CPP
INVESTMENT
BOARD

ANNUAL REPORT 2001

Fiscal year ended March 31, 2001

CANADA
PENSION PLAN
INVESTMENT
BOARD

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

PROFILE

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. By March 31, 2001, we had $7.2 billion invested in Canadian and foreign equities and by 2011 we expect to be managing at least $130 billion in a diversified investment portfolio.

The CPP Investment Board is governed by a board of directors with extensive business, investment and financial expertise, and is managed by investment and business professionals from the private sector.

We operate independently of the Canada Pension Plan and at arm’s length from the federal and provincial governments.

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CPP INVESTMENT BOARD

VISION

Earn the confidence of Canadians that we are working for them to help the Canada Pension Plan to keep its pension promise.

MISSION

- Invest in the best interests of CPP contributors and beneficiaries.
- Maximize long-term investment returns without undue risk of loss, having regard for the obligations and assets of the Canada Pension Plan.
- Tell our story to Canadians.

LONG-TERM OBJECTIVES

- Contribute to the financial strength of the Canada Pension Plan.
- Earn returns that fairly compensate for the risks taken and costs incurred (i.e. risk-adjusted net value added).
- Manage the CPP Investment Board professionally and cost effectively.
- Help Canadians to understand what we are doing.

FISCAL 2001 OBJECTIVES	STATUS
Complete the recruitment of the senior management team.	Substantially complete.
Develop a comprehensive risk management framework.	Approved by the board of directors. See page 9.
Review asset allocation policy and develop investment strategy alternatives.	Approved by the board of directors. See page 12.
Enhance benchmarking and performance measurement capabilities.	Approved by the board of directors. See page 17.
Complete program of public reporting meetings across Canada.	Completed in January 2001. See page 2.

FISCAL 2002 OBJECTIVES

Implement investment risk management framework.

Diversify portfolio investment activities, including introduction of active management.

Control our costs as we expand operations and diversify investment activities.

Redesign and expand the Web site as our primary medium of public communications.

REPORT FROM THE CHAIR

A highlight of our second fiscal year was a series of public meetings at which President John MacNaughton and I discussed the progress of the CPP Investment Board with Canadians interested in our activities. Our legislation requires us to hold a public meeting at least every two years in each of the nine provinces that participate in the Canada Pension Plan. Meetings were held in January 2001 in Fredericton, Charlottetown, Halifax, St. John's, Winnipeg, Regina, Edmonton, Victoria and Toronto.

REACHING OUT TO CANADIANS

In addition to the public meetings, one of which was broadcast several times by a national television service, we engaged Canadians through open line radio shows, meetings with newspaper editorial boards and informal stakeholder get-togethers.

GAIL COOK-BENNETT CHAIRED OUR FIRST SERIES OF PUBLIC MEETINGS ACROSS CANADA IN JANUARY 2001.

The informal stakeholder meetings included pension fund portfolio managers, professionals and business executives, and pensioners at sessions in Atlantic Canada; university students, union leaders and anti-poverty advocates in Western Canada; and financial planners in Central Canada. As the public meetings were held in provincial capitals, we also discussed our progress with provincial finance ministers and their staff responsible for the Canada Pension Plan.

LISTENING TO CANADIANS

A number of issues emerged during these meetings:

- Canadians wondered if we are independent from governments in making investment decisions.

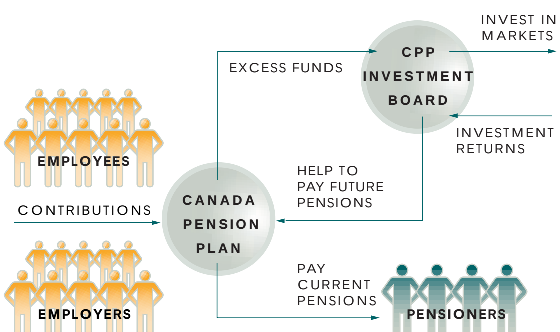
  We assured them that we are. Legislation requires the CPP Investment Board to be governed by an independent and qualified board of directors. We in turn have hired investment professionals from the private sector.
- Younger Canadians wondered if the Canada pension would be there when they retire. The federal Chief Actuary has projected that CPP contributions will exceed benefits until 2021. After that, contributions plus investment income will pay benefits. Our efforts will be especially important in helping to pay the pensions of younger workers who are decades away from retirement.

- Canadians were curious to know the expertise of the organization. We shared the credentials and experience of our president and executives hired to date, and the business and financial expertise of our board of directors.
- Some people wondered why we invest solely in equities. One reason is to complement the large bond portfolio owned by the Canada Pension Plan. Another reason is our long investment horizon, which should give equities time to show superior performance, despite periodic stock market downturns as occurred in fiscal 2001.

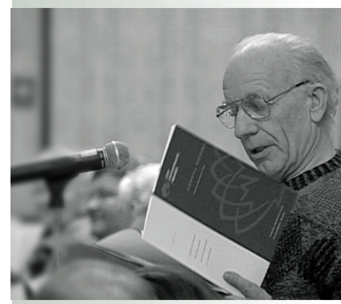
A DISTINCTIVE CROWN CORPORATION

In December 2000, the Auditor General of Canada issued an important report on the governance of crown corporations. He found that the boards of many crown corporations lack key skills and capabilities and have ineffective audit committees.

OUR RELATIONSHIP TO THE CANADA PENSION PLAN



The federal and provincial governments legislated that a preponderance of our directors have financial and business expertise and mandated a new nominating procedure to identify qualified directors. As a result, we were able to select a chartered accountant, an actuary, a retired bank executive, and a valuation specialist for the audit committee. In turn, they encouraged the development of an enterprise-wide framework to manage, assess and monitor risks.



ACKNOWLEDGEMENTS

To three outstanding founding directors, Susan Carnell, Richard McAloney and Pierre Michaud, my sincere gratitude for their commitment and judgment in our formative stages. To Gilbert Gill, Monique Leroux and Helen Sinclair, a warm welcome to the board of directors. To John MacNaughton and his staff, our appreciation for developing strategies that will shape the direction of the CPP Investment Board for many years to come.

GAIL COOK-BENNETT
Chairperson

REPORT FROM THE PRESIDENT

Our second full fiscal year saw substantive progress on many fronts. Our concept of a virtual corporation, led by a small team of experienced investment professionals, gained definition as we recruited key executives. We developed our strategic plan and investment management framework to provide context and cohesion for all our activities. We moved from solely passive to partially active investing. And we took our story on the road to communicate with Canadians.

While these developments were going on, we invested $5.6 billion in stock markets, which performed well in the first half of fiscal 2001 before declining sharply in the second half. As a result, we incurred a fiscal-year loss.

JOHN A. MACNAUGHTON PARTICIPATED IN RADIO SHOWS, MEDIA INTERVIEWS AND INFORMAL STAKEHOLDER GET-TOGETHERS AS PART OF OUR PUBLIC MEETINGS TOUR.

BUILDING OUR VIRTUAL CORPORATION

Our notion of a virtual corporation envisages a lean and cost-effective organization. Our small team of executives and their managers will develop strategies and establish partner-like relationships with external professionals to manage our assets and increase their long-term value. However, we will consider building internal capabilities if better results net of costs can be achieved.

The key building blocks of our virtual corporation are almost in place. Most of our executives have been recruited and other specialized professionals and staff are on board, bringing our team to 15 at year end. We anticipate a staff of approximately 30 people by the end of fiscal 2002.

We have the knowledge and experience to drive the CPP Investment Board forward with vigor and confidence.

OUR STRATEGIC PLAN

The development of our strategic plan was a major accomplishment in fiscal 2001. A key component is the investment management framework that is the intellectual link between our vision, mission and objectives and our strategies for advancing them.

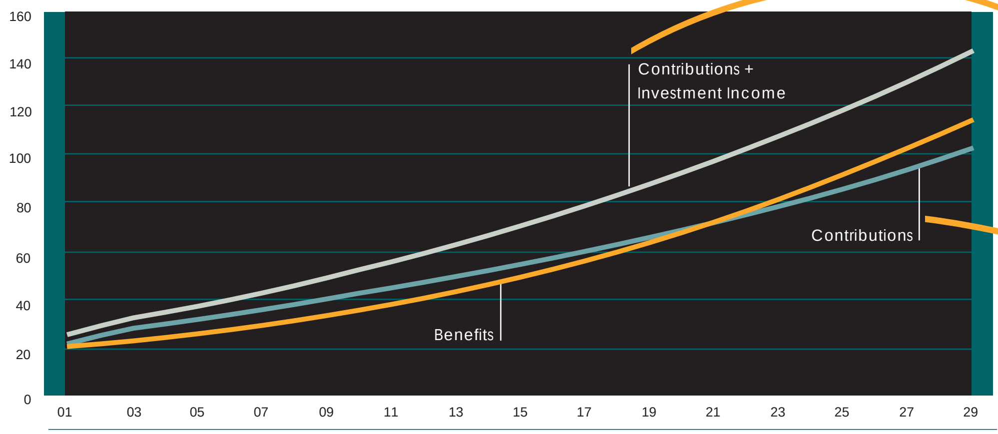
One of our challenges is to earn at least the rate of return assumed by the Chief Actuary for the assets we manage. If we do that consistently, we will make a positive contribution to the Canada Pension Plan in the decades ahead.

The actuarial assumption is a 4 percent real rate of return (4 percent above inflation), a rate no assets currently guarantee. The closest are federal government real-return bonds that yielded 3.5 percent above inflation at the end of March 2001. If that is the best that a risk-free asset can offer, then obviously we will have to assume risk to maximize returns to the level required. Balancing risks and rewards is central to our work.

The Chief Actuary has projected that contributions by workers and employers will exceed Canada Pension Plan benefit payments to pensioners until 2021. The growth in assets we create by investing the annual excess over the next 20 years, and the annual investment income those assets generate, should more than compensate for the shortfall between contributions and benefit payments for decades after 2021.

HELPING TO PAY FUTURE PENSION BENEFITS

($ billions)



Assure long-term CPP financial viability.

Contributions alone will exceed benefit payments until 2021.

With such a distant investment horizon, we can afford to be patient and assume risk by investing in assets that may produce negative returns from time to time, but will generate positive results over the long term. The assets with the best risk/reward profile for our purposes are equities.

Risk is a double-edged sword. The more risk we take on to earn superior long-term returns, the higher the potential loss in the short term. Our objective is to generate risk-adjusted net value added, that is returns after costs that are appropriate to compensate for the risks taken.

THE MOVE FROM PASSIVE TO PARTIALLY ACTIVE INVESTING

Since making our first investment in March 1999, we have invested solely in equities to balance the large bond portfolio and cash reserves owned by the Canada Pension Plan.

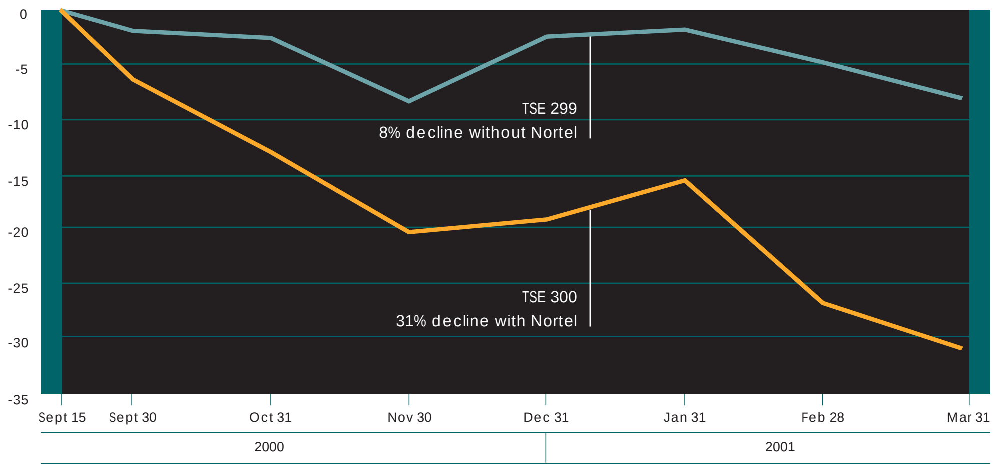
Our Canadian equity investing is governed by federal regulation. During our first 18 months, we could only invest passively in index funds. (Outside Canada, we could invest actively or passively and so far have decided to invest passively in equity index funds). The Canadian equity restriction worked well in our first fiscal year, when the TSE 300 index ranked among the top performers in the world.

In August 2000, the regulation was relaxed to allow up to 50 percent of the capital allocated to Canadian equities to be actively managed. We made our first active decision soon after the regulatory change became effective. Our goal was to reduce our exposure to Nortel Networks, a stock that represented 35 percent of the TSE 300 Index at the time and about 28 percent of our total assets. That level of concentration in a single stock carried far too much risk, no matter how good the company.

In essence, we divided our Canadian equities effective September 15 between the TSE 300 fund and a fund of the TSE 300 excluding Nortel. The difference in performance through the remainder of the year was startling, as the following chart illustrates. This initiative avoided $535 million in losses that would otherwise have occurred and reduced our largest concentration in a single security to approximately 4 percent by year end.

Our first active investment decision avoided $535 million in losses – the difference between the TSE 299 and TSE 300 performance.

MANAGING RISK REDUCED LOSSES
(% cumulative nominal decline)



2001 INVESTMENT PERFORMANCE

The $5.6 billion we received in fiscal 2001 from the Canada Pension Plan was invested in Canadian and foreign equities. By year end, we had $7.2 billion in assets under management, of which 70 percent was invested in Canada and 30 percent in the United States, Europe and Asia.

Stock markets around the world finally corrected mid-way through our fiscal year after the longest and strongest rise in history. In fact, between September 2000 and March 2001 they experienced the worst six-month declines since 1974. For our full fiscal year, the markets in which we invested declined by 17.8 percent. By contrast, we ended the year with a negative total portfolio return of 9.4 percent for an $852 million net loss.

The $42 billion (at estimated market value) portfolio of bonds and money-market securities owned by the Canada Pension Plan earned approximately $3.8 billion in fiscal 2001. On a consolidated basis, the equity and fixed-income assets available to the Canada Pension Plan produced a positive return of approximately 7 percent.

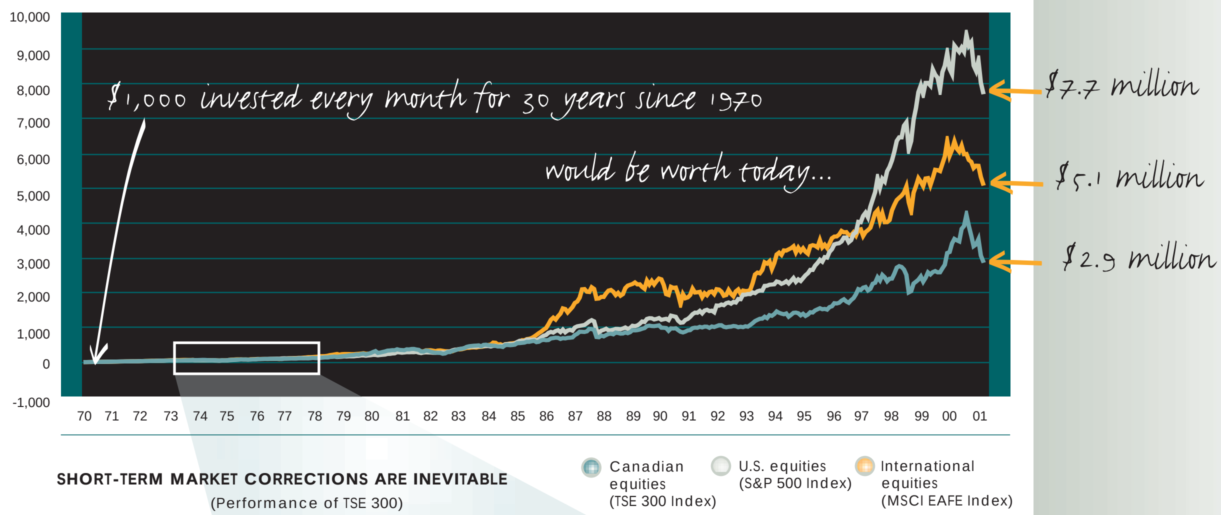
Our results are discussed in the Investment Performance section of this report beginning on page 15.

BUYING OPPORTUNITIES

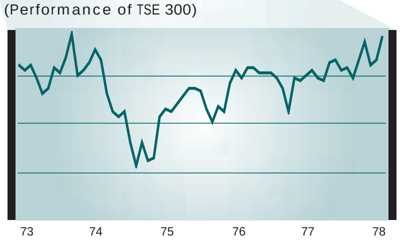
Few investors take joy in declining markets. We were in the fortunate position of being able to put large and frequent cash inflows to work at more advantageous prices as the year progressed and acquire more shares for the same amount of money. This dollar cost averaging put us in a stronger position to benefit when markets recover. As a patient long-term investor we are not deterred by the severity of the recent market downturn that affected our short-term results.

Corrections followed by recoveries are the natural behaviour of equity markets, with five major corrections in the past 30 years. In 1973-74, for example, the TSE 300 Index declined steeply and took more than five years to fully recover, as the following chart illustrates. Yet capital invested over the long-term grows at a compounded rate that more than compensates for a market correction even as harsh and as long as the one in 1973-74. We will see many more major corrections followed by recoveries as we invest to maximize our long-term returns.

LONG-TERM REGULAR INVESTING PAYS OFF
($ thousands)



SHORT-TERM MARKET CORRECTIONS ARE INEVITABLE
(Performance of TSE 300)



Down markets like this one are buying opportunities for a long-term investor.

LOOKING AHEAD

So far we have invested only in publicly traded equities. In fiscal 2002, we will expand into private market investments. Over long time periods, private equity returns, particularly from merchant banking and venture capital, can be substantially higher than public equity returns. Private market investments fit well with our goal of long-term patient growth.

Initially, we plan to participate in private markets through limited partnerships or pooled funds by establishing ourselves as a preferred investor with a dozen or more of the best fund managers in the world. In fiscal 2002, we may commit up to $1.8 billion to private equities to be invested over five years. These investments should start to positively influence our total portfolio return toward the end of the initial five-year period. In the meantime, we will make further commitments on an annual basis. Our approach to investing in private market investments is discussed further on page 13.

Federal and provincial finance ministers are considering the removal of the remaining regulatory restrictions on our Canadian equities during fiscal 2002. This would give us the same flexibility to enhance returns and mitigate risks as other investors. However, index investing will remain a core strategy.

TELLING OUR STORY

Communicating with Canadians and other interested parties is a continuing priority. We accept our responsibility to explain to Canadians what we are doing with their money.

The public meetings held across Canada in January 2001, and discussed in the Report from the Chair, was one approach. We also communicate through our Web site and media interviews, and our executives and I make speeches and presentations throughout the year to a wide range of stakeholder audiences.

The CPP Investment Board is also attracting attention from other countries seeking solutions to their public pension challenges. Several groups from Europe, Asia and the United States have visited us. We believe we have a convincing story to share with them as well.

APPRECIATION

Thank you to my colleagues for joining the CPP Investment Board so that together we can build an effective investment organization to help secure the public pension promise.

Thank you to our directors for their support and guidance as we take on more complex and demanding investment challenges.

Thank you to Canadians who participated in our first public reporting tour in January 2001. There is nothing quite as refreshing as a citizen asking a question that cuts through the complexities and obtuse jargon of investing to get at a simple point – will we make money over the long term to help pay the Canada pension? The answer is 'yes' as will become evident with time.

JOHN A. MACNAUGHTON
President and Chief Executive Officer