



# CPP INVESTMENT BOARD

1999 Annual Report  
Canada Pension Plan Investment Board

For the six-month period ended March 31, 1999

Report from the Chair	2
Board Mandate and Governance	5
Management Discussion and Analysis	13
Financial Review	21
Corporate Information	32

## Corporate Profile

The role of the Canada Pension Plan Investment Board is to increase the long-term value of Canada Pension Plan (CPP) assets through prudent participation in capital markets. In this way, the Investment Board will help the plan to keep its long-term pension promise to Canadians.

The Investment Board receives funds not required by the CPP to pay current pensions. The first transfer of funds occurred in March 1999 and the Board had \$12 million in investment assets at March 31, 1999. The federal government has projected that assets should grow to \$88 billion by 2008, based on the Board receiving approximately \$66 billion of CPP funds over the next 10 years.

The Investment Board is governed by a 12-member board of directors with extensive business, investment, financial and professional expertise, and is managed independently of the Canada Pension Plan.

The Canada Pension Plan itself is administered by the federal government, which collects contributions and pays pensions. The federal government sets contribution rates and benefit levels in conjunction with the provincial governments.

## Report from the Chair



The directors of the CPP Investment Board are privileged to have the opportunity to create an investment organization that will be of vital importance to Canadians in the decades ahead by helping to sustain the financial viability of the Canada Pension Plan. We hope this first annual report reflects the care taken in laying the foundation for this new venture.

The 12 founding directors of the CPP Investment Board met for the first time on November 18, 1998 to implement the legal framework for the new organization. Subsequently, the board of directors formulated governance procedures, outlined investment policies, examined approaches to communications, developed procurement guidelines and selected external fund managers to handle the first cash flow projected to arrive by March 1, 1999.

### Integrity and Independence

The corporate governance practices, code of conduct, and conflict of interest guidelines formulated by the directors are all designed to set high standards of performance, disclosure and ethical behaviour.

The Investment Board operates independently from the Canada Pension Plan under legislation that gives the responsibility for investment decisions to the Investment Board. Our focus is on CPP contributors and beneficiaries whose interests will be served by maximizing the investment returns on funds transferred to the Investment Board by the pension plan without putting the money at undue risk.

### Initial Investments

An early decision was the determination of the asset mix between equities (such as the shares of publicly traded companies) and fixed-income securities (such as bonds).

In setting the asset mix, the Investment Board is required to take into consideration federal and provincial government bonds that constitute most of the pension plan's assets. The bond portfolio is administered by the federal Department of Finance. Starting with these fixed-income assets, the goal, under the current investment policy, is to diversify the asset mix by investing all new cash flows in equities.

Initiating exposure to public capital markets and shifting the assets from all bonds to a mix of bonds and equities are important changes for the Canada Pension Plan. We are proceeding carefully in implementing this policy. Currently, federal regulation restricts the Investment Board in the short term to substantially replicating broad market indices for Canadian equity investments. This is an efficient and low-cost way to build broad equity exposure quickly. This policy will be reassessed, with a recommendation from the Investment Board, as part of the current triennial review of the Canada Pension Plan by the federal and provincial governments.

The shift to equities includes investments outside Canada, where the Investment Board has chosen to invest in stock index funds.

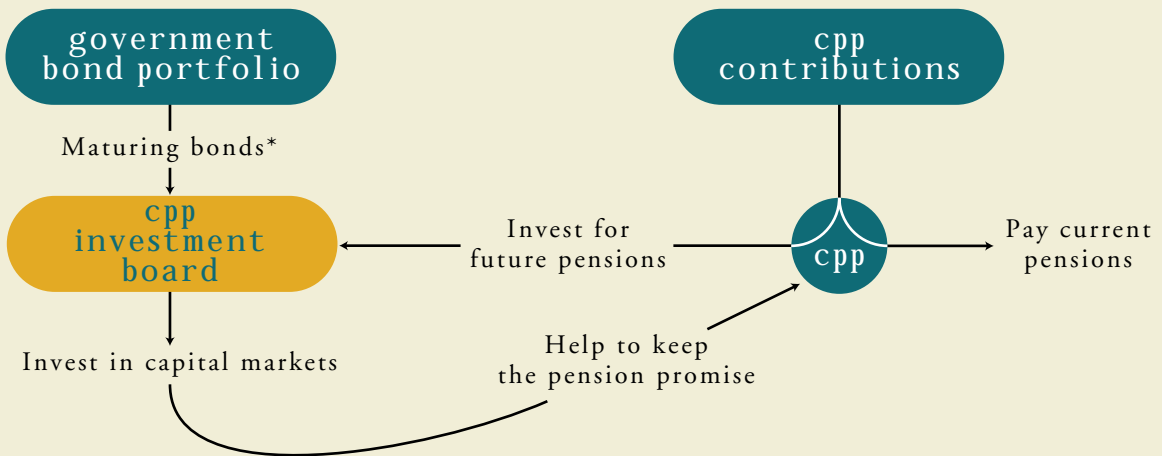
To implement the strategy, a fund manager was retained to replicate The Toronto Stock Exchange 300 Index and a second fund manager was retained to replicate the Standard & Poor's 500 Index in the

United States and the EAFE (Europe, Australia and New Zealand, and Far East) Index overseas. The TSE 300 Index contains the shares of large Canadian companies in sectors such as financial services, consumer goods, resources, and telecommunications. The S&P 500 Index is a broad cross-section of large U.S. companies, while the EAFE Index consists of about 1,000 leading enterprises in Europe, Australia, New Zealand, and the Far East. At least 80% of new cash is being invested in the TSE 300 fund and up to 20% in foreign indices.

The portfolios will approximate the returns of Canadian and foreign stock markets. In the short term, these markets could fluctuate widely and even turn negative. Over the long term, based on market history, they should exceed fixed-income returns, including federal and provincial bonds.

The asset mix and interim policy of investing 100% of cash flows in stock index funds mean that our investment performance may not be comparable to other large Canadian pension funds.

sources of cash flow



\*Bonds not required to pay current pensions and not renewed.

### Board Staffing and Expenses

The board of directors made the deliberate decision to maintain organizational flexibility until the Chief Executive Officer is recruited. Accordingly, we retained outside advisors, and employed contract staff to lead the transition team, act as Director of Finance and Operations, and develop monitoring and accounting procedures for investments. These activities involved the directors more than would have been the case if a permanent management team had been in place from the beginning.

At the request of the federal and provincial governments, and with the consent of the board, I discharged the responsibilities of the Chief Executive Officer during the start-up period. A special board committee is conducting the search for a permanent CEO and expects to announce its decision later this year.

Operating expenses were approximately \$1 million for professional and consulting fees, directors' fees and expenses, staff salaries and benefits, and office facilities.

## Communicating with Canadians

A large part of the Investment Board's responsibility is communication with stakeholders, and we have begun by issuing two quarterly reports and this annual report. The annual report is being distributed to major libraries, as well as federal, provincial and territorial governments. Future distribution will be reviewed based on the first year's experience.

The annual report will be published on the CPP Investment Board's Web site at [www.cppib.ca](http://www.cppib.ca) in June. Investment policies, code of conduct, quarterly financial statements and other basic information, along with answers to frequently asked questions, will also appear on the Web site.

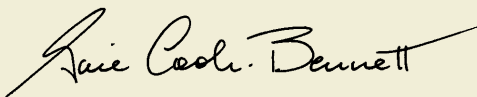
The board will hold public meetings in each participating province once every two years to discuss the most recent annual report and give Canadians an opportunity to comment. The first public meeting will be initiated after the CEO has been appointed and has become established.

## Outlook

The Investment Board's goal is to increase the value of CPP assets to help to cover the cost of future pensions, recognizing that the CPP pension is the basic retirement income for many people. The focus is long term to ensure the best returns possible are obtained for Canadians, consistent with prudent capital management.

## Acknowledgements

The officials in the Department of Finance were instrumental in ensuring an orderly transfer of responsibilities to the board; the Director, Transition Team, provided expertise and assistance which proved invaluable to our start-up; and the directors were productive and enthusiastic participants in the wide range of decisions required of a new organization. To all of them – a sincere thank you.



Gail Cook-Bennett  
Chairperson

# Board Mandate and Governance

Appointment of Directors

Separation of Board Chair and CEO

The Value of Corporate Governance

Role and Duties of Directors

Board Committees

Code of Conduct

Conflicts of Interest

Director and Management Compensation

Role and Duties of Management

Public Accountability

## Board Mandate and Governance



In 1996 the federal, provincial and territorial governments agreed on the need for a new Canada Pension Plan investment policy. This agreement, based on public consultation, ultimately gave birth to the CPP Investment Board. Its mandate is spelled out in the *Canada Pension Plan Investment Board Act* and regulations.

### Appointment of Directors

The federal and provincial governments created a special nominating committee to identify and recommend individuals with the expertise, experience and impartiality appropriate to overseeing the Investment Board's formation, management and performance. The committee consisted of business executives and government officials representing each province, with a private sector executive in the chair.

The federal Minister of Finance selected candidates from the nominating committee's list and, in consultation with provincial finance ministers, appointed 12 directors in October 1998. The Chair was appointed in consultation with the provinces and the directors.

The board has extensive investment, financial, business and professional expertise, and represents all regions of Canada. Brief director biographies appear on pages 10, 11 and 12.

In future, the board of directors plans to recommend criteria to the Minister of Finance for consideration in filling board vacancies.

The founding directors are appointed for up to a three-year term and are eligible for reappointment by the Minister of Finance for an unspecified number of terms.

### Separation of Board Chair and CEO

The positions of Board Chair and Chief Executive Officer are separate, with the Chair responsible for leading the board of directors and the CEO for leading management. Under legislation, the Chair cannot serve as an officer of the Investment Board, and the CEO cannot serve on the board of directors.

When the CEO is hired, the board will finalize terms of reference for the Chair in relation to the role and responsibilities of the CEO.

### The Value of Corporate Governance

The directors have formulated corporate governance policies and practices consistent with legislated requirements and the guidelines of the Toronto and Montreal stock exchanges for public companies.

Corporate governance focuses on:

- the *board of directors*, which represents the stakeholders, sets policies and oversees the management;
- *management*, which implements the policies set by the directors, develops the operating strategy, annual business plan and budgets, and manages the day-to-day business; and
- *stakeholders*, who are primarily CPP contributors and beneficiaries.

The governance process defines and clarifies these relationships – including roles, responsibilities, control mechanisms, reporting and accountability. The result is an emphasis on delivering value to stakeholders by increasing the long-term value of pension assets.



## Role and Duties of Directors

The board of directors accepts responsibility for the stewardship of the Investment Board and supervising management.

As fiduciaries, directors are required to act honestly and in good faith with a view to the best interests of the Investment Board. They must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Directors must use their specialist knowledge in carrying out their duties. Directors with accounting, actuarial, investment, business or legal expertise, for example, are subject to higher standards of care in areas that relate to their expertise.

Among other duties, the directors are responsible for:

- investment policies, standards and procedures;
- appointing an independent auditor;
- procedures to identify and resolve conflicts of interest;
- a code of conduct for directors, officers and employees;
- monitoring management, including decisions requiring prior board approval, and assessing management's performance;
- assessing the performance of the board itself; and
- stakeholder communications, including financial statements.

The board of directors has adopted corporate governance guidelines, a code of conduct, and conflict of interest guidelines developed with the assistance of an external advisor. It will complete a summary of the corporate governance process in a working document and develop annual performance evaluations for the Chief Executive Officer and the board of directors, as well as processes for strategic planning and succession planning.

## Board Committees

The board created four committees, two of which (the investment and audit committees) are required under the CPP Investment Board Act and two of which advance corporate governance and operating objectives.

The *investment committee* establishes investment policies, standards and procedures; and will review and approve management's annual investment plan and monitor its effectiveness. It will also review the investment risk management approach and approve the engagement of external fund managers and asset custodians. The committee consists of the full board.

The *audit committee* is responsible for overseeing financial reporting, the external and internal audit, information systems, internal control policies and practices. Responsibility for risk management is shared with the board of directors. The committee has four members.

The *human resources and compensation committee* will be responsible for reviewing and recommending the compensation philosophy for the Investment Board, recommending the performance evaluation process for the Chief Executive Officer, ensuring a succession planning program is in place, and reviewing organizational structure. The committee has three members.

The *governance committee* recommends governance policy, guidelines and procedures; makes recommendations on the board's effectiveness; monitors application of the code of conduct and conflict of interest guidelines; and assumes other duties at the board's request. The committee has five members.

The board formed ad hoc committees at the request of the Chair to address issues requiring immediate decisions, such as the hiring of an investment advisor to identify, screen and short-list qualified fund managers. During this process, directors previously associated with companies on the short list were excluded from board discussions.

## Code of Conduct

The code of conduct is designed to create a corporate culture of trust, honesty and integrity. When there is doubt that is not addressed by written policies, situations are to be tested against questions such as – is it in the best interests of the Investment Board, and therefore CPP beneficiaries and contributors, and will it meet or exceed the standard of behaviour expected by the Canadian public?

Among the requirements of propriety, the code states that directors and members of their immediate families should not accept entertainment, gifts or favours that create or appear to create a favoured position for contractors or suppliers doing business with the Investment Board. Directors must notify the Chair before accepting a directorship or any position of authority in an entity that might benefit from, or be in conflict with, the Investment Board.

## Conflicts of Interest

Because the board requires directors with financial and investment expertise, conflicts of interest must be expected from time to time and managed appropriately. Conflicts are most likely to arise because directors serve on the boards of companies in which the Investment Board owns shares.

The Investment Board's legislation sets conflict-of-interest provisions that are even stronger than those found in the *Canada Business Corporations Act* and the *Bank Act*. Specifically directors are required to:

- make timely disclosure of any investment transactions, and not just material transactions, between the Investment Board and entities in which they have a material interest;
- abstain from voting on resolutions concerning transactions in which they have a material interest; and
- abstain from participating in discussions about transactions in which they have a material interest.

Conflicts of interest must be disclosed in writing and entered into the minutes of board or committee meetings.

## Director and Management Compensation

A consulting firm was retained to advise on board compensation and recommended fees based on the median compensation for directors of TSE 300 companies. Directors are paid an annual retainer of \$12,000 plus \$900 for each board or committee meeting attended. However, separate fees are not paid for investment committee meetings when they are held on the same day as board meetings, which is the expected schedule. Committee chairs are paid an additional \$3,000 annual retainer.

The board met six times between November 1998 and March 1999. The investment committee met five times, the audit and governance committees twice each, and the human resources and compensation committee once. Directors also attended numerous CEO search and ad hoc committee meetings to address key start-up issues. Director compensation for meetings, including retainers, totalled \$168,550.

As an interim arrangement during the start-up period, Board Chair Gail Cook-Bennett discharged the responsibilities of the chief executive at the request of the federal and provincial governments, and with the consent of the board. She earned total compensation of \$135,000 in that capacity from October 1, 1998 to March 31, 1999. Dr. Cook-Bennett received no additional compensation as Chair or as a director.

When senior staff are hired, the board of directors will develop appropriate compensation-for-performance targets, and the compensation of the top five officers will be disclosed in the annual report.

## Role and Duties of Management

Under the leadership of the CEO, management will be responsible for developing a strategic plan for review and approval by the board of directors. Management will be accountable for its performance through the CEO to the board of directors.

The Investment Board had no permanent staff in fiscal 1999. When the CEO is hired, management's responsibilities will be defined further, including spending and investment limits that do not require prior board approval.

## Public Accountability

The Investment Board's governing legislation imposes rigorous accountability, including a transparent investment policy, a detailed annual report that must be publicly available, quarterly reports, and public meetings at least once every two years in each participating province.

In addition, the federal Minister of Finance can order a special audit at any time, and must initiate a special examination of the Investment Board's systems and practices at least once every six years.

As part of its accountability, the Investment Board is required to publish in the annual report its success in reaching the prior year's investment objectives and the objectives for the next year and the foreseeable future. The objectives for the year 2000 are to recruit the Chief Executive Officer; to invest more than \$1 billion of new cash flow in Canadian and foreign equities; to develop comprehensive longer-term investment and operating strategies; to keep stakeholders informed through quarterly reports, the annual report and a Web site, and to plan public meetings for each participating province; to further advance corporate governance policies by adding performance evaluation processes for the CEO and board of directors, as well as processes for strategic planning and succession planning.

## The Board of Directors



Gail Cook-Bennett



Mary C. Arnold



Susan C.E. Carnell



Gerard V. La Forest

### **Gail Cook-Bennett**, *Ontario*

Economist; Chairperson of the CPP Investment Board. Held academic positions at University of Toronto and senior executive positions at Bennecon Ltd. and the C.D. Howe Institute, Montreal. Director of Cadillac Fairview, Enbridge Consumers Gas Company, Groupe Transcontinental G.T.C. Ltée, Mackenzie Financial Corporation, The Manufacturers' Life Insurance Company, and Petro-Canada. (Former director of the Ontario Teachers' Pension Plan Board.)

### **Mary C. Arnold**, *Alberta*

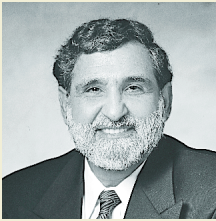
Chartered accountant; senior member of Arnold Consulting Group Ltd., management consultants, Edmonton. Director of Atomic Energy of Canada, EPCOR, Alberta Credit Union Deposit Guarantee Corporation, Edmonton Community Foundation, and Alberta Performing Arts Stabilization Fund.

### **Susan C.E. Carnell**, *Ontario*

Economist, retired. Held senior positions in the investment and financial services sector, including chief economist with Richardson Greenshields of Canada and economist at Royal Trust Corporation and Conference Board of Canada.

### **Gerard V. La Forest**, *New Brunswick*

Counsel at Stewart, McKelvey, Sterling, Scales. Following career in legal practice and academe, served on New Brunswick Court of Appeal and Supreme Court of Canada. Consultant to and member of federal and provincial government task forces and royal commissions.



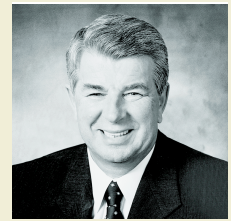
Jacob Levi



Richard W. McAloney



Helen M. Meyer



Pierre Michaud

**Jacob Levi**, *British Columbia*

Actuary; partner in Eckler Partners, actuarial consultants. Serves as external actuary to public sector pension plans and Workers' Compensation Board of British Columbia. Former chairman of the workers' compensation committee of Canadian Institute of Actuaries and member of B.C. executive of Canadian Pension and Benefits Institute.

**Richard W. McAloney**, *Nova Scotia*

Chartered Financial Analyst and chartered accountant; CEO of Nova Scotia Association of Health Organizations Pension Plan. Served in senior investment, pension and treasury positions with Nova Scotia Department of Finance. Past director of several boards, including Pension Investment Association of Canada.

**Helen M. Meyer**, *Ontario*

Financial executive; president of Meyer Corporate Valuations Limited. Served in senior corporate finance positions with Merrill Lynch Canada, Morgan Bank of Canada and Dominion Securities Limited. Commissioner with Ontario Securities Commission, governor of the Cundill Funds.

**Pierre Michaud**, *Quebec*

Chairman of Réno-Dépôt Inc. and Provigo Inc. Director of Castorama S.A. of France, Capital d'Amérique (subsidiary of Caisse du Dépôt et Placement du Québec), Laurentian Bank of Canada, Loblaw Companies, Old Port of Montréal Corporation, and Montreal Expos. Active in non-profit and charitable organizations.



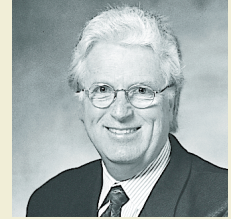
Dale G. Parker



M. Joseph Regan



Richard M. Thomson



David Walker

### **Dale G. Parker**, *British Columbia*

Corporate director. Former CEO of British Columbia Financial Institutions Commission, Bank of British Columbia, and Workers' Compensation Board of British Columbia. Director of Talisman Energy, North West Life Insurance Company of Canada, North West Life Insurance Company of America, and Agro Pacific Industries. Active in charitable and non-profit organizations.

### **M. Joseph Regan**, *Ontario*

Bank executive, retired. Spent 40 years with Royal Bank of Canada, ultimately as senior executive vice president for strategic initiatives. Former Chair of Pension Commission of Ontario. Served as director of Canada Pension Plan Advisory Board and Ontario Pension Board. Currently director of Bank of Tokyo – Mitsubishi (Canada) and High Liner Foods.

### **Richard M. Thomson**, *Ontario*

Bank executive, retired. Former chairman and CEO of Toronto Dominion Bank. Director of Canadian Occidental Petroleum, CGC Inc., INCO, S.C. Johnson & Son, Prudential Insurance Company of America, The Thomson Corporation, Toronto Dominion Bank, TrizecHahn, and Hospital for Sick Children Foundation.

### **David Walker**, *Manitoba*

President of West-Can Consultants Ltd. Former professor of political science, Member of Parliament for Winnipeg South, and Parliamentary Secretary to Minister of Finance. Chief federal representative for federal, provincial and territorial consultations on the Canada Pension Plan. Director of Fulbright Foundation, St. Boniface Hospital and Manitoba Theatre Centre.