



CPP  
INVESTMENT  
BOARD

# Policy on Responsible Investing<sup>1</sup>

October 13, 2005

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<sup>1</sup> This policy replaces the *Social Investing Policy* (April 2004).

# POLICY ON RESPONSIBLE INVESTING

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### 1.0 Our Mandate

The Canada Pension Plan (CPP) is one of Canada's most important social programs. It collects mandatory contributions from working Canadians and their employers and promises to pay pension benefits to workers throughout their retirement years. The plan also pays supplementary benefits, such as disability pensions and survivor benefits to family members. Currently, the CPP serves the retirement interests of approximately 16 million contributors and beneficiaries.

The CPP Investment Board operates within a governance model designed by the federal and provincial finance ministers during the reforms of the CPP in 1996-97.

The model is a careful balance of independence and accountability. The CPP Investment Board operates at arm's length from governments. Investment decisions are made by investment professionals and overseen by an independent board of directors with financial and business expertise. The CPP Investment Board is accountable to Parliament, the federal and provincial finance ministers who serve as stewards of the CPP, and to its 16 million contributors and beneficiaries across Canada.

Established in 1997 by the *Canada Pension Plan Investment Board Act* (the "Act"), the CPP Investment Board is responsible for investing the CPP reserve fund, which is comprised of all CPP funds not needed to pay current benefits.

The Act requires the CPP Investment Board to:

- i. Assist the Canada Pension Plan in meeting its obligations to contributors and beneficiaries;
- ii. Manage CPP assets transferred to the CPP Investment Board in the best interests of CPP contributors and beneficiaries; and
- iii. Invest with a view to achieving a maximum rate of return without undue risk of loss having regard to the factors that may affect the funding of the Canada Pension Plan and its ability to meet its financial obligations on any given business day.

The Act prohibits the CPP Investment Board from carrying on any business or activity, or exercising any power, that is inconsistent with these objectives.

As at June 30, 2005, the CPP reserve fund had assets of \$87 billion. In his most recent report to Parliament, Canada's Chief Actuary said the CPP is sustainable for at least the next 75 years.

Income from investments will not be required to help pay CPP benefits until approximately 2022, 17 years from now, and the assets of the CPP reserve fund are expected to continue to grow for many years.

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### 2.0 Our Principles

The CPP Investment Board is a long-term investor consistent with the long-term needs of the Canada Pension Plan. As an owner, we are committed to encouraging companies to adopt policies and practices that enhance long-term corporate financial performance.

In its corporate governance, business practices and investment strategy, the CPP Investment Board is guided by certain principles. These are set out in the Act and the regulations to the Act as well as in the CPP Investment Board's *Code of Conduct and Conflict of Interest Procedures for Officers and Employees, Investment Statement, Disclosure Policy, Proxy Voting Principles and Guidelines, Communications and Stakeholder Relations Policy* and this document, our *Policy on Responsible Investing*. (Copies of all of these documents are available on our website at [www.cppib.ca](http://www.cppib.ca).)

In particular, we are guided by certain principles as they relate to the broad and constantly evolving issue of responsible investing. These include, but are not limited to, the following:

- The overriding duty of the CPP Investment Board, consistent with its mandate, is to maximize investment returns without undue risk;
- Portfolio diversification is an effective way to maximize long-term risk-adjusted returns;
- Portfolio constraints either increase risk or reduce returns over time;
- Recognizing that the importance of environmental, social and governance (ESG) factors varies across industries, geography and time, responsible corporate behaviour with respect to ESG factors can generally have a positive influence on long-term corporate performance;
- Disclosure is the key that allows investors to better understand, evaluate and assess potential risk and return, including the potential impact of ESG factors on a company's performance;
- Investment analysis should incorporate ESG factors to the extent that they affect long-term risk and return;
- There should be a clear division of authority and responsibilities among shareholders, directors and managers;
- Employees, customers, suppliers, governments and the community at large have a vested interest in positive corporate conduct and long-term business performance.

In many ways these principles are self-reinforcing, but at times they can be in conflict with one another. Our *Policy on Responsible Investing* sets out how we apply these

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principles to the management of the CPP reserve fund. In doing so, we strive to be both principled and pragmatic, taking into account industry norms, corporate performance, competitive issues, regulatory requirements and other factors necessary to put specific issues into a fair and practical context.

In particular, we believe that responsible corporate behaviour with respect to environmental, social and governance (ESG) factors can generally have a positive influence on long-term financial performance.

We define environmental, social and governance factors as having one or more of the following characteristics:<sup>2</sup>

- Are the focus of public concern
- Have a medium to long-term horizon
- Are qualitative and are not readily quantifiable in monetary terms
- Reflect externalities not well captured by market mechanisms
- Are often the focus of a tightening policy and regulatory framework
- Arise throughout a company's supply chain.

As appropriate we use this definition to define the application of our key principles to our engagement program, including our proxy voting guidelines.

### 3.0 Our Investment Strategy

The CPP Investment Board is in the process of diversifying its investment portfolio across asset classes, economic sectors and global geographies. In January 1999, the CPP reserve fund was comprised entirely of government bonds. Today, the portfolio includes private equity, venture capital, real estate, infrastructure, publicly-traded equities, cash and cash equivalents, and government bonds. The diversification process is ongoing.

Many issues pertaining to responsible investing relate to the ownership of publicly-traded equities. Most of the holdings in approximately 1,800 public companies in the CPP reserve fund are the result of our passive investing approach to publicly-traded equities. This means that in our passive public equity portfolio we do not pick individual stocks, but rather invest in a portfolio of indices constructed and administered by independent third parties. This approach enables the CPP Investment Board to invest large sums of capital in diverse business sectors in Canada and around the world in an efficient and cost-effective manner.

With regard to investing in private equity, the CPP Investment Board typically invests in limited partnerships with other leading institutional investors and does not exercise a governance role.

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<sup>2</sup> To determine the factors that contribute to responsible corporate behaviour, the CPP Investment Board has subscribed to the definition used by the Enhanced Analytics Initiative, a voluntary effort among financial institutions to commission research that incorporates environmental, social and governance factors (ESG).

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As the CPP reserve fund evolves, we will build our internal capability over time to become a more active investor in publicly-traded equities. Currently, we have retained four external managers to actively manage a relatively small portion of the reserve fund and expect to expand our external and internal active management in the future.

### 4.0 Our Policy

The CPP Investment Board believes that disclosure is the key to building confidence and allowing investors to better understand, evaluate and assess investment risk and return. This belief is reflected in the CPP Investment Board's own commitment to transparency. The CPP Investment Board's *Policy on Responsible Investing*, which succeeds its *Social Investing Policy*, reflects the next step in the continuing evolution of our commitment to disclosure and the manner in which we invest the CPP funds entrusted to our care.

In defining this policy, the CPP Investment Board has taken a broader view of the impact of environmental, social and governance factors on long-term investment performance.

The CPP Investment Board is committed to encouraging corporate behaviour that enhances long-term financial performance. To date, the CPP Investment Board has focused its attention on two critical areas – disclosure and corporate governance. We expect to expand this focus over time to include support for key initiatives surrounding the disclosure of information regarding ESG factors.<sup>3</sup>

The CPP Investment Board is pursuing its goal of encouraging corporate conduct that enhances long-term financial performance through a policy of engagement. This reflects the current thinking among leaders in the field of responsible investing that active shareholder engagement is preferential to screening stocks, a process by which certain companies or entire industries are precluded from consideration for investment based on non-financial or “social” criteria.

Consistent with the CPP Investment Board's belief that artificial constraints decrease returns and/or increase risk over time, we do not screen stocks. We believe that engagement is a more effective approach through which shareholders can best effect positive change and enhance long-term financial performance. Moreover, we believe engagement is consistent with our mandate and highly complementary to our investment objective to maximize investment returns without undue risk.

For the CPP Investment Board engagement means, among other things:

- i. Participating in the broader domestic and international discussion about definitions, priorities, standards and best practices in the emerging fields of responsible investing;

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<sup>3</sup> ESG is a framework utilized by the Asset Management Working Group within the United Nations Environment Programme Finance Initiative.

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- ii. Joining coalitions, and endorsing standards and programs, designed to enhance disclosure and improve corporate conduct;
- iii. Supporting and conducting research into the long-term financial materiality of ESG factors, including the development of better tools for quantifying how these factors affect securities valuation;
- iv. Advocating the development and implementation of disclosure standards and protocols on ESG factors as a means of making those factors more accessible to and quantifiable by the investment community;
- v. Supporting shareholder resolutions that encourage the disclosure of the impact of social, environmental or governance factors that may contribute to or detract from long-term investment returns and risk;
- vi. Supporting the adoption and disclosure of codes of conduct and other governance guidelines, policies and standards that empower boards of directors on behalf of the shareholders and reaffirm management accountability;
- vii. Voting our proxies in support of our principles;
- viii. Where necessary, engaging management and corporate boards, either directly or in concert with like-minded investors, on specific issues.

The CPP Investment Board does not screen stocks. It considers as eligible for investment the securities of any issuer all of the businesses which are or would be lawful if carried on in Canada and is domiciled in any country with which Canada maintains normal financial, trade and investment relations.

We believe the CPP Investment Board's support of enhanced disclosure and good corporate conduct will produce positive long-term change and contribute to long-term corporate financial performance.

### 5.0 Our Process

We have established the following internal and external processes to facilitate engagement.

#### 5.1 Industry Dialogue

The CPP Investment Board participates in a number of forums:

- UN sponsored Investor Group developing the Principles of Responsible Investment
- Canadian Coalition for Good Governance
- International Corporate Governance Network
- Institutional Investor Summits on Climate Risk

- Pension Investment Association of Canada (Governance Committee, Chair)

### 5.2 Exercising Proxy Votes

The CPP Investment Board has internal staff resources dedicated to monitoring proxy voting issues. We disclose how the CPP Investment Board is likely to exercise its proxy votes on a range of corporate issues through our *Proxy Voting Principles and Guidelines* (available at [www.cppib.ca](http://www.cppib.ca)).

The CPP Investment Board works with Institutional Shareholder Services (ISS) to cast proxy votes in accordance with our established guidelines.

We exercise our proxy votes and post how we voted on our website (see <http://www.cppib.ca/how/proxyvoting/index.html>).

A dedicated email address, [proxyvote@cppib.ca](mailto:proxyvote@cppib.ca), allows a shareholder company, director or officer to contact us with any concerns regarding proxy voting issues.

Certain shareholder proposals and voting matters that fall outside of the CPP Investment Board's proxy voting guidelines are elevated to the CPP Investment Board Proxy Voting Review Committee which is chaired by the President and CEO and comprised of senior officers within the CPP Investment Board.

### 5.3 Shareholder Proposals

Where appropriate, the CPP Investment Board will work with other investors to draft and recommend shareholder proposals.

Proposals are reviewed on a case-by-case basis by the CPP Investment Board Proxy Voting Review Committee.

### 5.4 Direct Engagement

The CPP Investment Board is not averse to contacting corporate boards or management teams directly to discuss concerns over issues of corporate conduct. We are in the early stages of this part of our engagement program and expect to increase our capability and commitment to this program over time.

## 6.0 Our Outlook

### 6.1 Emerging Standards

The CPP Investment Board is currently reviewing many of the emerging national and international standards for responsible investing.

Examples of the initiatives under current review include:



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- UN sponsored Investor Group developing the Principles of Responsible Investment
- Enhanced Analytics Initiative
- Extractive Industries Transparency Initiative
- Investor Network on Climate Risk

Any changes or amendments to this policy as a result of this review and other ongoing initiatives will be reflected in an amended policy statement and posted to our website.

The CPP Investment Board welcomes public comment on this policy. Please e-mail your comments to [csr@cppib.ca](mailto:csr@cppib.ca).