The Race for Assets

Canada vs. the World

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Canadian investors have been at the forefront of the shift towards alternatives: some of them have been in alternatives for decades, while others have moved up the experience curve rapidly by building dedicated professional alternative asset management teams. Our report demonstrates that Canada's investors have a tremendous capacity for innovation. Perhaps unsurprisingly, we also reveal that satisfaction with returns from alternatives remains high, although Canadian investors continue to agitate for change. Canadian institutions are already among the world's most admired and influential. As our report shows, they look set to retain that status in the years to come.

Jon Lofto
Director, Alternatives
CIBC Mellon

Key themes for Canadian Institutional Investors

- Transparency
- Fee compression
- Environmental, social, governance factors

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The Race for Assets

Canada vs. the World

Foreword

With moderate growth predicted over the coming year, a volatile geopolitical climate, and rising trade tensions in many economies, institutional investors are increasingly seeking investments that shelter their capital from short-term risks and market movements while also generating strong returns.

In the years since the financial crisis, alternative assets, such as private equity, real estate, infrastructure, private debt and, to a lesser extent, hedge funds, have largely offered this kind of shelter as investors have allocated increasing proportions of their assets under management to this area of the investment market.

Against this backdrop, we surveyed some of the most sophisticated investors on the planet – Canadian institutional investors – to gain insights into their current alternatives exposure and future plans. Taking an active approach to managing their portfolios, Canadian investors have been at the forefront of the shift towards alternatives: some of them have been in alternatives for decades, while others have moved up the experience curve rapidly by building dedicated professional alternative asset management teams.

An earlier global survey of institutions investing in alternatives, *The Race for Assets*, undertaken by BNY Mellon, provides a counterpoint for the results of our Canadian survey. It found that just over half of investors (53%) were seeking to increase their allocations to alternative assets over the coming 12 months and 12% expecting to decrease their exposure. *The Race for Assets: Canada* survey highlights an even stronger appetite among Canadian investors, with a higher proportion (58%) expecting increased allocations to alternatives over the next 12 months, and no respondents expecting to reduce their exposure. Real estate currently accounts for the largest proportion of Canadian investors' exposure (versus private equity globally). As we move through 2019, greater diversification across alternative asset classes and by region are trends to watch out for.

Our report demonstrates that Canada's investors have a tremendous capacity for innovation. A large proportion invest via funds of funds – often an entry point to new investment areas and a means of pooling smaller resources. Yet a similar proportion have also taken a different tack: partnering with other investors to invest in funds and making direct investments, both of which can improve the economics of investing in alternatives. These routes are far more common among Canadian investors than the well-trodden path of investing in traditional fund structures. The move towards direct investing is also evident among investors globally – the BNY Mellon survey found that 55% of respondents are looking to increase their direct investment activity.

Perhaps unsurprisingly, we also reveal that satisfaction with returns from alternatives remains high, although Canadian investors continue to agitate for change. Throughout our conversations across the alternatives industry – with asset owners and private fund managers – we hear the same three themes: reducing fees, increasing transparency and elevating sustainability factors are the three key areas where Canada's institutions will focus their efforts over the next 12 months in their dealings with fund managers.

Nevertheless, Canada's investors, with their long-term focus and strong in-house resources, look increasingly set to forge their own alternatives paths. Two-thirds already invest directly into portfolio companies and infrastructure assets and over half are looking to increase their direct investment activity, giving them greater control over their investment allocations.

Canadian institutions are already among the world's most admired and influential. As our report shows, they look set to retain that status in the years to come. ■

1 Alternative asset allocations continue to grow.

What is fueling their rise?

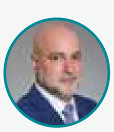
The years since the financial crisis have seen alternative assets rise in popularity among institutional investors. In an era of historically low interest rates and volatile public markets, the world's pension funds, insurance companies, endowments, foundations and other investors have sought yield, enhanced returns and a shelter from volatility through their alternatives allocations.

Canadian investors, among the most sophisticated globally, have been no exception. Indeed, the proportion of assets allocated by Canadian pension plans to alternatives has doubled over the past decade: in 2006, alternatives accounted for 15.3% of their investment allocations; by 2017, the figure had grown to 30.3%, according to the Pension Investment Association of Canada.[1]

There is no sign of this trend abating. More than half (58%) of respondents to our survey expect allocations to alternatives among Canadian investors to increase further over the next 12 months. The remaining 42% say alternatives allocations will remain stable, while no respondents expect them to decrease. The attraction of alternatives is summed up by an investment manager CIO: "Alternative investments have distinct benefits that we don't see in traditional investments. They provide good diversification, can offer higher returns at low risk and a key advantage is that they are less volatile."

The long-term nature and investment horizons of alternative investment types such as infrastructure, real estate and private equity are also seen as a good match for many investors, as one pension fund managing director notes: "Alternative investments are the best fit for long-term strategies, which is why Canadian investors will be increasing their allocations. They are not subject to the volatility often seen in public markets."

"Amid a hunt for returns and diversification, we continue to see interest in alternative classes among Canadian investors. Accessing alternatives can be complex and challenging, and demand continues to grow for solutions that provide exposure to alternative assets for investors across the spectrum of size and sophistication."



Ron Landry
Head of Product
CIBC Mellon

What do you predict will happen with allocation volumes in the alternatives market among Canadian investors over the next 12 months?

Canadian institutional investors among the world's heaviest allocators to alternatives

Canadian investors also appear to be marginally more likely to increase allocations to alternatives than their global counterparts. In BNY Mellon's Race for Assets survey released in late 2017, 53% of global institutional investors said they expected alternatives exposure to increase over the coming 12 months, a little lower than the result for our Canadian study.

This attests to Canadian institutions' experience, comfort and associated expertise in alternatives relative to most other markets. Canadian investors – such as the C$368.5bn Canadian Pension Plan Investment Board (CPPIB), which has been investing in alternatives since 2001 and now has a 41.2% allocation to private equity, infrastructure and real estate – have become some of the most influential institutions globally, particularly when it comes to alternatives. Canadian pension funds, for example, have a higher proportion of assets allocated to alternatives than those in the US, the Netherlands, the Nordics and Australia, according to a recent PwC report.[2]

58%

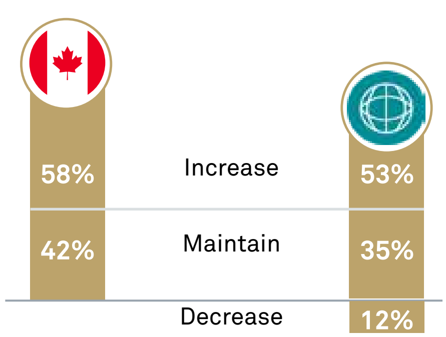
Expect to increase allocation to alternative investments overall

42%

Expect allocation levels to stay the same

Canada vs. the World

Expectations to increase allocations:



International exposures

Unsurprisingly, all survey respondents had exposure to North American investments across each of the alternative asset classes in which they invest. Taking in the large US market as well as domestic investments, North America presents a sizeable investment market. Indeed, in the global BNY Mellon survey, North America accounted for the largest proportion of exposure outside the region local to respondents, with, for example, 60% of Europe, Middle East and Africa (EMEA) investors and 42% of Asia-Pacific investors having exposure to North American private equity.

Canadian investors clearly seek geographic diversification through their alternative investments as well. This is particularly the case in private equity, where 79% of those that invest in this area had exposure to Europe, 42% to Asia-Pacific, 35% to Latin America and 5% each to the Middle East and Africa. The geographic spread is similar for real estate, albeit at smaller proportions, with exposure in Europe among 38% of real estate investors, followed by Latin America and Asia-Pacific. Canadian respondents' international exposure to private debt, meanwhile, is focused mainly on Europe at 54%. This reflects the relative nascence of this type of alternative investment – private debt funds have yet to develop a significant presence outside the US and Europe.

Overall, Canadian investors appear to have marginally less of a home bias than their global counterparts. In the BNY Mellon survey, 25% of EMEA investors had exposure to North American real estate and 36% to North American private debt, while 9% of Asia-Pacific investors had exposure to North American real estate and 11% to North American private debt.

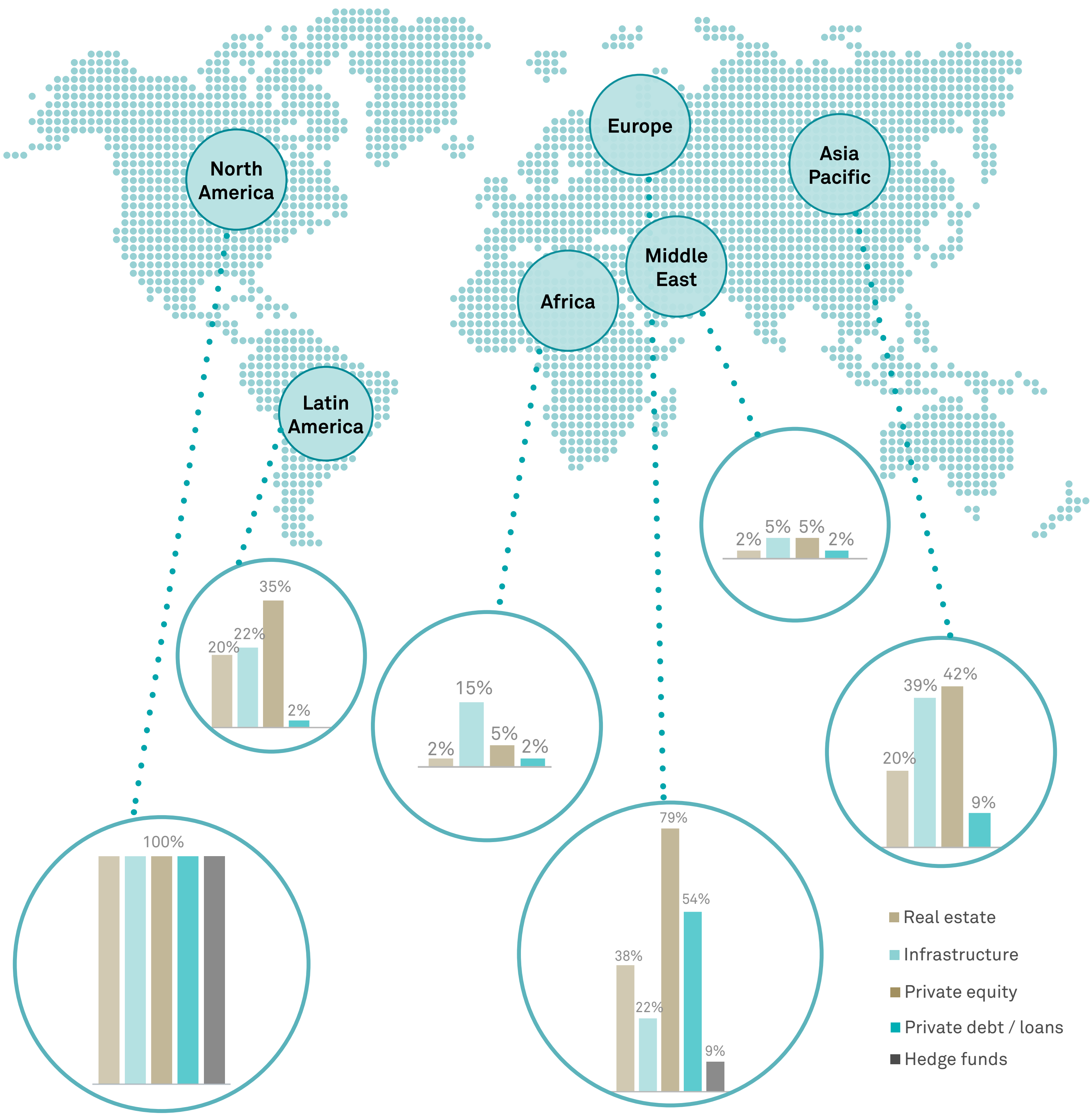
Canadian investors view infrastructure as a means to gain exposure to emerging markets. Outside North America, infrastructure opportunities in Asia-Pacific are the most popular choice, with 39% saying they have investments in these markets and 15% saying the same for Africa.

The exception to the global outlook of Canadian investors in their alternatives allocation is hedge funds, where the only other region considered is Europe, and even here, just 9% have exposure. This is a function of the low exposure to this form of alternative among Canadian investors – hedge funds account for just 1.4% of Canadian investors' average alternatives exposure. This compares with 6.8% of alternatives exposure going to hedge funds among global investors, according to the BNY Mellon global *Race for Assets* survey.

Infrastructure is a popular means to gain exposure to emerging markets.

Outside North America, infrastructure opportunities in Asia-Pacific are the most popular choice, followed by Europe/Latin America, Africa, and the Middle East.

For each of these investment types in which you are invested, please indicate which regions you currently have exposure to (inclusive of funds and direct investments)



Future plans

Canadian investors look set to increase their international exposure further – possibly more so than investors globally. In the BNY Mellon global *"Race for Assets"* survey, upwards of 95% of investors globally were seeking to invest more locally across most of the alternative asset classes.

Where Canadian investors may once have had a home bias in the investments they made – in its first year of operation (1999), CPPIB, for example, invested only domestically as a result of investment restrictions – our study findings suggest a more varied approach to the alternatives sub-asset classes than may be evident among investors globally.

A pension fund managing director sums up his plan's view:

> **"We have a global approach and a diversified investment mix. The spread of investments really helps us in overcoming the various market-based challenges such as inflation and macro uncertainties."**
>
> Pension Fund Managing Director

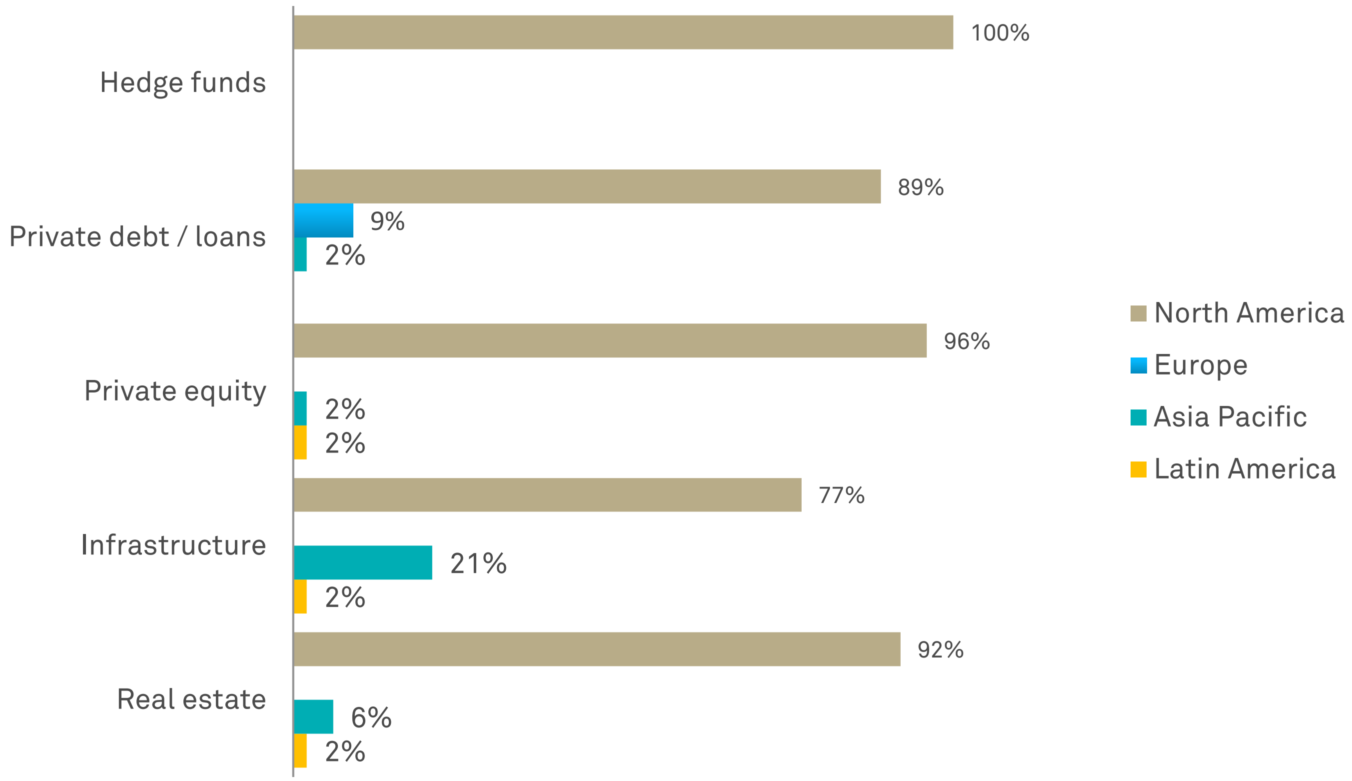
Every single respondent invested into hedge funds, and 96% of those with private equity exposure expect to increase allocations to North America. However, just 77% of those with infrastructure investments are seeking to increase investments close to home. In addition, 21% are looking for more Asia-Pacific opportunities, while just 2% of respondents are seeking greater opportunities in Latin America, underscoring the trend for emerging markets investments in this corner of alternatives. In this way, Canadian investors have a greater appetite for risk than their global counterparts – the BNY Mellon study showed that just 4% of EMEA investors are seeking more exposure to infrastructure assets in Asia-Pacific.

Private debt is the only asset class in which Canadian investors are seeking increased exposure to Europe (9% say this). This compares with just 1% of overall North American respondents in the BNY Mellon survey, suggesting that US investors are looking less to European private debt, and 3% of Asia-Pacific investors, while 79% of EMEA investors were looking to increase exposure in Europe. This reflects the growth of European private credit strategies: in 2008, 18 Europe-focused private debt funds raised US$7.5bn in aggregate, according to Preqin figures;[3] in 2017, this had grown to 56 managers gathering US$45bn.

This variation in approach is characterized by a pension fund manager:

> **"We have invested in every market based on the opportunities and challenges and the best fit for us. For private equity, we have invested in multiple regions as the opportunities are good internationally and we are comfortable with global exposure. For hedge funds, however, we restrict investments to North America as we are not comfortable with the way hedge funds are managed in other regions."**
>
> Pension Fund Manager

For each alternative asset class, please indicate the region to which you would most like to increase your exposure



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Shifting Asset classes

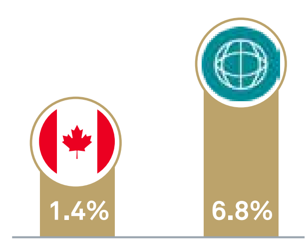
Q Asset classes are vying for position in Canada. Which are up and which are down?

Canadian investors have a wide range of allocations on average to the different sub-asset classes within the alternatives space. Real estate is the dominant type of alternative investment, currently accounting for 42% of Canadian investors' alternatives portfolios. The predominance of real estate can be attributed to strongly rising property markets globally since the global financial crisis. Nowhere has this been more evident than in Canada itself: real estate prices nationally increased by over 44% in the five years to November 2018, according to the Canadian Real Estate Association.[4]

Yet the last six months have seen Canada's real estate price growth cooling somewhat. With concerns around Chinese economic growth – the country reported its slowest growth in nearly three decades in 2018[5] – and rising interest rates in key markets such as the US, some investors may be calling the top of the real estate cycle. Indeed, Canadian investors expect their real estate exposure to fall as a proportion of their alternative investments over the next 12 months, to an average of 38.8%. This may also reflect some disappointment with returns: nearly a third of respondents (30%) said real estate had performed worse than expectations over the past 12 months – a far higher percentage than for any of the other alternatives.

Canada vs. the World

Average allocation to hedge funds:



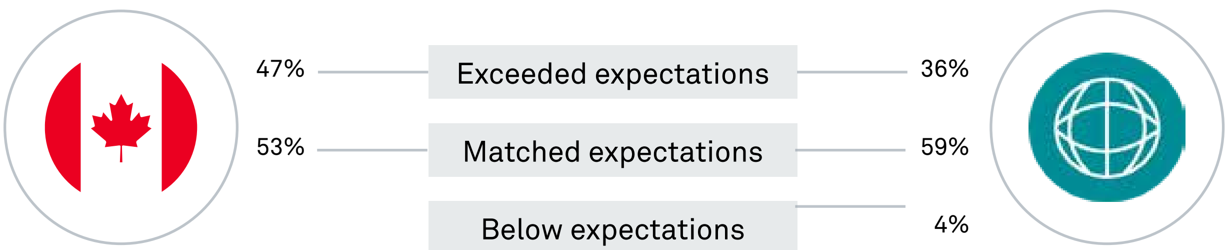
Private equity continues to climb

Private equity, private debt and infrastructure look set to gain from this reallocation of capital, our survey results suggest. Private equity, currently accounting for, on average, 18.7% of Canadian investor alternative allocations, is expected to rise to 20.9%. Infrastructure investments will increase marginally to 20.2% from an average of 20% and private debt to 18.5% from 17.9%.

In the case of private equity, the rationale for the increase is clear: 100% of Canadian investors in our survey said that this asset class has performed at least in line with expectations, including nearly half (47%) who say its performance has exceeded them. This compares with 59% globally who said private equity had matched their expectations and 36% who said it had exceeded anticipated performance. Private debt has also largely performed well for respondents, a quarter of whom say it has produced better returns than anticipated and just 4% saying performance has been disappointing. This matches exactly the global picture in the BNY Mellon *Race for Assets* survey.

Canada vs. the World

Private equity performance



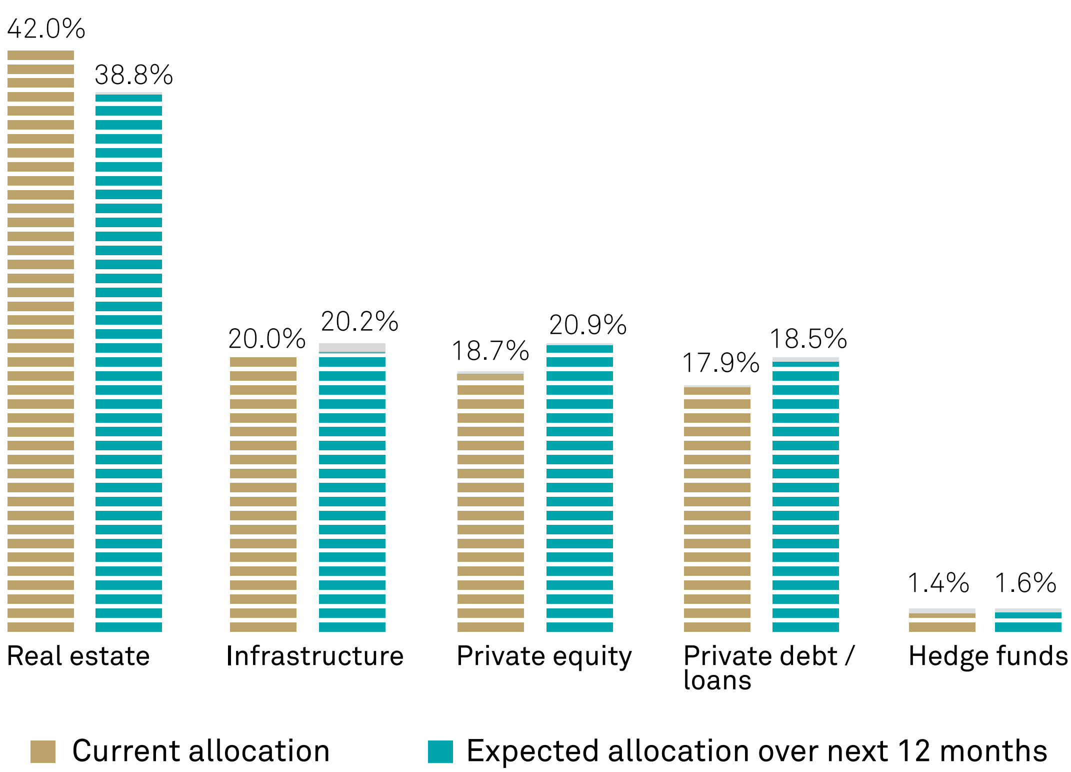
Hedge funds static

While hedge funds have either met Canadian investors' return expectations or exceeded them, they currently account for just 1.4% of respondents' alternatives allocation, rising to just 1.6% in the next 12 months (this compares with an average allocation by global investors of 6.8%, according to the BNY Mellon *Race for Assets* survey). This type of alternative investment has waned in popularity since the onset of the financial crisis as a result of some high-profile governance failures and poor performance relative to historical levels and to that of other alternatives – and even traditional investments. The fact that Canadian investors seem satisfied with returns from hedge funds perhaps suggests that their small allocations enable them to be highly selective in their investment choices.

The Eurekahedge Hedge Fund Index,[6] for example, shows returns of -4.06% for 2018, barely outperforming the -4.38% for the S&P 500 (including dividends). Well over half (59%) of hedge funds posted negative performance last year, according to Preqin.[7] A number of hedge funds have also closed shop over the last few years, including Highfields Capital Management, which managed US$12.1bn, and the US$2bn Criterion Capital Management, both of which returned all capital to investors in 2018. The year also saw the AUM of hedge funds globally decline by 3.4% to US$2.36trn, according to Eurekahedge, a time when other alternatives, such as private equity, continue to attract capital: the amount of dry powder held by private equity funds globally hit a new record in December 2018 at US$1.2trn, Preqin figures suggest.[8]

The fact that Canadian investors seem satisfied with returns from hedge funds perhaps suggests that their small allocations enable them to be highly selective in their investment choices.

Average current and expected allocations to alternative investment types (inclusive of funds and direct investments)



For each of these alternative investment types in which you are invested, how have they performed over the past 12 months relative to your expectations for the asset class (inclusive of funds and direct investments)?

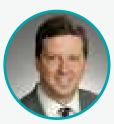
	Better	As expected	Worse
Real estate	12%	58%	30%
Infrastructure	20%	63%	17%
Private equity	47%	53%	
Private debt / loans	24%	72%	4%
Hedge funds	36%	64%	

Multiple access points

Canadian investors employ a variety of strategies for gaining exposure to alternative assets, with funds of funds being the most popular, used by 70%, followed closely by those partnering with other Limited Partners (LPs) to invest in funds, used by 68%. While the former may be used by investors seeking exposure to new geographies or investment strategies, both are likely to be employed by smaller investors that may not have the resources to source, select and monitor investments alone.

Indeed, as provincial regulations of institutional investors become more relaxed – Ontario and Quebec, for example, changed solvency requirements for defined benefit pension plans in a move that is likely to encourage these investors to allocate more to alternatives – there look to be more opportunities for smaller and mid-sized plans to partner and, in some cases, pool alternatives resources.

"As asset owners begin to focus on direct investments and joint ventures they need to consider a variety of new challenges – from attracting, retaining and compensating the right investment professionals to addressing the unique accounting, administration and reporting requirements of these assets.



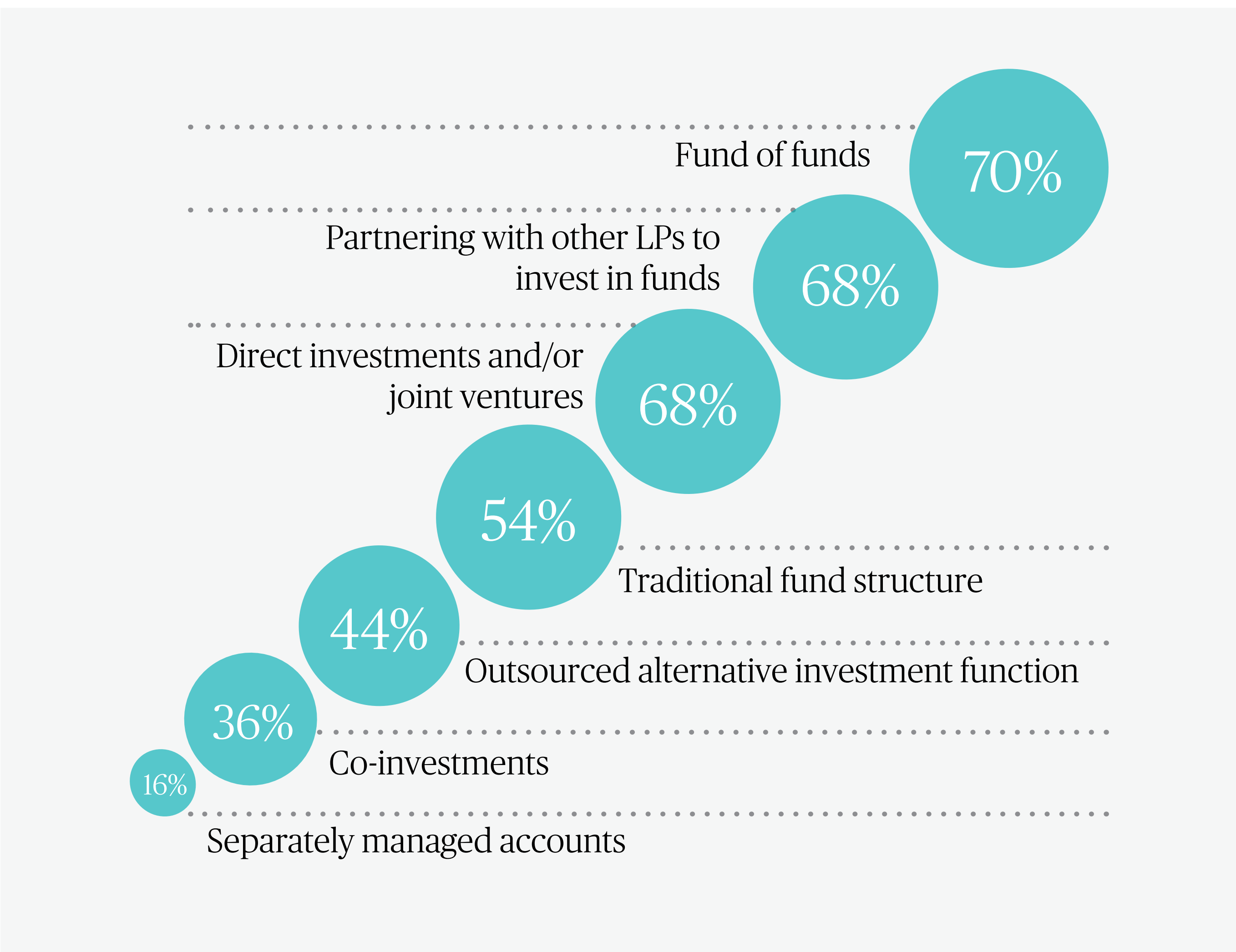
Jon Lofto
Director, Alternatives
CIBC Mellon

Direct investments (where institutions invest directly in companies without using a fund manager) and joint ventures (where investors team up with other institutions to make investments) also came in second place, with 68% of Canadian investors making these types of investments.

Canadian pension funds, together with some sovereign wealth funds, have led the way globally in the use of these strategies. This is in keeping with the moves by large Canadian institutional investors such as CPPIB, The Ontario Teachers' Pension Plan (OTPP) and Public Sector Pension Investment Board (PSP) in establishing offices overseas in Europe and Asia – in part to pursue direct investment programs in areas such as private equity. Similarly, the C$299bn Caisse de dépôt et placement du Québec (CDPQ) has its own infrastructure investment arm, CDPQ Infra, which makes direct investments.

The route more commonly associated with alternatives in other markets – traditional fund structures – is taken by just over half of Canadian investors.

Which investment models does your firm currently employ? (Select all that apply)



"We're seeing more and more interest from sophisticated asset owners in establishing direct investment plans, and even evolving into asset managers themselves, managing funds on behalf of underlying institutional investors. Sophisticated investors see this as a way to improve the economics of private market investing, as well as gain transparency into underlying investments and ensure their investments are consistent with their ESG program requirements."

Megan Gentilesco
Director, Alternative Investment Services
BNY Mellon

28%

of respondents plan to adopt new technology solutions to increase transparency.

"Innovative technologies and processes like blockchain, cloud, digital and advanced analytics can help with greater transparency – something that is desired by every investor. They allow ready availability and direct access to data in real time so that investors can understand the state and performance of their investments first hand."

Endowment Manager

“Increasingly, investors are looking at how ESG metrics can inform the oversight of assets. Conventional wisdom for many years held that “social” factors had no place in the business world, and that organizations had to either be socially/ethically focused or turn a profit, but not both. Today, such is not the case, as many for-profit businesses engage with environmental, social and governance concerns. Investors are looking to achieve financial returns while also incorporating and mitigating ESG risk, generating long-term value, and creating positive impacts on society. Demand is growing for investors to take ESG factors into account, thanks in part to interest among clients, pension plan members and other stakeholders to align investment decisions with their values.”

Cynthia Shaw-Pereira
CIPM, Lead Consultant, Client Solutions & Business Development, Global Risk Solutions
BNY Mellon

Canada vs. the World

Viewing importance of ESG:

Canada		World
78%	Very important	67%
22%	Somewhat important	19%
	Not important at all	14%

3 Canada vs. the World

Standards for Fund Managers

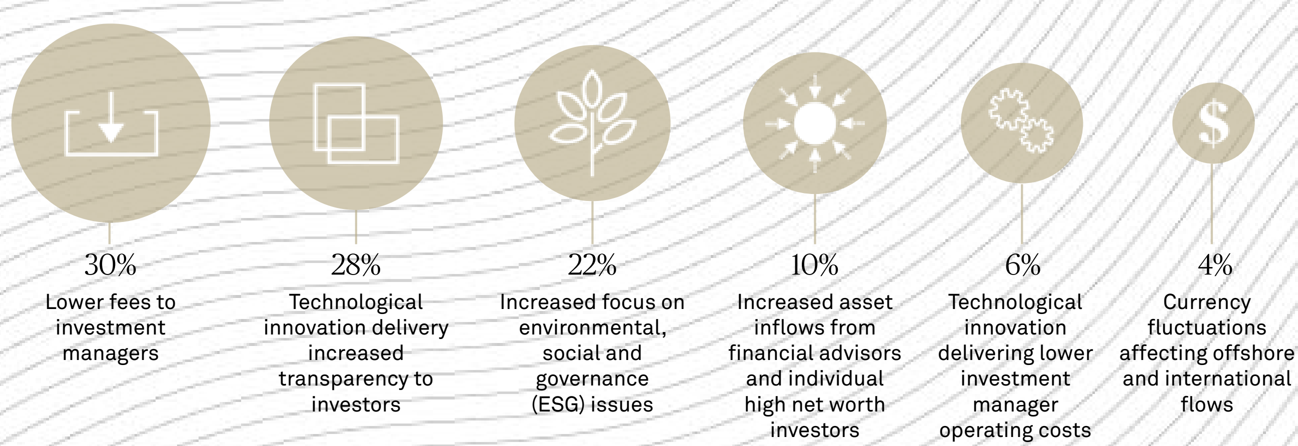
Q The standards for fund managers are changing. What do investors want?

Investors in alternatives have placed themselves firmly in the driver's seat in the years since the 2008 financial crisis, with three main areas of focus: lower fees, increased transparency and integration of Environmental, Social and Governance (ESG) factors into investment and monitoring practices. The responses to our survey also highlight these points as being important to Canadian investors.

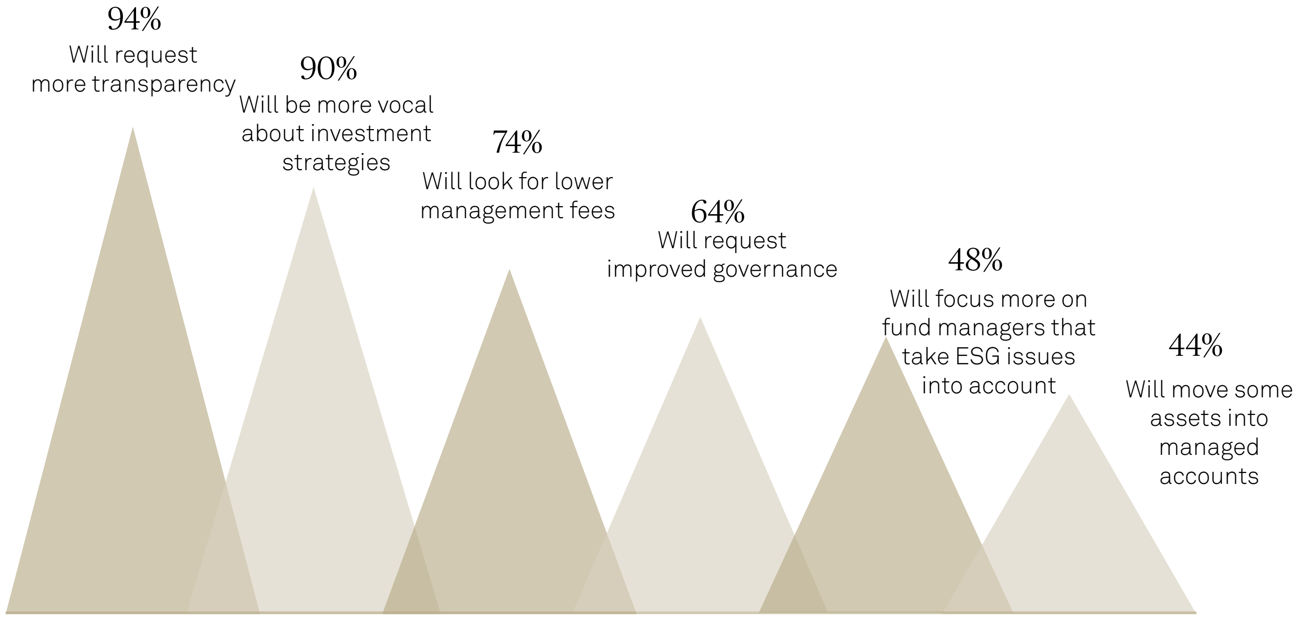
Fee compression

Looking ahead, Canadian investors are anticipating further pressure on fees in alternatives. This was the top trend in the space for the coming 12 months, mentioned by 30% of our respondents. In addition, 74% of respondents said they would look for lower management fees over the next 12 months.

What do you predict will be the most significant trend in the alternative asset investing space over the next 12 months? (Select one)



In what ways do you expect your approach to investing in fund managers to change in the next 12 months? (Select all that apply)



Institutional investors have long sought lower fees from alternatives managers, where a 2-and-20 (2% management fee and 20% carried interest) structure was once seen as the norm. In reality, fees have varied significantly by manager for some time, but the trend has been decidedly downwards since the financial crisis, in particular as investors increasingly seek fee reductions in return for large allocations, through separate accounts or through co-investment.

Investors' increasing experience with direct investment also has a part to play, as a managing director of a pension fund explains: "The demand for lower fees will take center stage as more institutional investors gain experience of direct investments. They are being more upfront in asking investment managers for reductions as they now know how to manage investments and what the ideal fee structure should be."

In private equity, for example, 40% of capital managed by funds raised in 2018 is subject to a fee of 1.5% or less, according to a recent study that says, "There are signs that 2% is losing prominence as the market standard."[9] Meanwhile, in private debt, management fees averaged 1.5% in 2017 funds, Preqin figures show.[10] In most cases, lower management fees are concentrated toward the larger end of the fund spectrum, as investors have sought to ensure fund managers are passing on the benefits of economies of scale.

In hedge funds, the driver is slightly different. After years of declining performance – returns have averaged of 3.4% per year since 2010, compared with 18.3% in the 1990s, according to Hedge Fund Review's fund-weighted composite index – it has become increasingly difficult for managers to justify a 2-and-20 structure. Today, just 3% of hedge funds now charge a 2% management fee and 16% of funds charge 20% of profits as carried interest, with the remainder charging rather lower, according to a Credit Suisse analysis.[11]

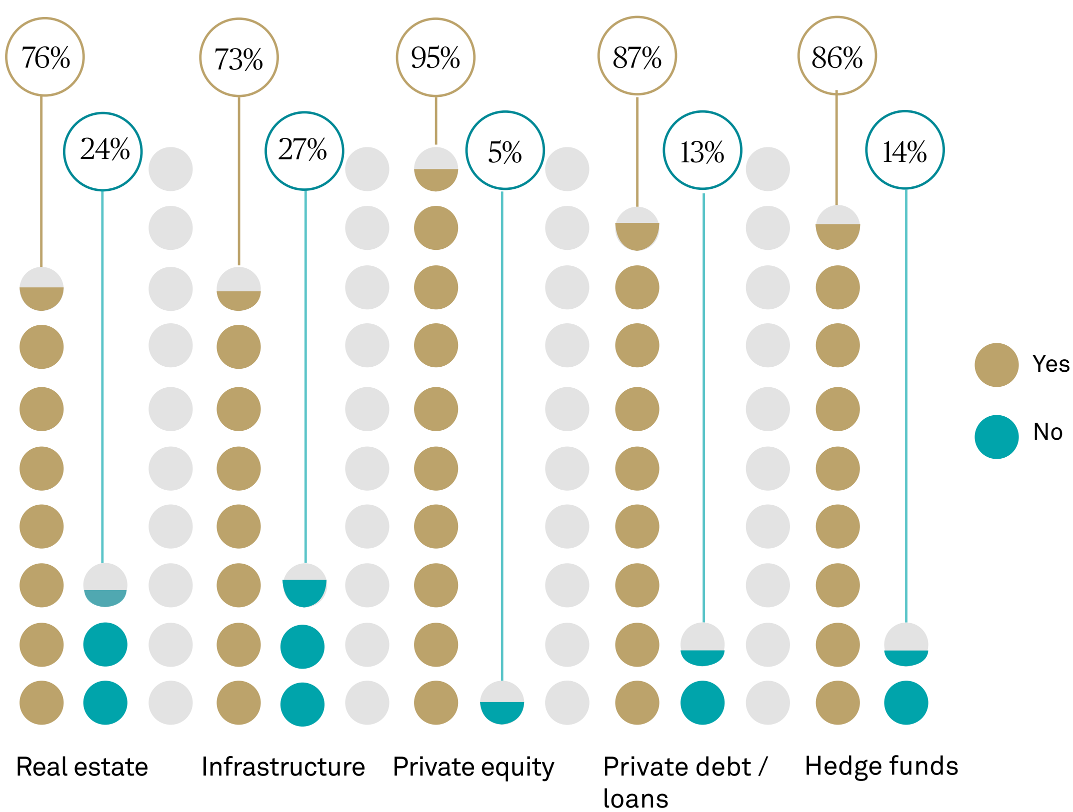
Innovation to open doors?

Canadian investors are also expecting increased transparency through the adoption of new technologies, a trend noted by 28% of respondents. An endowment investment director, for example, notes: "Innovative technologies and processes like blockchain, cloud, digital and advanced analytics can help with greater transparency – something that is desired by every investor. They allow ready availability and direct access to data in real time so that investors can understand the state and performance of their investments first hand."

Alternative fund managers are starting to adopt new technologies, although their use remains patchy, with some private equity firms only just starting to look beyond legacy systems.[12] Indeed, a 2016 EY private equity survey found that 68% of firms used spreadsheets for valuation, 58% for portfolio analytics and 44% for investor relations.[13] However, over 2019, into 2020 and beyond, improvements may be made to automated, online and real-time reporting for investors. Two-thirds of private equity firms and 51% of hedge funds have invested in technology to improve fund accounting, and 62% and 54%, respectively, have improved technology in investor servicing, according to EY.

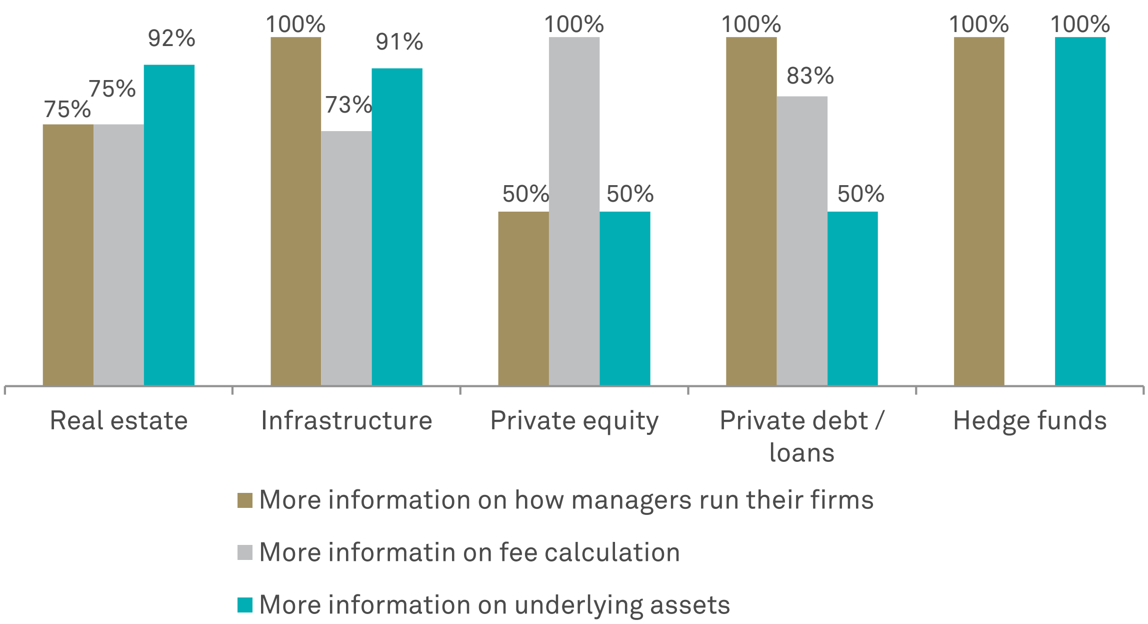
It seems as though these improvements are right on time – nearly all our survey respondents (94%) – will be seeking greater transparency from their alternative fund managers over the coming 12 months. Infrastructure may be a key area of focus for these efforts, as 27% say they are not satisfied with the level of transparency they receive from managers in this alternative asset, followed by real estate with 24%. Private equity ranks highest for satisfaction, with 95% saying they are happy with the level of disclosure they receive.

Are you satisfied with the level of transparency you receive for your fund investments in the following alternative investment types?



Among those institutional investors who said they were not satisfied with the level of transparency they receive, 100% said they would like to receive more information on how firms are run across infrastructure, private debt and hedge funds. Investors are also looking for more information on underlying assets: more than 90% who are not satisfied with transparency say this for real estate, infrastructure and hedge funds. In private equity, investors are keen to understand more about how fees are calculated, with 100% of unsatisfied respondents citing this, and it is also an issue with private debt, where 83% would like more information on fee calculations.

If you are not satisfied with the level of transparency you receive in a given asset class, what additional transparency would you like to receive? (Select all that apply)

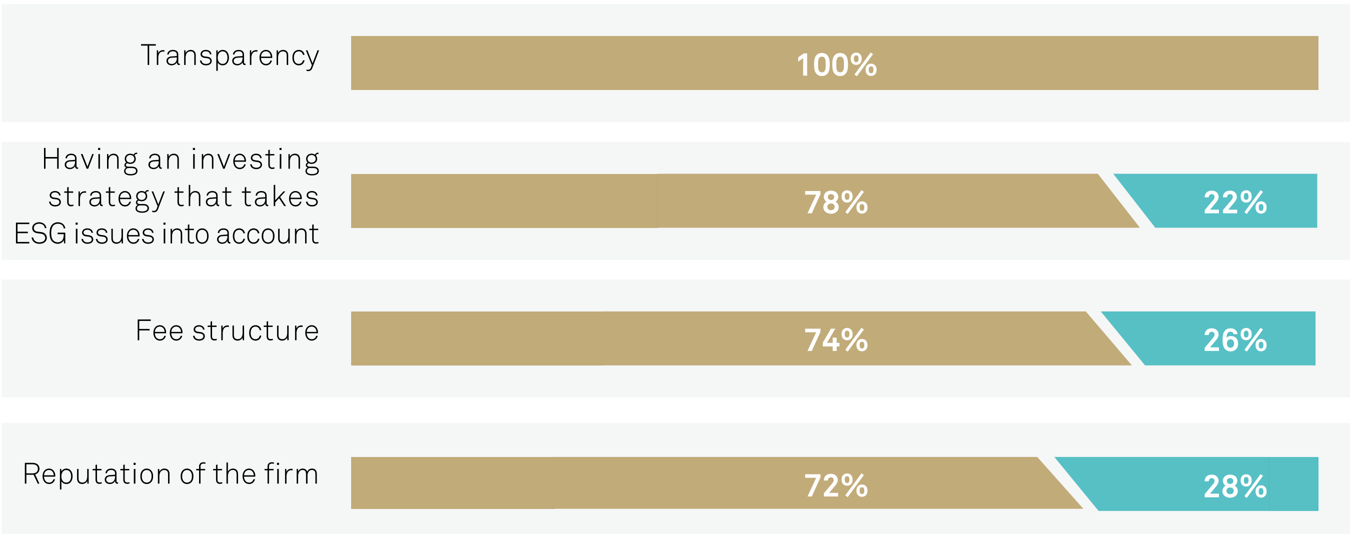


ESG on the rise

More focus on environmental, social and governance (ESG) issues was the third most cited trend, according our respondents, 22% of whom say this. ESG considerations are moving up the agenda among institutional investors globally and Canadian investors are no exception. Responsible investment now accounts for C$2.1trn or 50.6% of Canadian investors' AUM, up from 37.8% in 2016, according to the *2018 Canadian Responsible Investment Trends Report*.[14] Many of the country's pension funds now invest with a view to sustainability, as a 2017 report on Ontario pension plan policies and procedures demonstrates;[15] it found that 36% of plans in the province integrate ESG factors in their investments, a figure that rises to 67% for larger plans (those with over C$1bn in assets).

Our survey also finds that 48% of respondents say they will focus more on fund managers that take ESG into account over the next 12 months. While this is some way behind increased transparency and fee reductions, this is still nearly half of our sample and roughly in line with the statistics above.

As an investor considering asset managers, how important are the following factors?

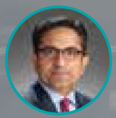


The same three issues – transparency, ESG and fee structures – are also among the most important factors when it comes to assessing asset managers, according to respondents. An insurance company director of investment says: "Transparency is critical when we consider asset managers. We want to know how much risk we will be exposed to and what investment strategies the asset manager is going to implement. There should be mutual understanding and enough transparency so we can monitor the performance at any time and be sure that our investments are doing well."

Investors are also looking to be more vocal about investment strategies with their fund managers. This is mentioned by 90% of respondents in a sign of investors' increasing confidence in alternatives. It is unclear how vocal they can be, given the limited control afforded by the main vehicle through which alternative investments tend to be made – the limited partnership – although this response may reflect an increasing desire to make co-investments alongside fund managers.

> **"We are looking closely at environmental benchmarks. We want to climb higher up the sustainability ladder and believe that these environment funds will deliver long term benefits to our plan."**
>
> Pension Fund Investment Director

"Larger funds in Canada are highly sophisticated and have made the transition to an asset management style earlier than even their US counterparts, which still consider themselves to be asset owners. The knowledge and experience of Canadian investors has enabled them to go deeply into more sophisticated investments, such as alternatives."



Abdul Sheikh
Vice President and Head of Pension and Custody Services
CIBC Mellon

4 Canada vs. the World

What distinguishes Canadian Investors

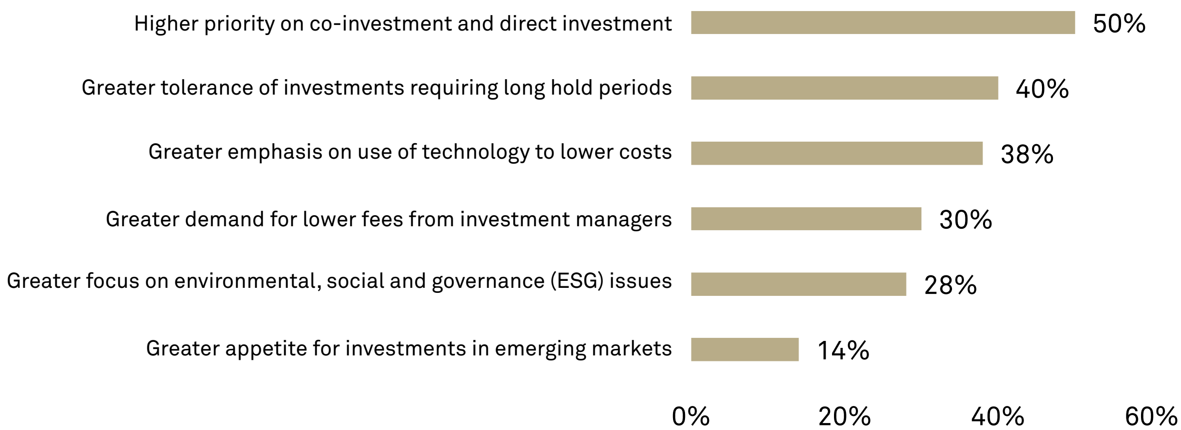
Canadian institutional investors are a group apart. What makes them unique?

Canadian institutional investors count among their number some of the most influential institutions globally. In 2018, The World Bank published a paper[16] outlining how the Canadian pension plan model could provide valuable lessons for other countries and pension programs. The paper made specific reference to the diversification benefits provided by "a significant allocation to alternative asset classes such as real estate, private equity and infrastructure." It is clear that Canadian investors are a group apart, with widespread adoption of alternative asset investment strategies a distinguishing characteristic.

Part of this shift in favour of alternatives is the result of a more active investment approach on the part of Canadian investors. "Larger funds in Canada are highly sophisticated and have made the transition to an asset management style earlier than even their US counterparts, which still consider themselves to be asset owners," explains Abdul Sheikh, vice president and head of pension and custody services at CIBC Mellon. "The knowledge and experience of Canadian investors enables them to go deeply into more sophisticated investments, such as alternatives."

When asked what distinguishes Canadian investors from others in the alternatives space, half of respondents selected the higher priority given to co-investment and direct investment, followed by a greater tolerance for longer investment horizons, selected by 40%.

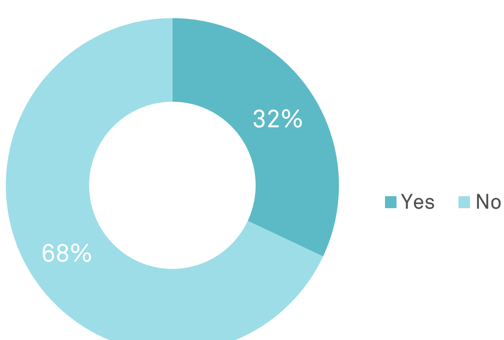
What do you think are the main differences, if any, between the alternative asset investing strategies of Canadian investors as compared to investors in other countries? (Select top two)



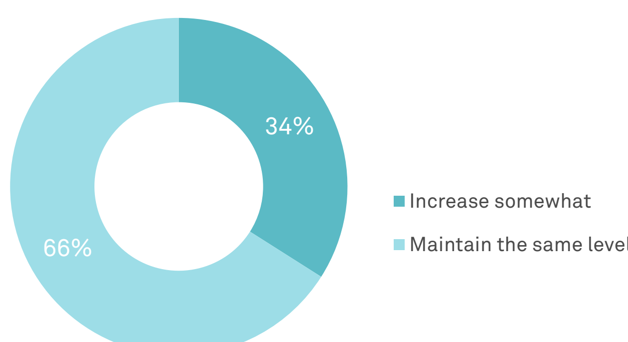
Direct and co-investment strategies higher than average

The results of our survey certainly tally with the view that Canadian investors have a stronger focus on direct and co-investment strategies than most other institutions. Nearly a third (32%) of respondents participate in private equity or infrastructure co-investments, with an average of 17% allocated to private equity co-investment strategies. By contrast, the BNY Mellon *Race for Assets* global investor survey showed that just 19% globally pursue alternatives co-investments, at an average allocation of 9.5%. This is set to rise further, with 34% of Canadian respondents saying they will increase their level of co-investment activity in the next two years and the remainder saying it will remain the same.

Are you currently participating in any private equity or infrastructure co-investments?

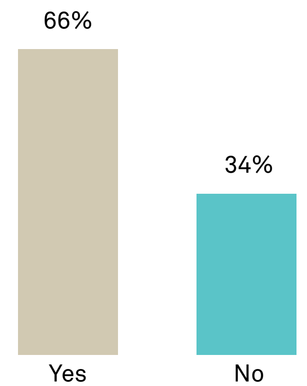


Over the next 12 to 24 months, how do you plan to change your level of co-investment activity compared to today, if at all?

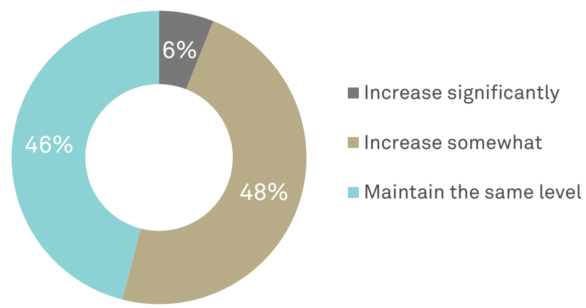


The Canadian responses for direct investments in private equity and infrastructure show an even more marked bias toward active investment approaches. Two-thirds of respondents to our survey say they make direct investments, accounting for an average of 32% of allocations, around double the proportion making direct investment globally and more than triple the allocation. Canadian institutions are clearly very satisfied with the direct investments: more than half (54%) say they plan to increase activity in the next two years, including 6% who say they will increase it significantly.

Do you currently make direct investments into portfolio companies or infrastructure assets?



Over the next 12 to 24 months, how do you plan to change your level of direct investment activity compared to today, if at all?



This level of direct and co-investment activity is only possible for investors with skilled and dedicated resources, given the high level of involvement that these types of investments require. Not only must institutional investors be able to quickly and accurately assess investment opportunities; they must also have enough experience to monitor these investments closely. Direct investment in particular takes time and experience in alternatives to be a successful strategy. Many Canadian investors have been investing in alternatives for more than a decade (in the case of CDPQ, since 1971) and many have built in-house teams to manage these investments – a feat made possible by the fact that many of Canada's pension asset managers manage capital on behalf of a number of institutional investors, which gives them scale. Nova Scotia Pension Services Corporation, for example, is owned by the Teachers' Pension Plan Trustee Inc. and Public Service Superannuation Plan Trustee Inc. It administrates and invests on behalf of these two pension plans as well as the Members' Retiring Allowance and three former Sydney Steel pension plans. The Investment Management Corporation of Ontario (IMCO) was created in 2016 to pool public sector investments in Ontario – managing C$60bn to date – while Alberta's AIMCo has 32 pension, endowment and government funds as clients.

In line with this, a clear majority (78%) of respondents see their firm as being sophisticated or experienced in alternative asset investing and just 2% made their first foray into the area during 2018.

Which of the following best describes your firm's experience with alternative asset investing? (Select one)

In it for the long term

The second distinguishing characteristic of Canadian investors is their focus on long-term objectives. While this is true of most institutional investors, the long-term view appears to be particularly ingrained among Canadian institutional investors. The World Bank report referenced previously also points to "long time horizons" as a key characteristic of Canadian pension funds. CPPIB, for example, has had projections completed by the Office of the Chief Actuary of Canada that found the pension plan is sustainable for the next 75 years. IMCO equally stresses long time horizons, describing itself as having "a long-term investment strategy."

This long-term view is at the heart of Canadian investors' approach to alternatives. Many forms of alternative investment, such as real estate, infrastructure and private equity are illiquid and require several years of commitment – sometimes up to 20 years in the case of infrastructure – and so require investors with long investment horizons that can keep capital tied up for many years. As a pension fund CIO notes:

> **"Our priority is to optimize investment returns over the long term. Infrastructure and real estate are our main area of investments as they are the right fit for this time horizon."**

Pension Fund CIO

These long horizons are also behind the push toward the integration of ESG factors into investment strategies, with many investors seeking sustainable returns.

> “We are bound by responsible investment guidelines and we focus on long-term value. To achieve this, we have many investments in infrastructure and real estate. In private equity, too, we invest strictly only in those with strong ESG credentials.”
>
> Endowment Director of Investments

Looking ahead

Canadian investors clearly have a strong foothold in the alternative investment space, with many seeking to increase their already significant exposure to areas such as private equity, infrastructure and private debt. With their high level of expertise and long investment horizons, Canadian investors are set to remain committed to alternative investments, even as cycles come and go.

Recent moves in Canada suggest that the nation will become an even larger source of capital for alternative strategies. These include changes to regulations governing the way pension plans base their funding in Ontario and Quebec, which enable funds to allocate more to illiquid assets as well as allocate to a greater range of asset classes and instruments. These reforms have the potential to be adopted by other Canadian provinces as well. They also include increased contributions flowing to some of Canada's pension plans, including CPPIB and the Quebec Pension Plan, which will be phased in from January 2019 through to full implementation in 2025. Some Canadian institutional investors are also employing leverage by issuing long-term bonds to invest in alternatives, including the real estate arm of AIMCo, which issued a C$400m bond in summer 2017.[17]

Greater consolidation among investors along the lines of provincial asset management organizations (including the Investment Management Corporation of Ontario, the Alberta Investment Management Corporation and British Columbia Investment Management Corporation) is another trend that will bring scale – and therefore a greater capacity to invest in alternatives – to Canadian institutional investors. Likewise, non-government multi-employer plans are also seeking growth and scale, such as CAAT (Colleges and Applied Arts and Technology) Pension Plan incorporating additional employers and plans through its DBplus initiative. To date CAAT has grown to more than 40 organizations including recent additions of the Royal Ontario Museum (ROM), Youth Services Bureau of Ottawa, and Postmedia pension plans.

ESG is also likely to move even further up the agenda for Canadian institutional investors as issues such as climate change present risks to investors in companies and assets; as stakeholders increasingly demand sustainable deployment of their capital; and as investee funds and companies increasingly offer opportunities that factor in ESG management and mitigation.

Overall, the stage is set for increased participation in alternative investments by Canadian institutions, many of which will continue to serve as models for best practice on a global level.

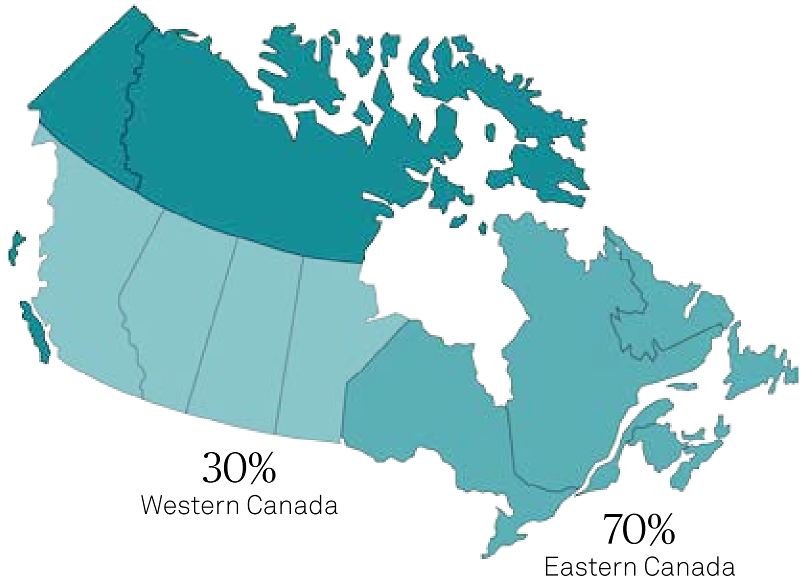
Methodology

The Race for Assets
Canada vs. the World

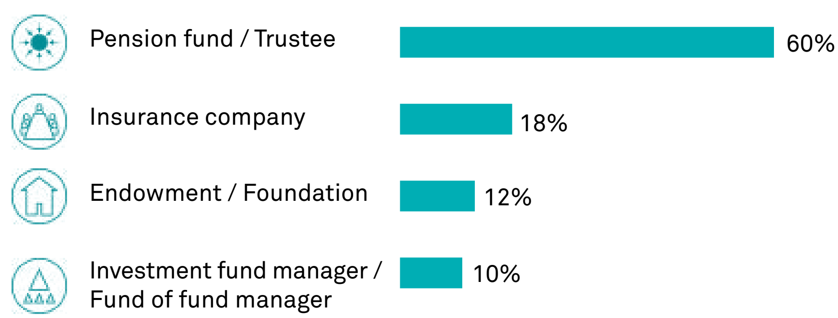
In the fourth quarter of 2018, CIBC Mellon commissioned interviews with senior executives from 50 institutional investors in Canada to understand their strategy for allocating funds to alternative investments (defined as private equity, hedge funds, real estate, infrastructure and private debt/loans). All participants in the study make allocation decisions at institutions with at least C$330m in assets under management (AUM). The median AUM of participant institutions is C$3.2bn; the average AUM is C$79.8bn.

BNY Mellon Global Race for Assets Series
The global peer comparison data in this report is based on BNY Mellon's published global Race for Assets research, which included commissioned interviews of senior executives from 350 large institutional investors to understand their strategy for allocating funds to alternative investments, as well as 100 alternative fund managers, to understand how they are reacting to a changing regulatory landscape and increasing demands from their institutional investor client base. To learn more, explore the BNY Mellon global Race for Assets series at:
www.bnymellon.com/raceforassets

Senior executive geographic splits:



Senior executive respondent splits:



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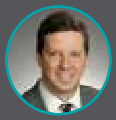
"Larger Canadian investors clearly have a strong foothold in the alternative investment space, with many seeking to increase their already significant exposure to areas such as private equity, infrastructure and private debt. With their high level of expertise and long investment horizons, Canadian investors will remain committed to alternative investments, even as cycles come and go."



Jon Lofto
Director, Alternatives
CIBC Mellon

About CIBC Mellon

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