



CPP
INVESTMENT
BOARD

BUILDING A DIVERSIFIED

CPP PORTFOLIO

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

2
0
0
3



TABLE OF CONTENTS

What's available on our
web site : www.cppib.ca

Profile 1

Chair's Report:
Building on the Governance Platform 2

A Board With Broadly Based Expertise 5

President's Report:
Long-Term Investing In Challenging Times 6

Management's Discussion and Analysis 9

Performance Review 14

Financial Statements 20

Governance Practices of Board of Directors 35

Corporate Information IBC

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

Who We Are



PROFILE

The CPP Investment Board is a Crown corporation created by an Act of Parliament in December 1997. Its long-term goal is to contribute to the financial strength of the Canada Pension Plan by investing in the best interests of 16 million CPP contributors and beneficiaries and by maximizing returns without undue risk of loss.

The CPP Investment Board invests in capital markets the funds not needed by the Canada Pension Plan to pay current pensions and is not expected to be required to contribute investment earnings to the CPP to help pay pensions until 2021. In order to build a diversified portfolio of CPP assets, the CPP Investment Board is currently investing in public equities, private equities and real estate to balance the cash and bonds owned by the CPP.

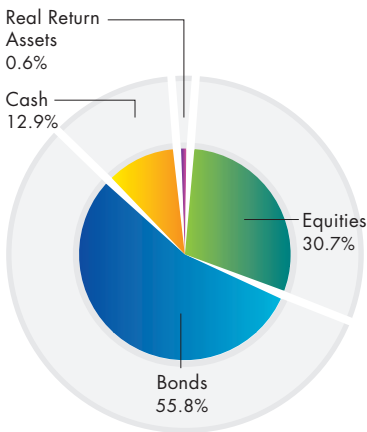
Our disclosure policy states that: “Canadians have the right to know why, how and where we invest their Canada Pension Plan money, who makes the investment decisions, what assets are owned on their behalf and how the investments are performing.”

By increasing the long-term value of funds available to the Canada Pension Plan, the CPP Investment Board will help the plan to keep its pension promise to Canadians.

Based in Toronto, the CPP Investment Board is governed and managed independently of the Canada Pension Plan and at arm’s length from governments.

For more information on the CPP Investment Board, visit our web site at www.cppib.ca.

CONSOLIDATED CPP ASSETS
Fiscal year ending March 31, 2003



CHAIR'S REPORT: BUILDING ON THE GOVERNANCE PLATFORM

The CPP Investment Board is anticipating fundamental developments that will shape its investment strategy and organizational structure for many years. Since the organization was created four and a half years ago, it has diversified Canada Pension Plan assets beyond the large long-term bond and cash portfolio owned directly by the plan. Today, CPP assets include public and private equities, as well as real estate assets.



GAIL COOK-BENNETT

Starting in fiscal 2004, the CPP Investment Board is expected to assume responsibility for managing all CPP assets, which currently total \$55.6 billion. This major development was approved recently by Parliament and is subject to the consent of the provinces. With this approval, the transfer of the bonds from the federal government in Ottawa to the CPP Investment Board in Toronto would occur over three years. The cash portion of the portfolio would be transferred beginning in fiscal 2004 and the CPP Investment Board would then be responsible for providing the Canada Pension Plan with cash so it can pay its benefit obligations.

These pending changes coincide with the expected rapid growth in cash flows from CPP contributions in excess of those required to pay current pensions. In response, increased focus is being placed on long-term investment strategy and the organizational structure and resources best able to achieve long-term success.

The foundation of the organization is the governance platform created by the federal and provincial governments to provide oversight of how the national pension plan's assets are managed. The platform carefully balances two principles that underlie the CPP Investment Board's powers and accountabilities.

The first principle is that the investment professionals make their decisions independently of governments, though consistent with legislation and regulations. For this reason, the board of directors was given responsibilities similar to those of a corporate board in the private sector. The board of directors (rather

About Our Board

than government) appoints the chief executive officer, approves investment and operating policies, approves the annual business plan and budget, appoints external and internal auditors and approves the engagement of external investment managers.

The second principle is full accountability and reporting by the CPP Investment Board to Parliament, the provinces and the people of Canada. Part of the mandated reporting is to hold a public meeting in every participating province once every two years. The second series of coast-to-coast public meetings was held in June 2002. While public meetings provide personal contact with directors and management, we also survey public opinion semi-annually and initiate and accept meetings with key stakeholder groups. As a visit to our web site will confirm, the CPP Investment Board has chosen to be a leader on pension fund disclosure. A full listing of investments is provided quarterly along with considerable policy and investment information.

Widely publicized examples of poor governance practices and unethical conduct have led to considerable public distrust. Since the growing assets of the CPP Investment Board come from employee and employer contributions, governance practices and ethical conduct, as well as long-term investment performance, are important to earning and maintaining trust.

Early last year we invited three specialists to review our governance policies and procedures: David Bonham, who chaired the Canadian Institute of Chartered Accountants' task force on conflicts of interest for audit firms; Purdy Crawford, who has served on securities industry committees examining conflicts and corporate governance; and Ted Hughes, a former superior court judge and ethics commissioner to federal and provincial governments. They suggested appropriate enhancements, which have been incorporated into our practices. One of the most interesting was to consider a part-time external advisor on conflicts and ethical conduct. We plan to appoint such an advisor within the next year.



Who We Are

In exercising its responsibilities, the board uses techniques gaining popularity in the corporate sector, such as sessions without management present and performance evaluations of the board itself and individual directors. These approaches facilitate consensus and enable the board to speak with one voice in dealing with change.

The board's responsibility for management oversight includes evaluating the performance and setting the compensation of management. Senior executives can receive annual bonuses for achieving corporate objectives approved by the board. They are also eligible for long-term incentives that are deferred and paid out after three years. The subsequent payout from the long-term incentive is adjusted by the absolute performance of the CPP Investment Board assets. In fiscal 2003, for example, the accrued incentives for prior years diminished by the same proportion as the decline in the organization's investment returns.



Effective accountability requires experienced directors whose expertise aligns well with the CPP Investment Board's strategic direction. An external nominating committee, appointed by the federal and provincial finance ministers and chaired by an experienced private sector chief executive and corporate director, is responsible for replenishing the board as the terms of members expire. As a result of their efforts we welcomed Germaine Gibara and Ronald Smith to the board late last fiscal year.

On his retirement from the board, I thank Dick Thomson for his enormous contribution as a founding director and Chair of the Human Resources and Compensation Committee. I also thank John MacNaughton, our chief executive officer, for his constructive dialogue with me as Chair and the board during the past year.

A handwritten signature in black ink that reads "Gail Cook-Bennett". The signature is written in a cursive, flowing style.

Gail Cook-Bennett, *Chairperson*

A BOARD WITH BROADLY BASED EXPERTISE

Board of Directors

The process by which directors are appointed is a departure from the traditional practice for crown corporations. An external nominating committee appointed by federal and provincial finance ministers, and chaired by an individual from the private sector, nominates candidates. The federal minister selects candidates from the committee's nominating list in consultation with provincial counterparts.

Chairperson

GAIL COOK-BENNETT
Economist.
Corporate director.
Former professor.



DALE G. PARKER
Corporate director.
Former financial executive.



MARY C. ARNOLD
Chartered accountant.
Management consultant.
Corporate director.



M. JOSEPH REGAN
Retired bank executive.



GERMAINE GIBARA
Chartered financial analyst. Management consultant.
Corporate director.



HELEN SINCLAIR
Financial executive.



GILBERT GILL
Chartered accountant.
Former provincial deputy finance minister.



RONALD SMITH
Chartered accountant.
Chief financial officer.



JACOB LEVI
Actuary.



DAVID WALKER
Business consultant.



HELEN M. MEYER
Chartered business valuator.



For a fuller description of board and committee responsibilities and membership, see governance section on pages 35-38.

PRESIDENT'S REPORT: LONG-TERM INVESTING IN CHALLENGING TIMES



JOHN A. MACNAUGHTON

The year ended March 31, 2003 was difficult for pension fund fiduciaries around the world. Global equity markets continued their punishing slump, producing some of the worst returns in a century, while fixed income markets delivered solid returns, as interest rates fell.

Because a relatively high percentage of Canada Pension Plan assets was invested in fixed income securities, losses were mitigated but not eliminated. The overall consolidated investment loss for the year was approximately \$1.1 billion for a return of minus 1.5 percent, compared with a \$2.3 billion gain in the previous fiscal year for a positive 5.7 percent return.

At March 31, 2003 the assets of the Canada Pension Plan consisted of \$38.1 billion in fixed income securities administered by the Department of Finance in Ottawa and \$17.5 billion in equities and real estate managed by the CPP Investment Board in Toronto.

The fixed income securities, representing approximately 69 percent of total CPP assets, consisted of \$31.0 billion in federal and provincial government bonds and \$7.1 billion in an interest bearing cash deposit. These assets earned \$3.0 billion for a positive return of 8.4 percent, compared with income of \$2.0 billion and 5.0 percent in 2002.

CPP Investment Board assets at March 31, 2003 were 31 percent of CPP assets, consisting of 89 percent public equities, nine percent private equities and two percent real estate. This portfolio lost \$4.1 billion during the year for a negative 21.1 percent return, compared with income of \$316 million and a positive 3.4 percent return in the previous year.

The discouraging equity markets did not distract us from advancing in a variety of areas important to our future:

- Public equities were transferred from pooled and mutual index funds managed by external investment firms to our own segregated account at a new custodian; a trade order management system was selected and is in the process of being installed; and internal cash and derivatives trading capabilities were developed.

How We Invest



- Transition managers were retained to assist us in investing large amounts of cash in domestic and foreign markets with minimal market impact.
- Responsibility for investing our passive public equity portfolio was transferred from external managers to internal management, saving potentially millions of dollars in fees on a sustainable basis each year.

These foundation-building initiatives enable us to undertake different approaches to passive equity management or to mitigate costs and to introduce active management strategies where we identify opportunities to add value.

Other important accomplishments during the year included:

- The documentation of investment beliefs shared by our directors and management as the foundation for consistent and integrated decision making.
- The continued diversification of CPP assets into private equities and the acquisition of our first private real estate investments.
- The preliminary modification of our passive Canadian equity portfolio to include a broader selection of stocks than those listed in the S&P/TSX Composite Index and other index weighting adjustments.
- Development of our proxy voting principles and guidelines, available on our web site at www.cppib.ca. We vote shares in support of resolutions judged likely to increase the long-term value of CPP investments and stimulate disclosure of information relevant to assessing the possible impact of corporate behavior on long-term investment prospects.
- The strengthening of our operational and investment teams with the hiring of nine new professionals and support staff, bringing our human resources to 35 people.

In the year ahead, we will focus on three areas:

First, the CPP bond and cash portfolio is scheduled to be transferred to the stewardship of the CPP Investment Board. This new responsibility will require

How We Invest

some additional staff. It will also influence our investment and organizational strategies as we manage assets to ensure the Canada Pension Plan has access to cash required to meet benefit payments.

Second, identifying and implementing successful active investment strategies is becoming more important as return expectations for both equity and debt markets are lower than the realized returns of the last 20 years of the twentieth century.

Third, the assets we are directly responsible for will quadruple from approximately \$17.5 billion today to almost \$80 billion over the next three years, necessitating our giving ongoing priority to long-term total portfolio design, the development of new benchmarks and risk management, and the continued diversification of the portfolio.

We expect the years ahead to be difficult ones for investors due to the uncertain global economic and geopolitical outlook. We expect market returns below those enjoyed during the 1980s and 1990s. Still, we continue to believe that the investment environment will be constructive for the CPP Investment Board. We will receive substantial cash flows for investment over the next two decades. As a result, we can build and diversify our portfolio steadily and patiently, while remaining focused on the long term. Investing during declining markets requires fortitude. Capital markets history gives us confidence that we are right in staying the course.

I thank our management team and employees for their dedication and hard work. On their behalf, I thank our board of directors for its support and wise counsel as we work together to serve the interests of the 16 million Canadians who are counting on us to help secure the promise of the Canada Pension Plan.

John A. MacNaughton, *President and Chief Executive Officer*