCo and the general mistrust that exists between many public sector workers and the Kenney government, a major rethink of why AIMCo should be directly subject to ownership by the Crown is warranted. Given the 2018 reforms, which eliminated the government's role as trustee and administrator of plans, there is no reason to have the government involved except as a client (AHSTF) and as a regulator of fund managers through the Alberta Securities Commission. A joint ownership model with the government as a client and part owner would also reduce tensions of fund managers wary about the government's intentions towards AIMCo as a tool of government policy. By reducing or eliminating government ownership, the independence of AIMCo as an investment manager would be achieved.

Policy Recommendation #1. Eliminate the Crown's sole ownership of AIMCo. Ownership positions would be subject to negotiations between the major clients of AIMCo; meaning, the Government of Alberta, WCB, LAPP, MEPP, PSPP, SFPP, and ATRF. Share ownership would be nominal, as the corporation would continue to operate on a cost-recovery basis. The proportion of shares held could be based on the amount of funds managed by AIMCo of each client. The articles of incorporation could address board representation eliminating the need for the provincial Cabinet to appoint all directors. Such an ownership structure is more common in Europe and is reflective of a more collaborative labour-employer relationship.[27]

Representation on AIMCo's Board

Table 6 on page 30 summarizes the governance structure of Alberta funds, and Table 7 on page 31 shows the situation in other Canadian provinces. The two tables detail the structure of representativeness of the boards.

The *AIMCo* Act does not address the representativeness issue but applies a conventional qualification test, an issue addressed below. In the case of Alberta pension sponsor and corporate boards, the changes in the UCP's Bill 22 introduced a qualification test that had been eliminated under the NDP's Bill 27. Currently all of AIMCo's board members are appointed by the provincial government after a selection process involving the board with input from the responsible ministry. These members can be replaced through orders in council and therefore directors *may* have an interest in satisfying the sole shareholder's direction to remain on the board. Since directors have no representative function, their duty is both to the corporation and to the minister responsible as sole shareholder. However, section 2.1 of the *AIMCo Act*, added in 2011, states: "In providing investment management services to designated entities, the Corporation shall act in the best interests of the designated entities." Although limited to investment management services, in practical terms investment management services constitute the whole nature of the relationship between the parties.

27 This is based on a conversation with AIMCo's Chief Risk Officer Remco van Eeuwijk respecting pension fund structures in the European Union.

Table 6: Governance of Alberta Funds: Representation on Investment Manager Boards

Fund manager	Representation on investment manager board
AIMCo	None. Directors are appointed by orders in council. No representation or residency requirements. Directors must have proven and demonstrable experience and expertise in investment management, finance, accounting or law, or experience as an executive or a director in a senior publicly traded issuer.
Local Authorities Pension Plan	Employee representatives include one member each appointed by the AFL, AUPE, CUPE, HSAA, UNA, and one representing non-union employees. A total of six employer representatives including three members appointed by AHS; and, subject to rotation rules, one from Alberta School Boards Association, the Council of Post-Secondary Presidents of Alberta, or another organization representing post-secondary institutions participating in the plan as designated by the corporation; one from the Alberta Urban Municipalities Association or the Rural Municipalities of Alberta; and one from the City of Edmonton or the City of Calgary.(1)
Public Service Pension Plan	Three members appointed by AUPE, one appointed by the Non-Academic Staff Association at the University of Alberta, and four employers' representative (three appointed by the responsible minister and, on rotational basis, one from the University of Alberta or the University of Calgary.(2)
Management Employees Pension Plan	Advisory and consultative board. Three employee representatives and three nominated by government and one non-voting member nominated by Public Commissioner's office.(3)
Alberta Heritage Savings Trust Fund	Standing Committee of Alberta's legislature. Nine MLAs review reports, approve AHSTF's annual report, and hold public hearings.(4)
Alberta Teachers' Retirement Fund	Eight members nominated by two plan sponsors: Government of Alberta and plan members represented by the ATA.(5)
Workers' Compensation Board	Not more than three representing employers, three representing workers, and three representing the general public.(6)

Sources: (1) *Joint Governance of Public Sector Pension Plans Act*, Schedule 1, sections 4 (sponsor board) and section 29 (corporate board). (2) *Joint Governance of Public Sector Pension Plans Act*, Schedule 2, section 4 (sponsor board) and section 20 (corporate board). (3) https://www.mepp.ca/page/the-board (4) *Alberta Heritage Savings Trust Fund Act*, section 6. (5) Teachers' Pension Plans Act, section 5. (6) *Workers' Compensation Act*, section 5.

As shown in Table 7, the elements of representatives on the boards of these major plans varies. For BCI, representation is given to pension plans. For the Canada Pension Plan Investment Board (CPPIB), regional interests must be considered. For OMERS, representation is determined by sponsor boards. For *Caisse*, three-quarters of board members must reside in Québec, and two-thirds of board members must be independent.

Table 7: Governance of Major Canadian Pension Funds: Representation on Investment Management Boards

British Columbia Investment (BCI)	The trustees of the four statutory pension plans (College Pension Plan, Public Service Pension Plan, Municipal Pension Plan, and the Teachers' Pension Plan) each appoint one member. The minister of finance appoints three directors, two of whom must be representative of BCI's other clients. The third appointee by the minister is designated under the act as the chair of the board.[1]
Canada Pension Plan Investment Board	Appointment by the federal cabinet. The federal minister of finance appoints a committee with representatives from participating provinces. Before appointments are made, the minister of finance must consult with ministers of participating provinces. Factors to be taken into account include representation of regions; financial ability and relevant work experience; no more than three of 12 directors may reside outside Canada.[2]
Ontario Municipal Employees Retirement System (OMERS)-Administration Corporation	Fourteen members nominated by sponsor organizations and appointed by the Service Corporation Board (SC Board), plus an independent chair also appointed by the SC Board in a joint process with the Administration Corporation (AC Board).
Ontario Teachers' Pension Plan (OTPP)	Professional board. Eleven-member board appointed by the Government of Ontario and the Ontario Teachers' Federation. Five members are nominated by the government and Ontario Teachers' Federation. The board members elect a chair, who is the eleventh member.
Caisse de dépôt et placement du Québec (Caisse)	Professional board, unrepresentative. Minimum of nine, maximum of 15 members. Two-thirds of the board must be independent. "Board members other than the chair and the president and chief executive officer are appointed by the Government for a term of up to five years, after consultation with the board. Three quarters of board must reside in Quebec."[3]

Sources: Annual Reports, legislation, and websites. (1) https://www.bci.ca/who-we-are/governance/board-of-directors/board-members/ (2) CPPIB Act, section 10 (3) Caisse de depot Act, sections 5, 5.4, 5.5.

Table 7 illustrates there are many examples of group/employer sponsors and public sector union representation for boards, including the OTPP, where joint governance was a key factor. Appointments accomplished through nominations by sponsor and employee groups often use head-hunters to seek out suitable, qualified candidates. OTPP combines both a "professional board" with a representational committee. The Government of Ontario and the Ontario Teachers' Federation (OTF) are joint sponsors of the OTPP and share responsibility for funding the plan (the Alberta NDP's Bill 27 legislated a similar joint governance arrangement). Under the OTPP structure there is a six-member committee that decides on plan benefits and contribution rates. OTPP's "independent board" is appointed by the government and the OTF. This assures the plans' sponsors get a say in who they are selecting.

Another possible model is BCI, where four members of the seven-member board come from statutory pension plans and another two members are representative of BCI's other clients, with the last member being appointed by the government who serves as the chair. In the case of OMERS, sponsor organizations nominate board members.

Now is the time for a complete rethink of the composition of AIMCo's board. While the present board is composed of "blue chip" members, as illustrated by the VOLTS situation (see Section 3), blue-chip boards can be found lacking. AIMCo's blue-chip board is competent on paper, but their qualifications only require "experience and expertise in investment management, finance, accounting or law or experience as an executive or a director in a senior publicly traded issuer" (AIMCo Regulation, section 5). Absent are a host of significant skills including scientific or medical backgrounds, actuarial science, computer science, environmental science, information technology, and human resource management. As noted in Table 3 (page 10), AIMCo directors are appointed by the Alberta cabinet and have had a partisan interest in the past that should play no role in a director's duty or skill sets.

Another problem relates to AIMCo's all-white board, which directs the business and affairs of this corporation. If AIMCo is to model best practices in governance, including diversity concerns, the government must reassess the adequacy of its current recruitment process. In particular, given AIMCo's oil and gas investments, one or more Indigenous members would be an asset, and so would individuals with experience in the trade union movement. In addition, no current directors reside in Asia, Africa, South America, or Europe—all continents where AIMCo has a presence.

Finally, about two-thirds of the money that AIMCo is investing is owned by pension plan members, and they should have a stake in AIMCo's ownership and representation on AIMCo's board of directors.

Policy Recommendation #2. Representation on AIMCo's board should be broadly apportioned on the percentage of investments contributed. For example, given LAPP assets now represent roughly one-third of the assets under AIMCo's management, it should receive up to one-third of the seats on the board. Likewise, the Government of Alberta should have up to one-quarter of the board seats to represent its contribution of assets, including the AHSTF, endowments, and liquidity investments. The appointment of members would be the sole responsibility of the pension plans' corporate boards and the government. This makes sense because the provincial government is no longer trustee of the plans nor responsible for unfunded liabilities with the exception of pre-1992 teachers' pension entitlements.

Policy Recommendation #3. Qualifications or skills required should be defined in a refurbished *AIMCo Act* to make it difficult for the government to change these details for political reasons. The qualifications or skills required should not be narrowly defined to only include corporate executives or corporate board members ("blue chips").[28] Skill should be defined more broadly to include a range of professional backgrounds, such as human resources management, Indigenous affairs, environmental sciences, information technology, and medical science. Non-Canadian directors should broadly reflect AIMCo's investments in other geographic markets. The government should also give consideration to requiring certain mandatory minimum quotas to ensure there is gender and racial diversity reflecting Alberta's current demographics.[29]

Sole Provider of Services

The UCP's Bill 22 removed a pension board's right to seek out new investment managers. AIMCo's unstated fear could be that if LAPP went elsewhere, AIMCo would be left with much smaller investment pools, thereby degrading its capacity to recruit staff or access larger deals to spread costs over a larger asset base. Prior to Bill 22, the NDP's approach gave AIMCo a five-year period to prove its investment costs and performance were superior or at least equal to alternative managers. This five-year period of time should be lengthened given the requirement to ensure a healthy tension between the asset manager knowing their performance and expenses are being closely watched and clients having the choice to move some or all assets from AIMCo. A longer time period would balance AIMCo's need to invest in information technology and cybersecurity and to make long-term commitments to staff, with a pension fund's freedom of contract. If the above recommendation on joint ownership were enacted, there would probably be less desire to leave AIMCo because of pension plans' capacity to nominate directors to AIMCo's board. Indeed, pension boards would be able to replace directors where they collectively believe their directors are not providing good oversight of AIMCo management.

Policy Recommendation #4. Give plan participants and owners the option to give two-years notice of departing after AIMCo has managed its funds for eight years. If, after eight years, a pension board and co-owner of AIMCo concludes AIMCo's performance is inadequate to satisfy its fiduciary commitments to beneficiaries and members, it would be able to transfer all or some of its funds to a new manager.

28 In June 2020, Christina Gray, the former minister of labour in the Notley government introduced Bill 203, the Pension Protection Act. The purposes of the act was to "ensure members are adequately consulted in respect of significant decisions that may impact their pensions funds before those decisions are made or implemented by the Government" (section 2) https://docs.assembly.ab.ca/LADDAR_files/docs/bills/bill/legislature_30/session_2/20200225_bill-203.pdf In December 2020. Shannon Phillips, the NDP's finance critic introduced Bill 208, the Alberta Investment Management Corporation Amendment Act, 2020. Amendments to section 4 on board appointments proposed a 15-member board with the LAPP board, PSPP board, SFPP board, and the ATRF board to each appoint one member and the remainder appointed by the provincial Cabinet in accordance with regulations. https://docs.assembly.ab.ca/LADDAR_files/docs/bills/bill/legislature_30/session_2/20200225_bill-208.pdf. Bill 203 and Bill 208 were both defeated by the UCP majority government.

29 Section 4.1 of AIMCo's 2017 Mandate and Roles Document, agreed upon by the NDP minister of finance, defined "gender parity" as meaning that women would be at least five of the 11 directors. AIMCo's current board, as of November 4, 2021, has four women and seven men.

Independence from Government

On December 11, 2019 AIMCo's then-CEO Kevin Uebelein wrote an opinion piece which appeared in the *Edmonton Journal* entitled "Independence at core of AIMCo's mandate" (Uebelein, 2019). In a stern defense of AIMCo's independence from government, Uebelein dismissed the idea that "recent moves by the Alberta government to broaden and solidify AIMCo's scope of clients is motivated by a desire by government to control those investments." How Uebelein, who was to leave by the end June 2021, could speak for the government's agenda is unclear. Curiously, Uebelein did not mention the government's monopoly over appointing directors.

Uebelein also claimed that AIMCo's independence from government is written explicitly into the *AIMCo Act*. This is inaccurate. The act does not state that AIMCo is independent, and AIMCo is legally an agent of the Alberta Crown. However, the Mandate and Roles Document signed in September 2017 between AIMCo's board chair and former minister of finance Joe Ceci states, "AIMCo operates independently and at arms-length from the Government of Alberta, and it is governed by a professional board of directors that is independent of the Government of Alberta and AIMCo management" (AIMCo, 2017).[30]

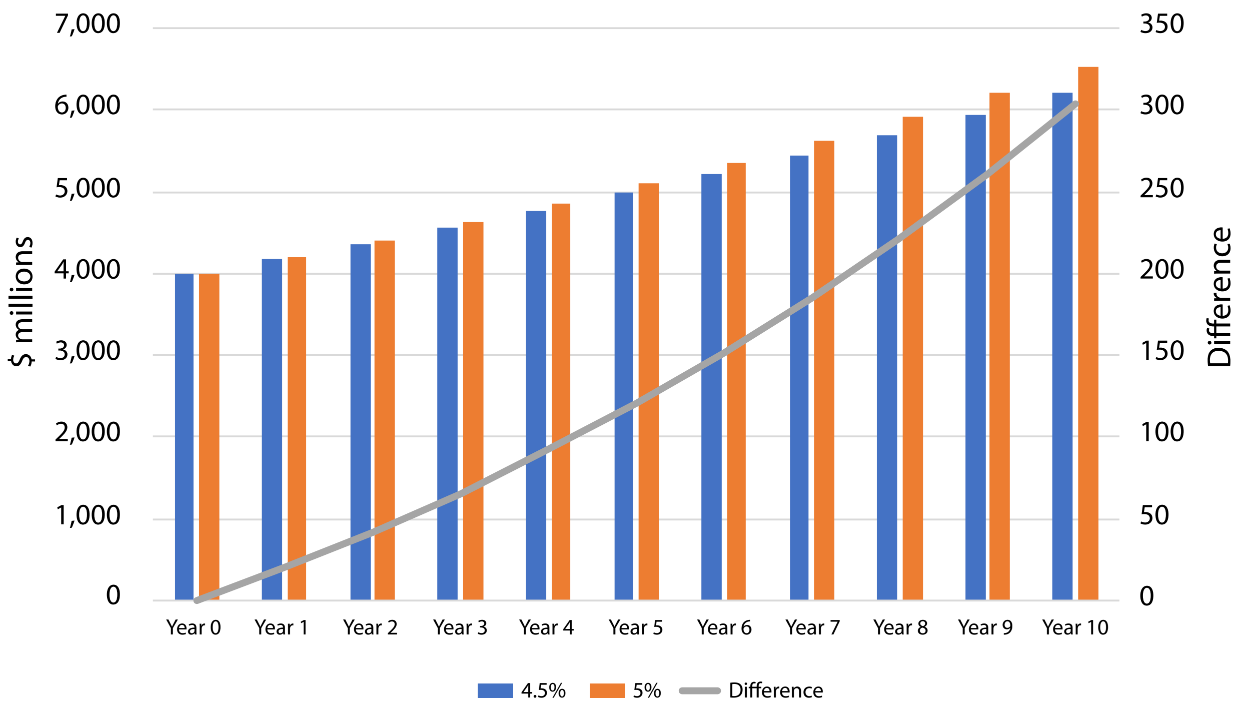
Policy Recommendation #5. Implement a new ownership structure with the government holding a minority position to prevent governments using AIMCo funds for their own political purposes.

30 The preamble to the Mandate and Roles Document states: "Although AIMCo operates independently and at arm's length from the Government of Alberta, there is broad cooperation and collaboration between AIMCo and the Government of Alberta."

Appendix A. Principles of Investment Management

The use of investment managers is premised on the idea that *active management*, which involves strategic asset allocation and securities' selection, will produce better returns than *passively managed* portfolios. This claim is a controversial one in the literature, and passive investment vehicles with low costs are becoming more prevalent.

Figure 5: Difference in Value of 50 Basis Points on $4 billion over 10 Years ($ millions)



Active investing embraces a wide variety of strategies, but it requires daily attention to market movements and is premised on the theory that active management can "beat the market" after taking transaction costs into account. A well-informed active investor may be able to outperform market indexes over time and thereby obtain extra returns (known as "alpha"). Empirical research in finance suggests that specific factors, such as momentum, can result in "small cap" corporations producing excess returns over the long run. As Figure 5 above shows, over long periods of time and with billions of dollars at stake there are significant benefits in choosing a good active investment manager.[31]

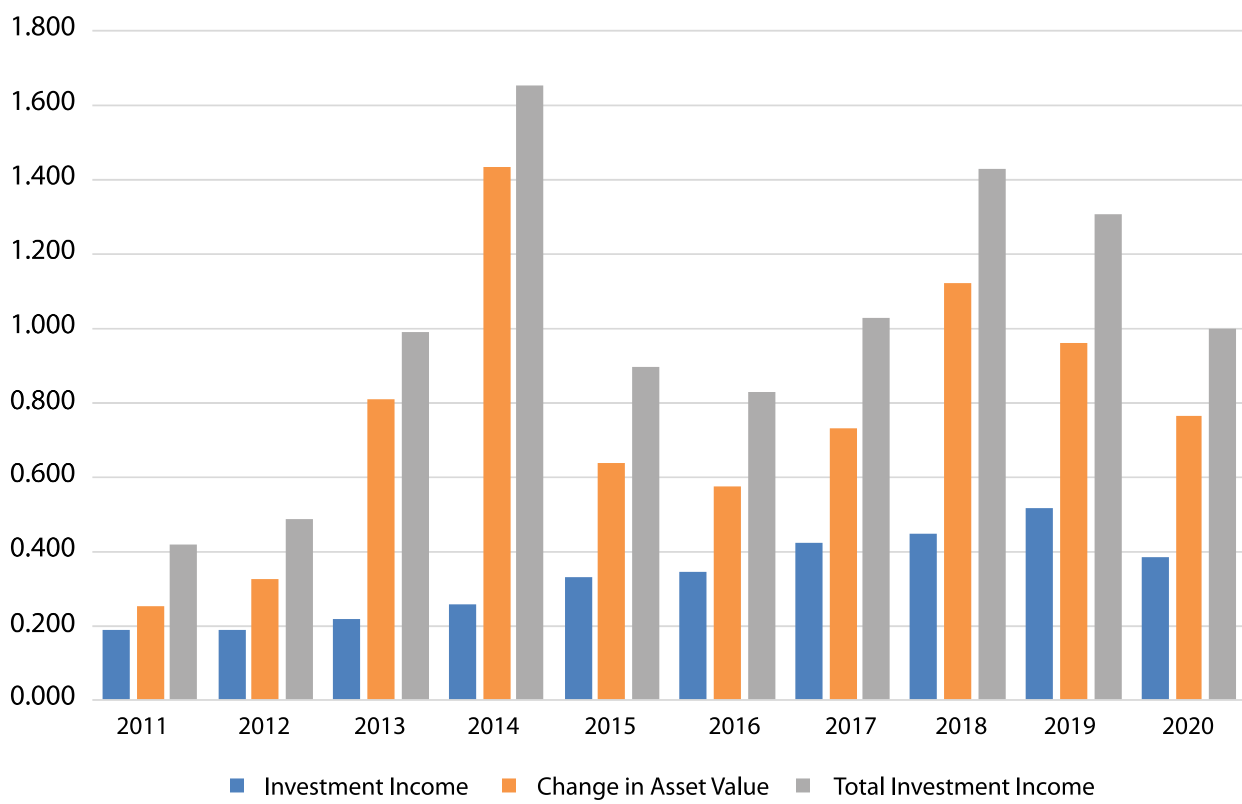
Passive investment strategies take the view that adding alpha is essentially a myth. Passive investment strategies are based on a financial theory known as the "efficient market hypothesis." There is extensive research, for example,

31 This speaks to one of the controversies surrounding the UCP's changes to provincial pension fund management. The Local Authorities Pension Plan, Public Service Pension Plan, Management Employees Pension Plan, and Special Forces Pension Plan must continue to utilize AIMCo as their investment manager.

that actively managed mutual funds fail to beat a strategy of just holding a broad and general stock market index like the TSX composite. Low investment management expenses are an important way to add value over time. Since arithmetically only 50 per cent of managers can outperform a benchmark over time, if one buys the index at a very low cost then an investor will derive alpha by eliminating the overhead that goes with the trading of securities or purchases of real estate or infrastructure. (This is not the case for certain markets such as real estate or infrastructure which are not actively traded.) For example, if the manager can save 0.2 per cent each year by running a passive strategy using indices, this move over the long term should produce similar or possibly better results than the average active investment strategy.

Investment income comes in two forms: 1) dividend and interest payments, and 2) realized and unrealized gains or losses on the investment portfolio. As Figure 6 shows, the greatest component of total investment income is derived from gains on the sale or the holding (orange bars) of investments (unrealized gains or losses can also be called "paper" gains or losses). These sources of income are much more volatile than dividend and interest income.

Figure 6: ATRF Composition of Change in Asset Value to Investment Income, 2011–2020



Source: ATRF, Audited Financial Statements for years ending August 31, 2011–2020. Change in asset value includes both realized and unrealized gains (losses).

Diversification is another critical element in stabilizing investment income over the long term. Diversification can take many forms: asset class, geography,[32] industrial sectors, individual securities, and investment strategies. The industry has evolved a variety of investing strategies including: value investing, the use of leverage to enhance returns, index investing, special situation (opportunistic) investing, and high frequency trading.

Much analysis is devoted to the use of diversification in reducing risks. Positive correlation between asset classes makes a portfolio vulnerable to broad-based financial crises. Fixed income is used to reduce reliance on volatile realized and unrealized gains on equities by providing a steady known stream of income, normally with low levels of risk. Infrastructure assets also provide stable cash flows usually adjusted for local inflation.

While corporate boards set investment mix (see Table 2 on page 6), the broad range for the various funds under which AIMCo operates gives AIMCo significant room to formulate strategies or construct portfolios to earn returns above benchmarks.

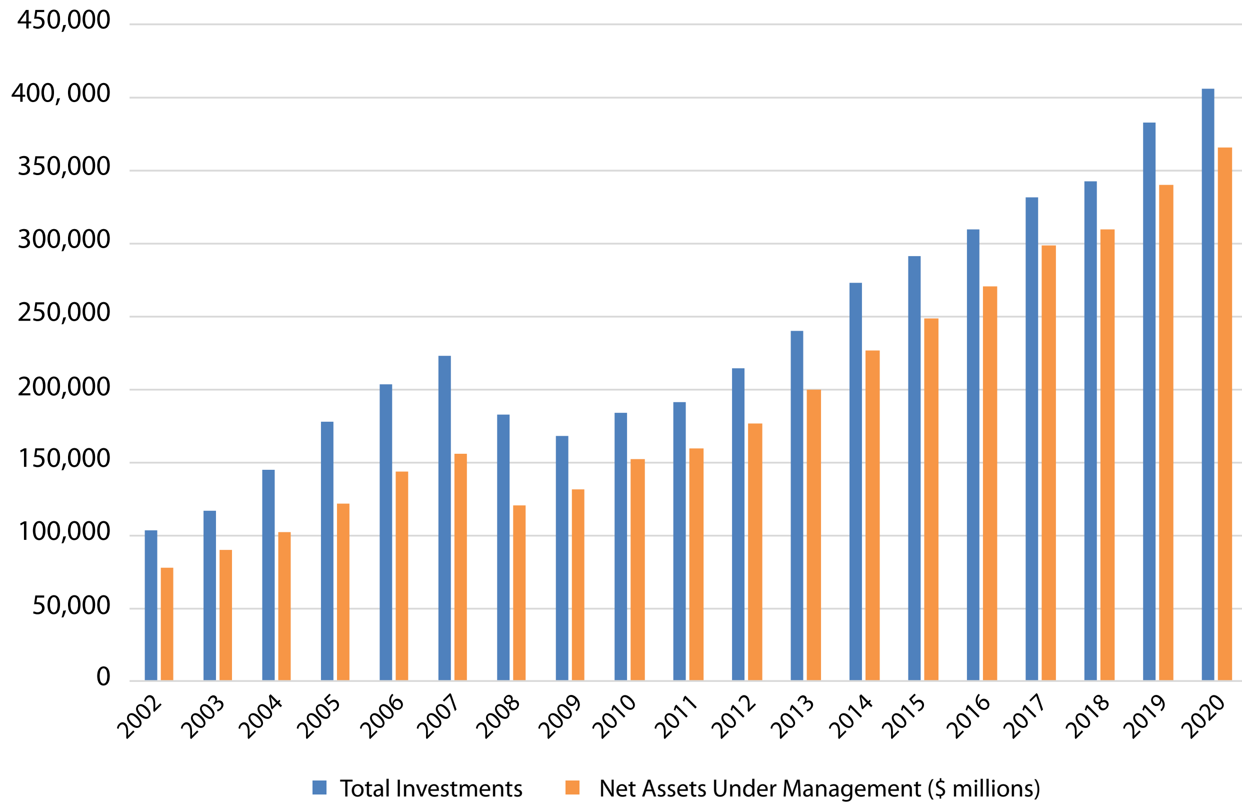
Another investing strategy employs leverage. This strategy entails borrowing or issuing debt at a low interest rate (Canadian pension funds have excellent credit ratings) to earn higher returns that more than cover the interest payments. By expanding the funds under management, a fund can marshal more financial resources to capitalize on investment opportunities. Figure 7 shows the magnitude of leverage employed by Québec's *Caisse*. *Caisse*'s use of leverage is the difference in size of their total investments (blue bars) and the net assets under their management (orange bars).

Leverage is also used extensively by the OTPP and by the CPPIB. There are also other ways an investment manager might employ leverage without borrowing. As discussed in the main text (see the "March 2020 Losses" sub-section on page 17), by entering into contracts that have contingent returns that vary according to the performance of a particular index or mathematical relationships, the manager is leveraging the credit rating of the whole fund.

A fund manager can enter into a contract to pay another investor (counter-party) or receive payment from the counter-party depending on the volatility of a stock market index. The seller receives insurance premiums to insure the buyer of the contract against an unlikely market event such as extreme market volatility. However, when an unlikely event occurs, the "premium" payments received in the past and reinvested may be insufficient to pay out the insurance proceeds. This is when the whole balance sheet of the fund is affected and pension plan members and beneficiaries share the losses.

32 For example, AIMCo has 48.1 per cent of its assets in Canada, 31 per cent in the United States, 4.5 per cent in the United Kingdom, 1.4 per cent in Japan, and 14.7 per cent in the rest of the world (AIMCo, 2020, 3). Important changes were made by the federal government in the 1990s to allow pension funds more latitude to diversify holdings geographically. This was in part a response to the realization that Canada's equity markets only represent about 2 per cent of the global equity markets.

Figure 7: Use of Leverage by the *Caisse de dépôt et placement du Québec*, 2002–2020



Source: Annual Reports of the *Caisse de dépôt* et placement du Québec for fiscal years ending December 31, 2002–2020.

The use of debt is a controversial subject as it magnifies the effects of large price movements. There is also the cost of debt. Proponents argue it can allow the investment fund to improve returns under favourable conditions relative to funds that do not use leverage. But leverage increases losses under unfavourable conditions. The use of leverage should depend on the decision-maker's *appetite for risk* taking into account the plan members' and employers' appetite for risk. This is why representation on the governing investment board is essential to ensure the risk appetite is carefully considered.

Risk management balances risk of holding investments and the rewards deriving from ownership. Finance theory is premised on the notion that riskier assets earn higher returns over the long-term relative to "risk-free" securities like government bonds.

Responsible investing has emerged over the past decade. Investment managers, on behalf of beneficiaries, are expected now to consider more than financial attributes of an investment. Environmental, social, and governance

(ESG) factors must now be considered in making investments. Once invested in a particular company, active monitoring of shareholder resolution and board of director appointments now requires considerable resources (AIMCo, 2020, p. 43).

Appendix B. Qualifications

The measurement and comparison of investment performance is a difficult technical undertaking for a number of reasons. It is virtually impossible to do an "apples-to-apples" comparison of the performance of public sector investment managers. This difficulty is due to different fiscal year ends, different terminology, and different breakdowns of investment portfolio classes. For example, BCI reports Canadian public equity, global public equity, and emerging market equity separately, while AIMCo reports these separately and also as a total class. To do an "apples-to-apples" comparison would require access to internal financial reporting systems or proprietary services such as CEM Benchmarking (a global benchmarking company).

Benchmarks. For AIMCo's board and pension plan boards to hold AIMCo's management's investment performance to account it is necessary to compare a fund's performance against an appropriate benchmark. Such a benchmark reflects the nature of the assets managed and risks taken on. Selecting an *appropriate* benchmark has objective and subjective elements. It is objective in terms of matching the underlying benchmark to the assets managed in as much detail as possible. However, the selection of the benchmark could be biased towards a choice that makes beating the chosen benchmark easy which could then increase variable compensation of fund managers. In the case of private equity investments and infrastructure, benchmarking can be difficult in part due to the more subjective nature of valuing companies whose shares are not traded in public markets.

In the case of AIMCo and the major pension funds it manages, AIMCo sometimes uses different benchmarks for itself while pension plans use another index for asset classes in their respective asset mixes. For example, for private equity MEPP uses the Morgan Stanley MSCI All World Index, but AIMCo uses the Consumer Price Index lagged plus 6.5 per cent (5-year rolling average). As shown in Table 8, there is no standard that is used by all Albertan or Canadian public pension funds.

Shifting benchmarks. Benchmarks change over time as the asset mix and investment philosophy adapts and evolves. This makes it difficult to compare the performance of investment managers over longer periods of time. This means that the benchmark 4-year rate used by, for example, LAPP in 2010 to judge AIMCo's performance for private equity may be constructed differently than the 4-year benchmark used by LAPP in 2020.

Comparable time horizons. The choice of the time horizon is critical to analyzing the performance of any investment fund. In this report, we are relying heavily on 10-year returns of the fund because this approach reduces the impact of short-term return fluctuations and volatile annual changes.

This is appropriate given the long-term investment horizon of the pension or savings funds.

Table 8: Benchmarks Used by Canadian Public Pension Funds, 2019–2021

Fund (fiscal year)	Global Equity	Private Equity	Fixed Income	Real Estate
ATRF (2020)	Hybrid MSCI World (50%), S&P/TSX Composite (30%), MSCI Emerging Markets (20%)	MSCI World Index plus 2%	Includes FTSE TMX Universe Bond Index, FTSE TMX Long-term Government Bond Index	Customized IPD Global Property Fund Index
AHSTF (2021)	Not specified	Not specified	Not specified	Not specified
AIMCo (2020)	MSCI World Net Total Return Index	Total CPI 1 Month Lagged + 650 bps (5-year rolling average	Includes 8 different FTSE Canada (e.g., money market, real return bonds, etc.)	MSCI Global Region Property Index and for Canada MSCI REALpac/IPD All Property Index-Large institutional subset
LAPP (2020)	MSCI World Index	CPI plus 6.5%	Includes FTSE TMX Universe Bond Index, FTSE TMX Long-term Government Bond Index	Combined: 2/3 IPD Large Institutional All Property Index and 1/3 MSCI Global Region IPD Quarterly Property Index.
MEPP (2019)	MSCI All Country World Index (ACWI)	MSCI ACWI	DEX Universe Bond Fund	Combined IPD Large Institutional and MSCI Global Region Property Index
PSPP (2020)	MSCI World/MSCI World Minimum Vol Index	CPI plus 7%	FTSE Canada Universe Bond Index	MSCI Global Regional Property Index and MSCI REAL pac Canadian All Property Index
SFPP (2017)	MSCI World, MSCI EM, MSCI World Small Cap	Not specified	FTSE TMX L.T. Government Bond. FTSE TMX Universe Bond, FTSE TMX L.T. Government Bond	Not specified
BCI	MSCI World ex Canada Index	Nominal 7%	FTSE Canada All Government Bond Index	CPI plus 4%
Caisse (2016)	85% MSCI ACWI (Unhedged), 15% FTSE TMX Canada 91 Day T-Bill Index	Index partially hedge, consisting of 50% MSCI World and 50% State Street Private Equity Index	Includes FTSE TMX Universe Bond Index, FTSE TMX Long-term Government Bond Index	Aon-Hewitt Real Estate (Adjusted)
OMERS (2020)	Not specified	Not specified	Not specified	Not specified
OTPP (2020)	Not specified	Not specified	Not specified	Not specified

Sources: BCI's Pooled Fund Annualized Returns, March 31, 2019 (https://www.bci.ca/wp-content/uploads/2019/10/pooled-fund-annualized-returns-march-31-2019.pdf) and annual reports for fiscal years noted

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