



CPP
INVESTMENT
BOARD

it's about the **future**

A N N U A L R E P O R T 2 0 0 2



Canadians have the right to know

Canadians have the right to know why, how and where we invest their Canada Pension Plan money, who makes the investment decisions, what assets are owned on their behalf, and how the investments are performing.

Consequently, we are committed to pro-actively disclosing comprehensive and timely information about our investment activities, primarily through our web site, so that Canadians can understand how we are helping to keep the Canada Pension Plan promise.

Our timely disclosure of important developments is also made through news wire services. Examples are our quarterly and annual financial results, new investments, new partner-like relationships, executive appointments, and notice of public meetings.

We do not disclose information regarding investments under consideration or not completed, and we respect third-party confidentiality agreements. We comply with federal and provincial laws and regulations regarding such matters as privacy.

What's available on our website www.cppib.ca

• What's New	• Our Regulations
• Public Meetings	• Our Investment Challenge
• Results	• Investment Considerations
• Holdings	• Return Expectations
• News Releases	• Risk Management
• Quarterly Reports	• Public Market Investments
• Partnering Opportunities	• Guidelines for Public Market Investments
• Meet Our Team	• Private Market Investments
• Our Governance	• Guidelines for Private Market Investments
• Our Policies	• Measuring Total Fund Performance
• Canada Pension Plan	• Social Investing
• Our History	• Annual Reports
• Our Legislation	• FAQs

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Our investment and operating objectives

Our goal is to grow the value of assets available to the Canada Pension Plan to help pay pensions to today's workers, starting as early as 2021. Consequently, what we do is very much about the financial future for millions of Canadians.

While our investment focus is long term, we set annual investment and operating objectives, and report on them at the end of each fiscal year.

FISCAL 2002 OBJECTIVES AND PERFORMANCE

Implement investment risk management framework.

Expanded policies, guidelines and procedures to control risk and introduced a portfolio risk management system.

Diversify portfolio investment activities, including introduction of active management.

Diversified from exclusive investment in passive index funds to include externally managed private equity funds.

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

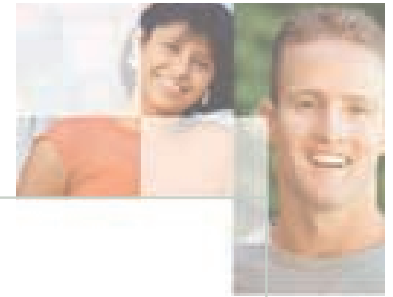
Held costs below board-approved budget, with expenses of 9¢ per \$100 of assets.

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

Substantially completed by year end for implementation in May 2002.

FISCAL 2003 OBJECTIVES

- Adjust our passive equity investing strategies to enhance long-term returns
- Initiate active public market investment programs to complement our active private equity investing
- Implement an internal audit function to augment the external audit function within an enterprise-wide risk management approach
- Enhance performance measurement and attribution reporting



Accountability *through disclosure and oversight*

Chair's Report

The CPP Investment Board is responsible for billions of dollars of retirement funds belonging to Canadians and must, therefore, be fully accountable to them. These funds must be managed to the highest professional standards and at arm's length from governments with qualified managers making investment decisions.

Accordingly, in framing the CPP Investment Board's legislation and regulations, the federal and provincial governments addressed both accountability and professional independence.

By legislation, the CPP Investment Board is required to report to Parliament through the finance minister, who tables our annual report in the House of Commons. Quarterly and annual financial statements are filed with the federal and provincial finance ministers, who are collectively responsible for the Canada Pension Plan. Furthermore, legislation requires the Chairperson and Chief Executive Officer to hold bi-annual public meetings in each province that participates in the Canada Pension Plan.

The CPP Investment Board has, however, moved far beyond these legislated disclosure requirements to embrace the philosophy described on the inside cover of this report. The belief that Canadians have the right to know how and where their dollars are invested and, of course, how their investments are performing dictates disclosure of investment policies, decisions and holdings. As a result of this pro-active process, Canadians and their representatives can assess the performance of the organization.

Oversight of management is a central duty of the directors to ensure compliance with the CPP Investment Board's legislated mandate. That mandate is to invest for CPP contributors and beneficiaries and to maximize investment returns without undue risk of loss. Critical to effective oversight is having directors



Gail Cook-Bennett

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Board-approved policies, including codes of conduct and conflict of interest procedures, can be found under Our Policies.

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with experience in financial services, investing and other areas pertinent to the Investment Board's responsibilities. The legislation and nominating process are quite clear in requiring directors with this experience.

The board's four committees provide more detailed oversight from different perspectives:

- The investment committee, consisting of the full board, reviews and approves all investment policies and strategies and the appointment of external fund managers. The investment policies were revised in fiscal 2002 and key elements are published as our Investment Statement.
- The governance committee oversees codes of conduct for directors, officers and employees as well as the identification and resolution of conflicts of interest. In fiscal 2002, it approved a revised governance manual.
- The human resources and compensation committee evaluates the performance, compensation and organization of management.
- The audit committee ensures that management has an effective internal control structure for enterprise-wide risks and oversees the completion of the financial statements with the assistance of the auditors. In fiscal 2002, an accounting firm was retained to provide on-going internal audit services, including the review of management's monitoring and evaluation of risks, the related policies, operating procedures and controls. The internal audit firm complements the activities of the external audit firm.

Through a rigorous process, objectives for the Chief Executive Officer and management are set and performance is monitored and rewarded annually.

The directors also engage in an annual self-assessment of their own effectiveness as a team and as individuals. The individual assessment questionnaire, for example, asks directors to evaluate their own



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The mandate and activities of board committees are explained under Our Governance.

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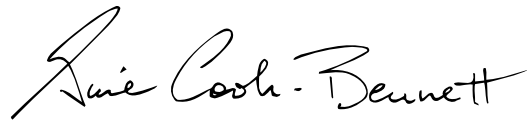
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contribution and rate their colleagues. Appropriate confidentiality is retained through use of an outside consultant to collate the information.

The governance model and processes do not, of course, guarantee organizational success, though we believe they contribute to good performance. As a relatively new organization we were honoured that the CPP Investment Board was selected as the winner of the Conference Board of Canada/Spencer Stuart governance award for the public sector in 2002. The award is an endorsement of key governance decisions made by the federal and provincial governments in the late 1990s in forming the CPP Investment Board. These decisions are the solid foundation on which we have developed our governance practices.

From time to time, directors must leave the board as their job responsibilities change or systemic conflicts arise. On behalf of the board, my sincere thanks to Monique Leroux who stepped down after a short but productive tenure. The CPP contributors and beneficiaries are served by a board of independently minded directors that exercises oversight over a professional management team committed to helping the Canada Pension Plan meet its long-term obligations.



Gail Cook-Bennett, Chairperson



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Governmental and public reporting is spelled out in our legislation and regulations, available under Why We Exist.

A board with the right expertise

The nominating committee that recommends individuals to serve as directors is required to consider candidates with financial, investment and business experience. The directors are responsible for investment policies, standards and procedures, appointing an independent auditor, approving policies to identify and resolve conflicts of interest, approving codes of conduct for directors, officers and employees, and monitoring and assessing management's performance.



Gail Cook-Bennett
Chairperson ^{1,3}
Economist.
Former professor,
business consultant.
Chair, investment
committee.



Mary C. Arnold ²
Chartered accountant.
Management consultant.
Chair, audit committee.



Gilbert Gill ²
Chartered accountant.
Former deputy finance
minister, Newfoundland
and Labrador.



Jacob Levi ^{1,2}
Actuary.



Helen M. Meyer ^{2,3}
Financial executive.



Dale G. Parker ¹
Corporate director.
Former financial
executive.
Chair, governance
committee.



M. Joseph Regan ^{2,3}
Retired bank executive.



Helen Sinclair ¹
Financial executive.



Richard M. Thomson ³
Retired bank executive.
Chair, human resources
and compensation
committee.



David Walker ³
Business executive.

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An explanation of the nominating process and directors' biographies are under Who We Are.

All directors are members of the investment committee, which reviews and approves management's investment strategy and recommendations for external fund managers.

¹ The governance committee is responsible for governance, measuring board effectiveness, and monitoring codes of conduct and conflicts of interest, including clear board and management authority for resolving perceived conflicts and ensuring directors and employees formally acknowledge their compliance semi-annually.

² The audit committee oversees financial reporting, external audit, information systems, internal audit and internal controls, and risk management.

³ The human resources and compensation committee is responsible for compensation philosophy, reviewing CEO's performance, succession planning and organizational structure.

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A distinctive *national, institutional investor*

President's Report



John A. MacNaughton

We have completed another productive year at the CPP Investment Board. Among our accomplishments:

- We earned \$316 million on equity investments for a 3.4 per cent rate of return.
- We expanded beyond passive public equity investing into actively managed private equity funds by committing \$2.4 billion to 14 external managers. These commitments will be invested over the next several years.
- We enhanced our investment accounting, performance measurement and risk management capabilities. This will enable us to refine our short-term and long-term portfolio risk management as our assets undergo rapid growth.
- We expanded to 23 permanent staff with the recruitment of professionals and support personnel in all investment and operating areas. We continue as a lean and focused organization committed to controlling overhead costs, developing and managing disciplined investment and operating strategies, retaining outside specialists to implement most of our strategies under our close supervision, and producing long-term returns that contribute to the financial strength of the Canada Pension Plan.

We are well positioned to move to the next phase of our development. As we shape our future course, it is important to remember that the CPP Investment Board is substantially different in purpose and design from many Canadian pension funds.

First, unlike a typical pension plan, the Canada Pension Plan does not have a target of being fully funded (that is, with assets matching liabilities). Born as a pay-as-you-go scheme in 1966, the plan is now designed to be partially funded, with assets projected to reach roughly 25 per cent of liabilities in future years. Contributions by employers and employees and investment income from the CPP Investment Board will help governments to meet their CPP obligations as they come due.

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Our approach to forming partner-like relationships with external investment managers is outlined under Partnering Opportunities.

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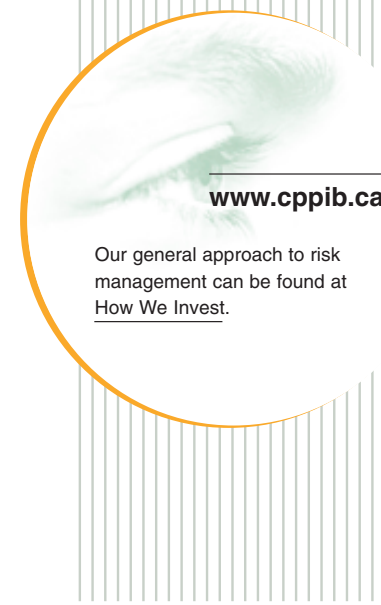
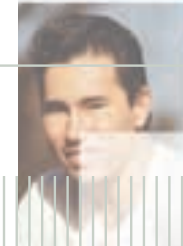
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Second, CPP benefits are fully indexed for inflation, which means we need to invest in assets that outperform inflation. The least risky investments that guarantee a return above inflation are real-return bonds. Unfortunately, they do not produce returns sufficient to satisfy the CPP's future needs. We have to assume some risks to earn higher returns over the long term.

Third, with high levels of annual cash inflow we will be a large institutional investor relative to the small Canadian market. Our assets will range between \$125 billion and \$150 billion by 2012. The exact amount will depend on the returns we earn, how much of the government bond portfolio held by the Canada Pension Plan is transferred to us, and the excess of CPP contributions over benefits paid. During the next decade, we expect to have between \$6 billion and \$8 billion of new cash to invest on average *every year*. Obviously, we want to avoid bidding prices up, especially in the Canadian public equity market. To diversify from having "too many eggs in one basket" we will maximize non-Canadian exposure to capitalize on growth in other world economies.

Fourth, the plan will not need cash from the CPP Investment Board for about 20 years. According to the Chief Actuary's assumptions, Canada Pension Plan contributions are projected to exceed benefit payments until 2021. This is good news for a cash-rich equity investor. We can take advantage of several business cycles to gain higher equity returns from economic growth in Canada and global markets, and invest a portion of assets in less liquid assets to earn higher returns.

These distinctive characteristics mean that we must move away from the limitations in our current strategy of replicating stock indexes for Canadian, U.S. and other markets. Our plan is to internalize the passive management of public equities, reconfigure the portfolio and retain external specialists to actively manage



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Our general approach to risk management can be found at [How We Invest](#).

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a portion of it. We will also expand our commitments in private equity and explore opportunities in income-producing real estate, infrastructure and natural resources. Our current and future investment strategies are described in the next section, Strategies for Long-Term Growth.

Finally, we differ from Canadian pension funds in that we work for and report to a national constituency of 16 million CPP contributors and beneficiaries, as well as to the federal and provincial governments. We accept the responsibility to keep them informed on changes in our investment strategy. With that in mind, we have greatly expanded the continuous disclosure of investment information on our web site. We also welcome hearing from Canadians at the public meetings scheduled across the country in June 2002, the details of which are posted on our web site.

Thank you to our board of directors for its guidance and support during the past year, and our dedicated staff for their commitment and hard work in ensuring that everything we do at the CPP Investment Board is designed to further the long-term financial strength of the Canada Pension Plan.



John A. MacNaughton, President and Chief Executive Officer

