



CPP
INVESTMENT
BOARD

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A N N U A L R E P O R T

Fiscal year ended March 31, 2000

*Helping to keep
the long-term
pension promise
to Canadians*



CANADA PENSION PLAN
INVESTMENT BOARD

The CPP Investment Board was created by an Act of Parliament in December 1997 to invest funds not required by the Canada Pension Plan to pay current pensions. On March 31, 2000 the CPP Investment Board had \$2.4 billion invested in capital markets and projects it will have \$100 billion of assets under management within the decade. These assets, and the income earned on them, will be available to the Canada Pension Plan to pay future pensions.

The CPP Investment Board is governed by a board of directors with extensive business, investment and financial expertise, and is managed independent of the Canada Pension Plan by a small team of senior investment and business executives.

The Canada Pension Plan is administered by the federal government, which collects contributions and pays pensions. The federal and provincial governments jointly set the plan's contribution rates, benefit levels and funding policy.

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2000 OBJECTIVES

STATUS

Recruit President and Chief Executive Officer	✓	John A. MacNaughton appointed effective September 1999
Invest more than \$1 billion of new cash flow in Canadian and foreign equities	✓	\$1.9 billion of new cash invested
Develop corporate strategy and initial business plan	✓	Strategy and business plan developed by management and approved by board of directors
Keep stakeholders informed through quarterly reports, annual report and Web site	✓	<ul style="list-style-type: none"> • Four quarterly reports issued • Annual report issued in June 1999 • Web site activated in June 1999
Plan public meetings for each participating province	✓	Meetings scheduled for fiscal 2001
Further advance governance policies	✓	<ul style="list-style-type: none"> • Performance evaluation process introduced for board of directors • Performance evaluation process introduced for the President and Chief Executive Officer • Strategic planning process implemented
Closely match appropriate market benchmarks	✓	Earned 40.1% versus 39.3% for total fund benchmark

2001 OBJECTIVES

- ① Complete the recruitment of the senior management team.
- ① Develop a comprehensive risk management framework.
- ① Review asset allocation policy and develop investment strategy alternatives.
- ① Enhance benchmarking and performance measurement capabilities.
- ① Complete program of public reporting meetings across Canada.



GAIL COOK-BENNETT

The ten-month start-up period during which the board of directors had sole responsibility for managing the CPP Investment Board ended in September 1999. After conducting an extensive search for a Chief Executive Officer, the directors selected John A. MacNaughton, who has more than 30 years experience as an investment banker and senior executive of investment firms in Canada and the United States. We believe that his expertise and values are ideally suited to leadership of the CPP Investment Board.

The board of directors is now focused on ensuring the effective oversight and governance of the CPP Investment Board. It is committed to leading-edge governance standards to enhance the integrity as well as the long-term performance of the organization.

DIVISION OF RESPONSIBILITIES

The clear division of responsibilities among governments, board of directors and management is key to the effective operation of the CPP Investment Board. The federal and provincial governments jointly set the legislation and regulations that define both our fiduciary duties and mandate to act in the best interests of CPP contributors and beneficiaries by maximizing investment returns without incurring undue risk.

New ground was broken for crown corporations with the procedure for identifying our directors. A nominating committee composed of federal and provincial representatives from the public and private sectors compiled a list of individuals whose professional or business training and experience met the characteristics described in our legislation. From this list, the federal and provincial ministers together chose the founding board of directors. The same process will be used to identify new directors, when vacancies occur.

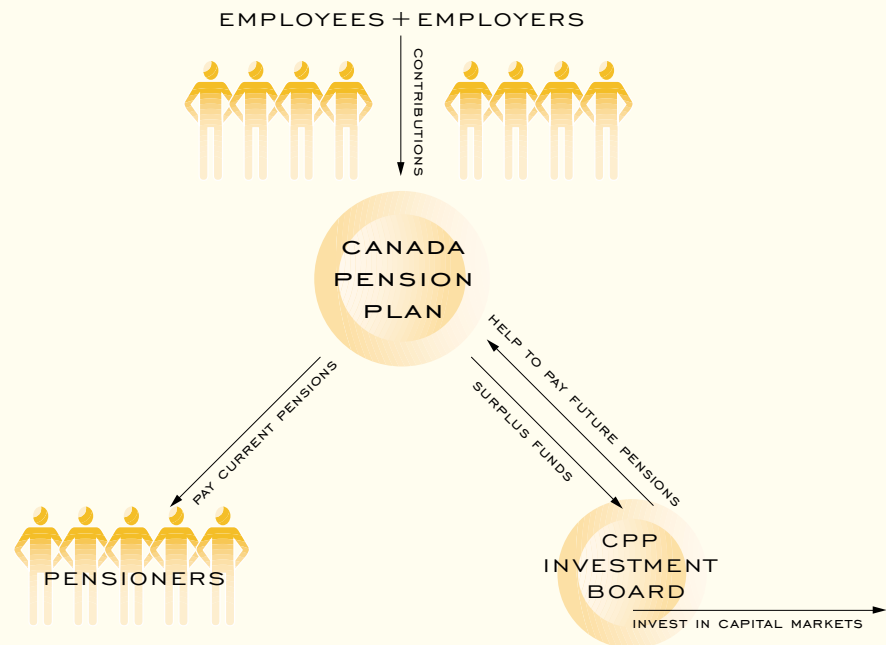
The directors have the usual responsibilities for oversight of strategic direction and broad business risks as well as overseeing effective communication to stakeholders. They ensure that appropriate policies and procedures are in place and hold management accountable for its activities. Management recommends the strategic direction and implements the approved strategies. It develops and implements the operating policies, annual business plan and budget, and manages the day to day business.

PERFORMANCE EVALUATION

A process has been developed for the directors to examine annually the performance of the board and its committees. The first evaluation involved each director completing a confidential questionnaire. The results were summarized by the Chair of the Governance Committee and reported to the board for discussion and action.

As part of its governance activities, the board of directors evaluates the performance of the President and Chief Executive Officer. The President sets objectives for the coming year and performs a self-appraisal for the past year. Directors submit written assessments and the summarized assessments are discussed by the board of directors and reviewed with the Chief Executive Officer.

ACCOUNTABILITY TO CANADIANS



The CPP Investment Board is accountable to a large proportion of the Canadian adult population. A policy of full and timely disclosure of information to these stakeholders has been adopted. Later this year, we will be talking directly to Canadians at public meetings to be held across the country.

While discharging the responsibilities of the Chief Executive Officer during the start-up period, I had the enthusiastic assistance and support of an excellent group of directors, who shared in the challenges and satisfaction of launching a new organization. To each of them I express my sincere appreciation.

Gail Cook-Bennett

GAIL COOK-BENNETT

CHAIRPERSON



JOHN A. MACNAUGHTON

I am honoured to be the founding President and Chief Executive Officer of the CPP Investment Board and eagerly accept the challenges and responsibilities of creating a new investment organization that will matter to the financial future of many millions of Canadians.

Like other nations, Canada has wrestled with the issue of how a state-run pension plan financed on a pay-as-you go basis can respond to the rising needs of an aging population. As sponsors of the Canada Pension Plan, our federal and provincial governments have shown world leadership in coming up with innovative solutions.

One of those solutions was to invest funds not needed to pay current pensions in capital markets. This decision led to the creation of the CPP Investment Board as a crown corporation. Our job is to increase the value of assets available to the Canada Pension Plan to keep its pension promise in the 21st century.

SPELLING OUT OUR MANDATE

My first task on arriving at the CPP Investment Board in September 1999 was to translate the legislated objectives into a strategic vision and operating mandate.

In developing our first strategy and business plan, we focused on designing the type of organization that would most effectively enable us to achieve the goal of optimizing investment returns on behalf of all Canada Pension Plan contributors and beneficiaries.

In doing so, we took into account several factors external to our mandate, such as the financial condition and obligations of the Canada Pension Plan, the pension income concerns and expectations of Canadians, and the historical performance of Canadian and foreign capital markets.

In addition, we considered internal factors, such as the regulatory environment, the projected rapid growth of funds transferred from the Canada Pension Plan to the CPP Investment Board, the need to build our capabilities ahead of asset growth, and the setting of effective strategies.

Our response to these external and internal factors was the development of the following Statement of Mandate:

STATEMENT OF MANDATE

- Our mandate is to assemble a team with the capabilities to invest the assets entrusted to the CPP Investment Board in the best interests of Canada Pension Plan contributors and beneficiaries.
- We will invest in ways that over the long term will maximize performance without undue risk and produce returns that compare favourably with a best-in-class peer group, while having regard to the financial condition and obligations of the Canada Pension Plan.
- Our performance will be measured and compared on an absolute and risk adjusted basis, and on a gross and net basis, to relevant capital markets benchmarks, the returns of our peer group, and the assumption of the Chief Actuary.
- To fulfill our mandate in ever-changing markets, we will explore regularly a broad range of investment strategies and alternatives. Based on comprehensive capital markets research and risk management techniques, we will pursue opportunities judged attractive in both public and private markets, using both passive and active investment approaches.
- Our vision is to build a virtual corporation with a small team of outstanding investment professionals that capitalizes on the best external capabilities. We will be open to building internal expertise and/or operations wherever and whenever equal or better performance can be achieved at lower cost.
- We will communicate in a full, open and timely manner so that our stakeholders will be able to understand what we are doing and how we are helping to keep the Canada Pension Plan promise.

THE CONCEPT OF A VIRTUAL CORPORATION

In the traditional corporate model, most implementation and support functions are performed internally and are an integral part of the core organizational structure. If we had chosen this model, we would have had to build an elaborate organization with extensive research and analytical resources, numerous portfolio managers, trading rooms for stocks, bonds and other financial products, specialized departments for such investment classes as merchant banking, real estate, and infrastructure projects, a large investment accounting department, and corporate departments for human resources, legal affairs and other services.

Instead, we chose the vision of a virtual corporation with a small team of senior executives responsible for working to develop investment and operating strategies, and then accessing and leveraging external expertise to help us manage our assets and increase their long-term value. This approach will ensure broad exposure to ideas, deal flow and service providers through partner-like relationships at home and abroad, while leaving open the option of developing staff expertise to implement components of our strategy wherever and whenever equal or better results can be achieved internally at lower cost.

Whether executed internally or externally, the senior team will be responsible and accountable for all aspects of our investment and business performance as well as compliance and control. The five most senior executives reporting to me will be pre-eminent specialists in research and risk management, public market investments, private market investments, communications and stakeholder relations, and finance and operations.

We believe the virtual corporation model will focus our energies on high value-added activities, provide access to more specialized skills and resources, offer flexibility in choosing required skills and capabilities, generate potentially better results at less cost, and provide risk management and diversification benefits. In other words, we will emerge as a strategic think-tank organization that takes full tactical advantage of the implementation talents already flourishing in the competitive marketplace.

The process of recruiting the senior team is underway and we expect to complete it by the summer of 2000.

MANAGING THE ORGANIZATION

The CPP Investment Board currently has a small staff managing our third-party relationships to ensure the prompt investment of funds and the measurement of investment performance. We also fulfilled all our obligations under applicable legislation and regulations as well as board-approved policies and procedures. These included the development and implementation of internal controls, comprehensive financial reporting, and public accountability for our activities and results.

In fiscal 2000, it cost \$3.7 million to operate the CPP Investment Board, of which \$0.5 million related to investment activities, such as fund management and custodial fees, and \$3.2 million to governance and administration. Total costs represented 31 basis points on average assets under administration during the year.

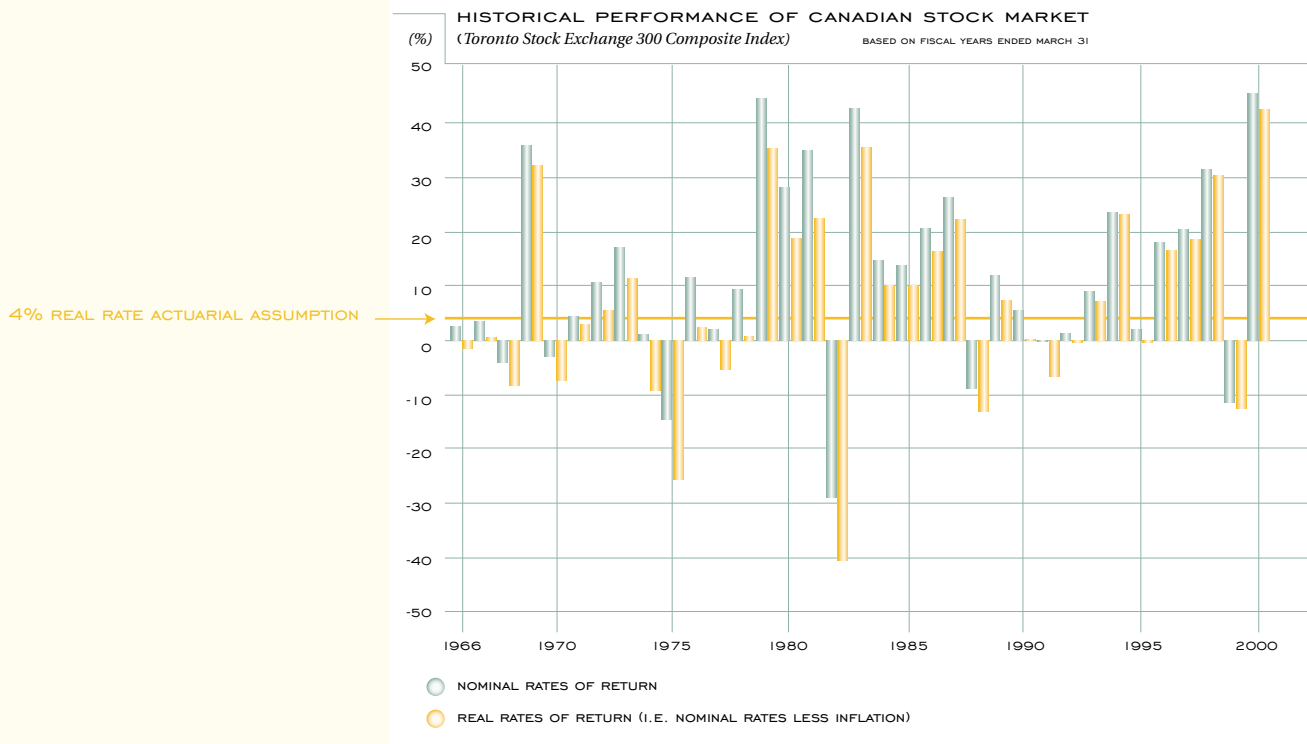
We will continue to be vigilant in managing costs with a view to maximizing net investment returns, which is the ultimate measure of our performance.

INVESTMENT ACTIVITIES

In the year ended March 2000, we continued the investment policy set by the board of directors in December 1998 of investing all cash received from the Canada Pension Plan in equities. Approximately 80% was invested in funds that replicated the Toronto Stock Exchange 300 Index, and 20% in foreign stock index funds, one for the U.S. and the other predominantly for Europe and Asia.

We enjoyed exceptional investment returns in our first full fiscal year because the TSE 300 Index was among the world's top performing markets. Our Canadian equity fund earned 45.3% and the foreign index funds posted a combined 16.6% return, for a total fund return of 40.1%.

While pleased to report these results, I caution that as we broaden our asset allocation base, the volatility of our portfolio will decline, as will the likelihood of achieving such outstanding annual results again.



The above chart tracks both the nominal and real rates of return for the Canadian stock market since the Canada Pension Plan was introduced in 1966.

As is evident, since the Canada Pension Plan was founded, the TSE 300 nominal return has exceeded 40% on only three occasions. Also the index was highly volatile from year to year, losing 11.3% as recently as fiscal 1999.

The federal Chief Actuary has estimated that we need to earn a real rate of return of 4% over the long term. In the past 34 years, the Canadian market produced an average real return in excess of 4%, notwithstanding the fact that real returns fell short of that level 50% of the time. While it is not possible

to hit the 4% real return target consistently year after year, we believe it is a prudent basis for future expectations.

Our investment performance is discussed further on Page 14.

REGULATORY CHANGE

A major development in fiscal 2000 was the decision of federal and provincial finance ministers to relax a restriction on our domestic equity investing. During our start-up period, we had been limited to investing all capital designated to Canadian equities in stock index funds. Under the revised regulation, we can now invest up to 50% of these funds in individual stocks. This amendment opens up our investment alternatives. Once the restriction is removed entirely, we will be able to invest on the same basis as other pension funds, if we so choose.

TALKING TO CANADIANS

An important part of my job is to keep Canadians informed of how we are managing their money. We do this in a variety of ways, including quarterly financial reports and this annual report. We also maintain an active Web site, deliver speeches and presentations to interested audiences, and participate in print and broadcast interviews across Canada.

The current year will be a busy one as we will hold our first public meetings across the country to discuss this annual report and our strategies and plans for the future. I look forward to these meetings so that we can explain to Canadians what we are doing to help keep the Canada Pension Plan promise.

ACKNOWLEDGEMENTS



The CPP Investment Board has an able and dedicated board of directors. I thank the directors for inviting me to lead the organization through its initial years. I also thank them for their guidance during the past year and their support for our strategy and business plan as we build for the future.

I would like to express a special thanks to my four colleagues who are the founding members of our permanent staff: Jane Nyman, Vice President – Finance and Operations; Henry Kim, Manager – Finance and Operations; Julie Winget, Administrative Assistant; and Barbara Sharp, Office Manager and Assistant to the President. Their dedication, enthusiasm and hard work enabled the CPP Investment Board to have a very successful first full year of operation. They have established high standards for those who will join us in the months and years ahead.

JOHN A. MACNAUGHTON
PRESIDENT AND CHIEF EXECUTIVE OFFICER