CPP INVESTMENT BOARD

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Remarks

by

John A. MacNaughton

President and Chief Executive Officer

Canada Pension Plan Investment Board

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Let me tell you a little bit about the CPP Investment Board, where we are, where we are going and how real estate fits into our plans. And then I will look forward to your questions.

As employers and employees, you are all familiar with the Canada Pension Plan. It is one of our nation's most important social security programs.

It is especially important to the millions of Canadians who will not earn enough during their working years to save and invest for a comfortable retirement.

The Canada Pension Plan was created in 1966 as a pay as you go plan. That is one designed so that the contributions of current workers and their employers paid the pensions of retired workers.

Unfortunately by the mid-1990s, the plan had lost its financial footing. More money was flowing out to pay benefits than was flowing in from contributions.

There was more trouble ahead. Canada was going through a dramatic demographic shift.

The baby boom generation was marching relentlessly toward retirement, starting in large numbers around 2011.

The chief actuary estimated in 1995 that the plan reserve would be exhausted by 2015. Future generations would have to pay more than 14 percent of their contributory earnings to keep up with the needs of retired Canadians.

To put it mildly, the financial burden on future generations would have been intolerable.

The impending crisis sparked an extensive review of the Canada Pension Plan and that led to changes in 1997.

One change was an increase in CPP contribution rates from 6 percent to 9.9 percent by January 1 next year.

According to the chief actuary, contributions will now exceed benefit payments until 2021 … enabling the plan to build up reserves.

A second major change was the decision the federal and provincial finance ministers made on how those accumulating reserves should be managed. They decided that they should be invested in capital markets. To do that, they created an arm's length Crown corporation staffed by investment professionals to make the investment decisions.

That is how the CPP Investment Board came into existence in October 1998, to invest excess CPP funds until they are required to pay future benefits.

By last June, we were managing $17 billion in assets.

Our internal team of experienced investment, finance and operations professionals keeps our costs under control by retaining outside specialists to implement our investment and operating strategies. This means we leverage the expertise already in the marketplace rather than duplicating it ourselves.

By the way, we are and plan to remain a lean and focused organization. Last fiscal year, we spent $11.4 million on our operations, about 10 basis points on average assets under administration for the period.

Our $17 billion in assets is invested solely in equities for two reasons. One is to balance the existing large CPP government fixed income portfolio. The second is because we believe that equities will outperform bonds over the long term.

Legislation currently before Parliament will result in the transfer of remaining CPP assets to our management starting next year. These assets consist of $7 billion in cash and about $33 billion in bonds.

All this adds up to about $56 billion in CPP assets that will be under our management. Within 10 years, however, those assets are expected to almost triple to exceed $160 billion. By then, we will likely be the largest institutional investor in Canada.

So what are we doing with all this money?

In our first three years, we invested passively in public equities through externally managed funds. These funds replicated well-known stock indexes in Canada, the United States and outside North America. We have recently completed the transfer of the underlying securities to our own segregated account and soon we will be managing a passive portfolio of our own design internally.

We are now in the early stages of implementing a more active equity investment strategy as well as a strategy for the government bond portfolio.

For example, early next year we will select investment firms to actively manage portions of our passive portfolio to add value above the returns that the markets will produce.

Part of our active investment program involves private equity which we expect to outperform public equity over the long term. Our target is to invest as much as 10 per cent of total assets in private equity.

Since initiating this program in June 2001, we have committed over $4 billion to venture capital and buyout funds. In the program's first year, about half a billion dollars had been drawn down for investment.

We are also looking for opportunities to invest in income-producing real estate and infrastructure assets. Our target is to invest as much as five percent of total assets in these opportunities.

We are taking our time in developing our real estate portfolio. In our general view income producing properties are overvalued. As a result, while we believe that real estate as an asset class could play a useful long term role in our portfolio, we are in no hurry to acquire real estate.

The CPP Investment Board is a cash-rich investor. We will have $6 billion to $8 billion of new cash to invest every year. We are ideally situated to provide liquidity to an illiquid market segment. Consequently, we can afford to be patient and opportunistic at the same time.

So far, our real estate exposure is through public equities where we believe valuations reflect discounts to direct property ownership. Our most conspicuous investment is our 29 percent ownership of Trizec Canada which translates into 10 percent of Trizec Properties.

Over time, we will consider all forms of exposure to real estate: direct ownership, limited partnerships, co-investments, joint ventures and REITs - in office, multi-residential, industrial and retail properties.

Because of the foreign property rule our preference is to invest in Canadian real estate, although we are also interested in opportunities in the United States and Western Europe.

As you have gathered from my remarks, the CPP Investment Board will be rapidly emerging as a major investor. We are fortunate to have both substantial positive cash flow and at least 20 years before we have to pay income to the Canada Pension Plan to help pay pension benefits.

Consequently, we will be a patient investor. With our eye on the long-term, we can afford to pace ourselves in building a diversified asset base at attractive prices.

Overtime real estate will play an important role in our portfolio. So we look forward to attending your future conferences, not only as an invited speaker but as an industry participant.

Thank you. I look forward to your questions.