The Role of the CPP Investment Board

CPP INVESTMENT BOARD

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Remarks by

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I am delighted to have this opportunity to talk to you about the role and responsibilities of the Canada Pension Plan Investment Board. And I look forward to responding to any questions you might have at the conclusion of my remarks.

At the outset … to put my comments in context … let me say that the Canada Pension Plan touches virtually all adult Canadians … and is very much part of the distinctive fabric of Canadian society.

For a large number of Canadians it is the cornerstone of their retirement income.

For that reason, decisions regarding contribution rates, benefits, retirement age, survivor entitlements and disability provisions are important to Canadians from coast to coast.

The CPP Investment Board is a new organization that is legally, functionally and even geographically separate from the Canadian Pension Plan itself. But we are part of the CPP world and will be an important funding source for the Canada Pension Plan in the decades to come.

I want to begin today by sharing with you a quick history of the Canada Pension Plan.

Second, I will discuss the mandate of the CPP Investment Board … before exploring the role that we and other pension funds will play as a force of change in Corporate Canada and capital markets.

Finally, I will close by outlining the future direction of the CPP Investment Board, which is entering a period of rapid change and rapid growth.

First, a review of the Canada Pension Plan.

It was created in 1966 as a pay-as-you-go plan. The idea was that each generation would pay the pensions of the previous generation. It was never intended to be a fully funded plan.

That made sense 30 years ago. The number of Canadians over 70 … the retirement age in those days … was small relative to the working population.

Back in the 1960s we had a booming economy … plentiful jobs … and rising wages.

Canadians could afford to be generous to the generation that had endured the hardships of the Great Depression in the 1930s … and the sacrifices of the Second World War in the 1940s.

The Canada Pension Plan was designed to provide all working Canadians with retirement income … as well as financial help to their families in the event the breadwinner died or became disabled.

That made sense, too. In the 1960s many Canadians did not have a pension. Those who did sometimes lost it if their employer went bankrupt.

Few had pension portability among employers. Workers who hated their jobs had to grin and bear it … or lose their pension entitlements if they quit.

By introducing pension portability and a guaranteed retirement income … the Canada Pension Plan accomplished important social change.

All in all, the plan was a great idea. It delivered full coverage, portable benefits, inflation protection and the major source of income for many seniors. And substantially more money came in to the plan each year than went out.

Let’s fast forward 30 years to the mid-90s.

By 1996, more than 10 million Canadians were contributors, paying $11 billion in CPP contributions … while 3.5 million Canadians were beneficiaries drawing close to $17 billion in benefits … for a deficit of $6 billion in that year alone.

Clearly more money was going out than was coming in.

Several factors caused the imbalance … and the plan was headed for serious trouble.

If something wasn’t done quickly either contributions would have to go up substantially or the plan reserve would be exhausted by 2015. The burden on future generations would be enormous.

This impending crisis sparked an extensive review by Federal and provincial governments … which led to fundamental change in 1997.

It was decided to put the Canada Pension Plan on a firmer financial footing by increasing contribution rates and improving plan administration. As a result, the plan will move over the next 20 years from exclusively pay-as-you-go to fuller funding.

According to the last federal actuarial report … at the end of 1997 … the plan’s assets of $36 billion represented about 8 percent of liabilities. Under the new funding formula … assets will eventually reach 20 percent of liabilities … a big step back from the edge of the fiscal abyss.

Let me turn now to my second topic – the CPP Investment Board which itself is an outgrowth of the process of review and change referred to a moment ago.

It was created by an Act of Parliament to manage the Canada Pension Plan's reserve assets … and commenced operations in October, 1998. We are independent of the Canada Pension Plan … which is administered by various federal departments.

Both the federal and provincial governments are responsible for setting CPP contribution rates and determining benefits … although Ottawa collects contributions and pays entitlements.

The CPP Investment Board has one job -- to invest funds received from the Canada Pension Plan. By increasing the long-term value of these assets … we will ultimately help the plan to meet its pension obligations.

In essence, we are an investment company building a diversified portfolio of assets.

But just what is our investment mandate?

Our legislation sets two clear objectives: First, to manage the assets entrusted to us in the best interests of the Canada Pension Plan's contributors and beneficiaries … and second, to maximize investment returns without incurring undue risk.

The key decision affecting long-term investment returns is the allocation of funds between equities and fixed-income securities … that is, principally between stocks and bonds.

In developing our asset mix policy, we consider the existing assets in the Canada Pension Plan. These are fixed-income securities, mostly bonds, and are managed by the Department of Finance.

To offset the dominance of these fixed-income securities … and to diversify the asset base … we are investing 100 percent of cash flows in equities.

At present, at least 80 percent is going into the Toronto Stock Exchange 300 Composite Index … which consists of Canada's leading public companies in technology, financial services … manufacturing … retailing … telecommunications and the resource industries.

The remaining 20 percent flows to two foreign stock index funds. One contains 500 large public companies in the U.S. … and the other about 1,000 companies in Europe, Asia and Australasia.

To date, we have received more than $3 billion from the Canada Pension Plan and put it to work in equity markets domestically and internationally.

About 90 percent of the combined assets of the Canada Pension Plan and the Investment Board are now fixed-income securities and only ten percent are equities. Clearly we have a long way to go before we achieve a reasonable asset mix.

According to a projection last December by the federal government, the CPP Investment Board will receive between $70 billion and $90 billion from the Canada Pension Plan by the end of 2007. We expect to have $100 billion within the decade.

This will position us as one of the largest institutional investors in Canada and an important investor on the global stage.

Which brings me to my third topic – the role we … and other pension funds for that matter … will play as a force in Corporate Canada and capital markets.

When I look back to the early years of my career as an investment dealer in the 1960s and 1970s … way back in the 20th century … public sector pension funds were invisible.

And with good reason. Governments required them to invest a large portion of their contributions in non-marketable government debt, often of the sponsoring government. In fact, many public sector funds had no choice but to invest in government debt.

One of the first fund managers to pursue a diversified mandate was Quebec's Caisse de dépôt et placement in 1966 … followed by OMERS, the Ontario municipal employees fund, in 1974.

But the institutionalization of pension capital had not happened to any serious extent by the 1970s. Private mutual fund companies and corporate pension funds were much more visible as pools of investment capital.

The big rush to pension fund capitalism occurred in the 1990s. Today, all provincial public sector funds … as well as virtually all federal funds … invest in domestic publicly traded stocks and bonds. As well, some have reputations as merchant bankers … or owners of large income-property portfolios … or as derivative traders. Several are prominent in international markets.

The migration of public sector pension assets to capital markets was completed just this month when the four remaining federal funds started to invest their members' contributions.

The new Public Sector Pension Investment Board will invest on behalf of the federal civil service, the RCMP and the Armed Forces … while Canada Post will invest its own pension assets.

Together … these four funds will invest about $3 billion a year in capital markets.

So the Canada Pension Plan Investment Board is very much part of a trend that has been underway for some time.

Pension assets have grown rapidly during the boom markets of the 1990s.

The top 100 Canadian funds have combined assets in the order of $500 billion … and the majority of them are public sector plans. Together, the public sector funds are responsible for approximately 80 percent of total assets.

Of the 10 largest funds … eight are public sector … each with more than $10 billion in assets.

Within just a few years … probably all 10 largest investment accounts in Canada will be public sector pension funds. The CPP Investment Board will be among them.

Pension funds are growing in more than size. As leading owners of Corporate Canada, they are also growing in influence.

For public companies the good news in this development is that it inextricably aligns the retirement income of Canadians with the financial well-being of the private sector. The better Canadian firms perform financially over the long term… the better off Canadians will be in their retirement years.

The bad news … at least for some … may be that these funds are becoming increasingly active as shareholders. The reason why is simple.

Pension funds are investing billions upon billions of dollars in a relatively small number of public and private companies in Canada. They have little flexibility to liquidate their holdings if they are unhappy with a company's performance.

The sometimes dismissive suggestion to shareholders that … "If you don't like the way we run the company, sell your shares" … is not actionable advice.

That is why most large pension funds … including public sector funds … take a keen interest in the governance practices of directors … and the commitment of management to enhancing shareholder value.

For our part … in exercising our voting rights … we will act sensibly, responsibly and with a long-term view.

Happily we do not have to be pre-occupied with the quarterly performance sweepstakes. We are long-term investors. In fact, for us the longer the better.

So to summarize … pension funds will be a force for continuing change in Corporate Canada and our capital markets … and I believe a positive one.

Let me turn now to my final topic -- the future direction of the CPP Investment Board.

I joined the Board last September … and soon after hired a vice-president of finance and operations. At this point, we are the only two members of the executive team.

But that is going to change over the next few months.

Our vision is to build a virtual corporation with a very small team of senior professionals.

This team will develop our longer-term investment strategies and retain outstanding external capabilities to implement those strategies through a series of partner-like relationships.

Of course, retaining external expertise may not always be the best course available to us. We will build staff resources where equal or better performance can be achieved at lower cost.

We don't need a big organization. A small one can be focused … have access to the best talents available at home and abroad … have the flexibility to respond to the rapidly changing global marketplace and economy … and, in all this, serve the public interest by being cost effective.

When I say a small team, I actually mean five very senior people reporting to me. We began the process of recruiting this team last week when we advertised for four Vice Presidents – one each to be responsible for Research and Risk Management, Public Market Investments, Private Market Investments and Communications and Stakeholder Relations. The response, I am happy to say, has been very strong.

Once selected these four new professionals will join me and our Vice President – Finance and Operations, and together we will develop a full menu of investmentopportunities.

In the future, we will look at the benefits of investing in private companies, merchant banking opportunities, infrastructure projects, venture capital initiatives, financial

contracts, income-generating real estate, and government and corporate debt securities.

In other words, we will consider the range of investments available to other investors.

Another important element of our new organization is communications with all stakeholders.

Canadians from coast to coast have a direct financial interest in how we manage the assets entrusted to us.

They have a right to know what we are doing with their money. And they will.

We are required to publish an annual report and … most unusual for a pension fund … quarterly reports as well.

And we are required to hold a public meeting at least once every two years in every province. We will hold all 10 meetings within the next 12 months.

On top of all that, we are communicating through the news media, our Web site, and speeches such as this one to your Rotary Club.

As I said earlier, we have a statutory obligation to maximize investment returns without undue risk of loss.

We know the public will want to hear from us and will scrutinize our performance intensely … so we will measure our performance in several ways against external benchmarks and publish the results for all to see.

I hope my remarks have helped you to better understand the role of the CPP Investment Board.

Our role is a complex and demanding one, and we are operating in a fish bowl. But I believe that we are embarked on a noble quest – to help deliver the pension promise and thereby make retirement more comfortable and secure for the millions of Canadian who are counting on us.

I am seized by the challenge and am delighted to be here today to tell you about the important work we have undertaken.

Thank you for the invitation to be with you this afternoon. I now look forward to your comments and questions.