



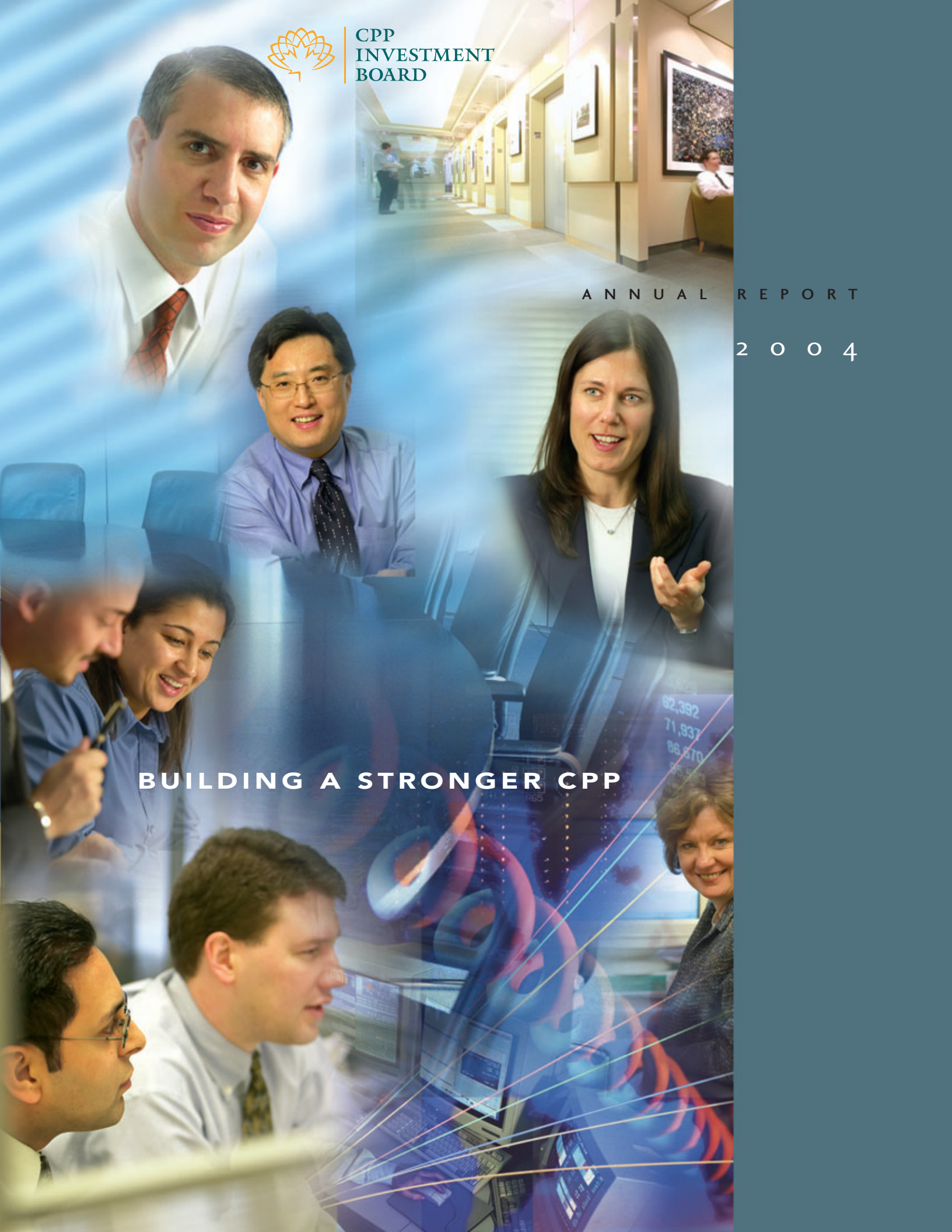
CPP  
INVESTMENT  
BOARD



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

2 0 0 4

**BUILDING A STRONGER CPP**



WEBSITE: WWW.CPPIB.CA

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 (CPP) by investing in the best interests of 16 million CPP contributors and beneficiaries and by maximizing returns without undue risk.

The CPP Investment Board invests in capital markets the funds not needed by the CPP 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 cash flows in publicly traded stocks, private equities, real estate and infrastructure 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 CPP, 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 CPP and at arm’s length from governments, but is accountable to Parliament and Canadians.

For more information on the CPP Investment Board, visit our website at [www.cppib.ca](http://www.cppib.ca).

- Meet Our Team
- Our Governance
- Our Policies
- Canada Pension Plan
- Our History
- Our Legislation
- Our Regulations
- Our Challenge
- Considerations
- Return Expectations
- Risk Management
- Public Market Investments
- Our Current Public Market Investments Strategy
- Private Market Investments
- Our Private Equity Partners
- Measuring Performance
- Social Investing
- Proxy Voting
- Partnering Opportunities
- Results
- Holdings
- News Releases
- Quarterly Reports
- FAQs
- Public Meetings
- Annual Reports

T A B L E O F C O N T E N T S

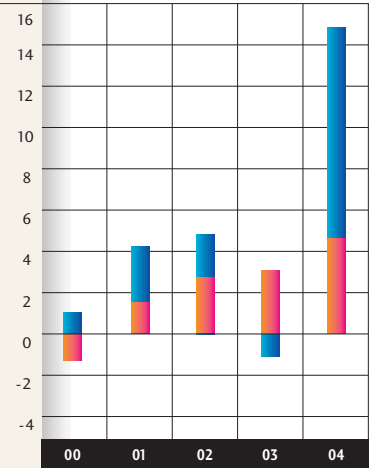
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FINANCIAL HIGHLIGHTS

RESULTS

for the fiscal year ended March 31

**Net Contributions & Investment Income (\$billions)**  
Fiscal year ending March 31



● Investment Income  
● Net Contributions

<b>FINANCIAL OVERVIEW</b> (\$ billions)	<b>2004</b>	<b>2003</b>
Assets	<b>\$ 70.5</b>	\$ 55.6
Net Contributions	<b>4.6</b>	3.1
Investment Income	<b>10.3</b>	(1.1)

<b>INVESTMENT PERFORMANCE</b> rate of return on investments (%)	<b>2004</b>	<b>2003</b>
Annual	<b>17.6</b>	(1.5)
Long-term goal of 4% (plus inflation)	<b>4.7</b>	8.5

<b>ASSETS</b>	<b>2004</b>		<b>2003</b>	
	(\$ billions)	(% of total)	(\$ billions)	(% of total)
Bonds	<b>30.2</b>	<b>42.9%</b>	31.0	55.8%
Publicly traded stocks	<b>30.1</b>	<b>42.7%</b>	15.6	28.0%
Private equities	<b>1.8</b>	<b>2.5%</b>	1.5	2.7%
Real estate and infrastructure	<b>0.7</b>	<b>1.0%</b>	0.3	0.6%
Cash	<b>7.5</b>	<b>10.6%</b>	7.1	12.8%
Money market securities	<b>0.2</b>	<b>0.3%</b>	0.1	0.1%
	<b>\$ 70.5</b>	<b>100.0%</b>	\$ 55.6	100.0%



## BUILDING ON OUR APPROACH TO GOVERNANCE

Governance of public and private corporations continues to stir widespread debate. As a Crown corporation investing billions of dollars on behalf of Canadians, the CPP Investment Board must be bold in ensuring the organization's integrity and credibility in a world of challenging investment markets and evolving governance expectations.

The CPP Investment Board's success depends on the expertise, professionalism and focus of our management and employees operating within a culture of integrity and transparency. This annual report focuses on their accomplishments. The governance of the organization begins with the modern governance model defined in our act, which is then overlaid by policy and practices that permit directors to conduct their oversight of management.

The CPP Investment Board's governance model was designed by the federal and provincial governments to balance the responsibilities of operating at arm's length from governments (as an investment company competing in the private sector) with accountability to Parliament, the provinces and the public (as one would expect from a Crown corporation). Public opinion research confirms that Canadians understand the importance of pairing the arm's length relationship with considerable transparency.

The delicacy of balancing responsibilities and accountability is reflected throughout the CPP Investment Board. One example is that commercial and proprietary information belonging to third parties with whom we do business must be kept confidential. And yet, through a proactive disclosure policy, the organization shares a great deal of information on our policies, procedures, investment philosophy, strategies, performance, assets under management and many other details. We believe this level of disclosure is unmatched by any Crown corporation or pension fund in Canada.

The decision to build a governance model that balances responsibilities and accountability was the outcome of consultation among the federal



GAIL COOK-BENNETT

## BUILDING ON OUR APPROACH TO GOVERNANCE


and provincial governments and the public in 1997. Since then, federal and provincial finance ministers have reviewed our governance on at least three occasions – in 1999 and 2002 as part of their triennial review of the CPP, and in 2003 when Parliament passed legislation with subsequent provincial approval to transfer all remaining CPP assets to the CPP Investment Board over the next few years.

At the board level, directors conduct their oversight by approving the boundaries within which management can operate and assessing regular reports on compliance. For example, capital put at risk is closely monitored by management and directors. Within defined risk limits the current strategy focuses on alternative ways of increasing the efficiency of the investment portfolio by such actions as increasing the number of asset classes, removing investment constraints, and striving for the excellent execution of the publicly traded stock portfolio and the private investment portfolio.

The boardroom culture within which directors oversee and contribute is always a challenge to describe. Clearly, our experienced directors, chosen for their expertise relevant to the organization's mandate, constructively challenge our professional and knowledgeable management team as we carry out our respective fiduciary duties.

As the CPP Investment Board enters an era of strong growth in which it must manage an enlarged sphere of complex relationships with external investment and business partners involving ever-growing sums of money, the focus is on anticipating possible events and adapting our approach to governance. An example is the evolution of the organization's handling of potential conflicts of interest.

In 1999, the directors developed and approved a conflict of interest policy and code of conduct. In 2002, we asked three outside specialists to review them. As part of the review, the board decided to create the role of a part-time external conduct review advisor with whom directors and employees could discuss ethical issues confidentially. On request,



**“Through proactive disclosure, the organization shares a great deal of information. We believe this level of disclosure is unmatched by any Crown corporation or pension fund”**

## BUILDING ON OUR APPROACH TO GOVERNANCE

the advisor's role is to help people make appropriate decisions in the face of complicated choices where there may be no clear or definitive answer. Importantly, the appointment, made in 2003, opens an outside avenue for whistleblowers.

John MacNaughton, the CPP Investment Board's first President and Chief Executive Officer, recently announced that he will retire during fiscal 2005, after five years in the position. John's extremely high standard of personal conduct, knowledge of capital markets and excellent ability to communicate combined to earn the CPP Investment Board credibility during its first phase of development and, in particular, the confidence of the sponsoring governments. Building a first-class team of professionals committed to management of the total investment portfolio, careful implementation of investment decisions and effective external interactions is his proud achievement. The Board of Directors salutes John for laying this solid foundation.

As Chairperson, it has been my privilege to work closely with John in a fascinating start-up situation that offered the opportunities to create cultures and practices designed to be robust and appropriate for the long term.

Looking forward, the directors are committed to identifying the very best leader to build on our strong foundation and guide the organization through the challenges of its next stage of development.



GAIL COOK-BENNETT,  
CHAIRPERSON

A BOARD WITH BROADLY BASED EXPERTISE

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.  
Corporate director.



**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 46-48.*

## BUILDING OUR PORTFOLIO AND OUR ORGANIZATION

The Canada Pension Plan reserve fund performed well in fiscal 2004, earning a 17.6 per cent rate of return to produce \$10.3 billion of investment income. Coupled with \$4.6 billion of contributions from employers and workers not needed to pay current pension benefits, the reserve fund grew by \$14.9 billion to \$70.5 billion.

**Stock Strategy Reaps Big Short-term Rewards** A large part of the reversal in CPP's investment fortunes from the \$1.1 billion loss (total CPP portfolio) in fiscal 2003 was the result of our decision to continue to build the equity portfolio throughout the market collapse that began in the fall of 2000 and continued to the spring of 2003, one of the worst declines in a century. Many Canadians were concerned that we might be on the wrong track and should invest in bonds, or hold cash and try to time the market bottom. Our decision to stay the course and buy shares in hundreds of quality Canadian and foreign companies resulted in equity gains of \$7.2 billion, versus a \$4.1 billion loss a year earlier. For us, the stock market collapse was a buying opportunity on a long investment journey.

**Assessing Investment Performance** The five years that the CPP Investment Board has been investing in equities to diversify the total CPP assets have included two outstanding years in equity markets (fiscal 2000 and 2004) and the negative period mentioned above. During the five years we have experienced returns on CPP Investment Board assets as high as plus 40.1 per cent in 2000 and as low as minus 21.2 per cent in 2003.

As one would expect, given that we have been building a private equity portfolio that has negative returns in early years and have been transitioning large amounts of cash into the market and experiencing the resultant "cash drag," we underperformed conventional benchmarks during years with rising markets, such as 2004, and typically outperformed them in declining years. We measure and compare our performance against benchmarks carefully, but do not regard benchmarks as primary metrics in determining how well we did. However,



JOHN A. MACNAUGHTON



## BUILDING OUR PORTFOLIO AND OUR ORGANIZATION

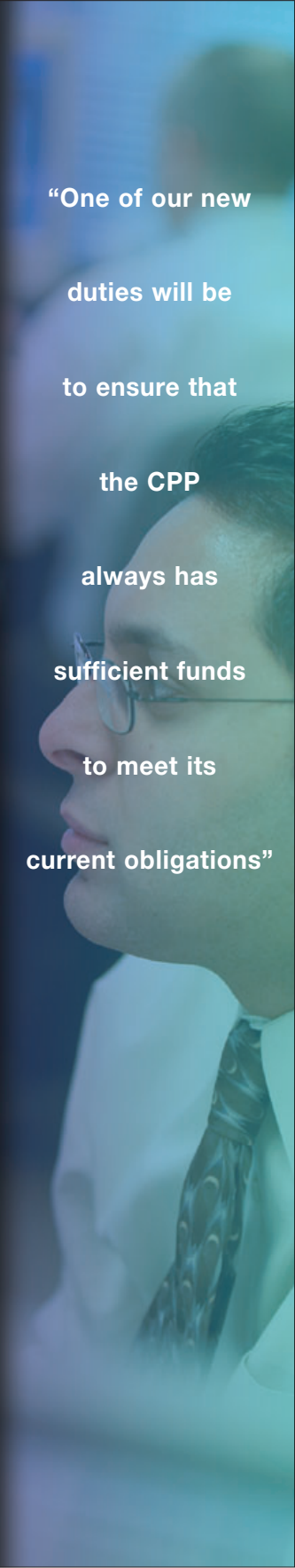
there are activities where benchmarks do have utility. An example is our active overlay program where they will be used to measure managers' skill in adding value.

One of the most important metrics is our performance in comparison to the level of return required to help sustain the pension plan. The minimum investment target for the CPP is a four per cent real rate of return (above inflation). If we can match that mark over the long term, the CPP Investment Board will have delivered on its mandate to help preserve the CPP. In fiscal 2004, the return on CPP Investment Board managed assets was substantially more than the plan's sustainability requirement. Since the CPP Investment Board invested its first dollar in March 1999, the assets we managed have exceeded the sustainability requirement by 69 basis points (or 0.69 per cent) – seemingly a small excess but one that, if compounded over decades, can add considerable wealth to the reserve fund.

**Investment Framework** The principal business of the CPP Investment Board is to manage the assets of the CPP in the context of its liabilities.

Our portfolio design decisions are made within our Investment Framework, which includes our investment beliefs and concepts used to more precisely define risk-return trade-offs. It is the basis upon which our investment strategies, policies, guidelines and procedures are developed to help achieve our investment mission. Our Investment Framework integrates total fund risk and return, is dynamic, takes into account plan liabilities and funding, and is decision oriented. It includes such concepts as minimum risk portfolio, capital at risk and risk-adjusted net value added.

**Portfolio Management** For us, portfolio management means translating our Investment Framework into a portfolio with the maximum expected return for a given amount of risk in the context of prevailing constraints. This ongoing process involves the design and efficient implementation of the total portfolio of public and private investments.



“One of our new  
duties will be  
to ensure that  
the CPP  
always has  
sufficient funds  
to meet its  
current obligations”

## BUILDING OUR PORTFOLIO AND OUR ORGANIZATION

During fiscal 2004, we strengthened both our internal and external portfolio management capabilities.

Internally, we designed and began transitioning to a global equity sector portfolio whose performance, we believe, will be more closely correlated with our liabilities. We began integrating at the total portfolio level private and public equity sector exposures as well as risk. Our internal trading capabilities were expanded; our product capabilities in various derivatives, in cash and foreign exchange markets were strengthened. All passive portfolio management, both design and implementation, is now done internally.

We also expanded our external capabilities. After a comprehensive search for active managers, we appointed the first two managers of an innovative active overlay strategy. We expect to appoint additional managers for this strategy in the months ahead. In private markets, we added to our network of private equity general partners by making seven first-time commitments. We made our first infrastructure fund investment. We now have relationships with 36 general partners based in Canada, the United States and Europe.

**Refining our Strategic Direction** Fiscal 2004, our fifth full year, was an appropriate time to step back, review what we had accomplished and decide where to take the CPP Investment Board in the years ahead. We re-wrote our vision statement, re-crafted our mission statement and articulated the values we try to reflect. (See page 49)

We also identified and explored seven strategic differentiators where we thought we already had sustainable competitive advantages or believed we could develop them. Our Investment Framework and approach to Portfolio Management, summarized above, were two of the seven. The other five were Governance, Human Resources, Management Systems, Innovative Development and Reputation.

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**BUILDING OUR PORTFOLIO AND OUR ORGANIZATION**

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All are important, but none more so than Human Resources. Very simply, to achieve our mission, the CPP Investment Board needs to recruit, develop and retain top caliber employees, and create a work environment in which they can flourish.

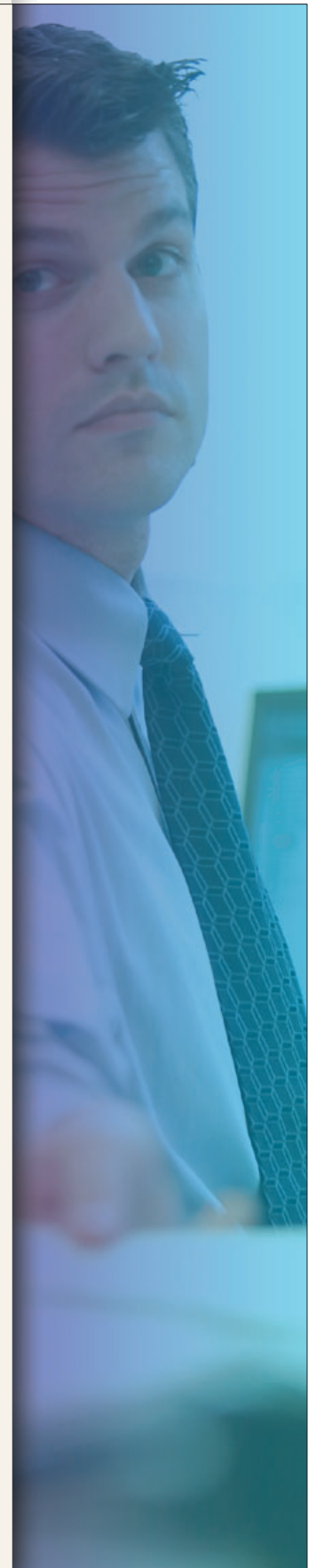
We are proud of the outstanding team of professionals we have attracted. For them, we are dedicated to creating a culture that exemplifies ethical conduct and courtesy, aspires to excellence, encourages intellectual curiosity and seeks to optimize outcomes by balancing clear individual accountability and authority with a respect for teamwork – a culture where people value the important work that has been entrusted to them by millions of Canadians.

The CPP Investment Board is destined to become one of the largest pension fund managers in the world. By attracting and keeping superior employees, it has the potential to become one of the most sophisticated and respected as well.

We will be doubling the number of employees to almost 100 in fiscal 2005 as we broaden and deepen our management and professional capabilities.

One of the reasons for this expansion is the dramatic increase in assets the CPP Investment Board will be managing: They are projected to increase to more than \$95 billion within three years and \$190 billion within the decade.

**Expanded Responsibilities** Another reason for growing our workforce is that our responsibilities are being increased. Legislation amending the *Canada Pension Plan* and the *Canada Pension Plan Investment Board Act* came into effect on April 1, 2004. As a result, CPP fixed income assets, both bonds and cash, are being transferred to our care. As well, the amended legislation has resulted in responsibility for providing cash management services for the CPP being transferred to the CPP



## BUILDING OUR PORTFOLIO AND OUR ORGANIZATION

Investment Board. In future, contributions to the CPP will flow to the CPP Investment Board and benefits will be paid from cash provided by the CPP Investment Board.

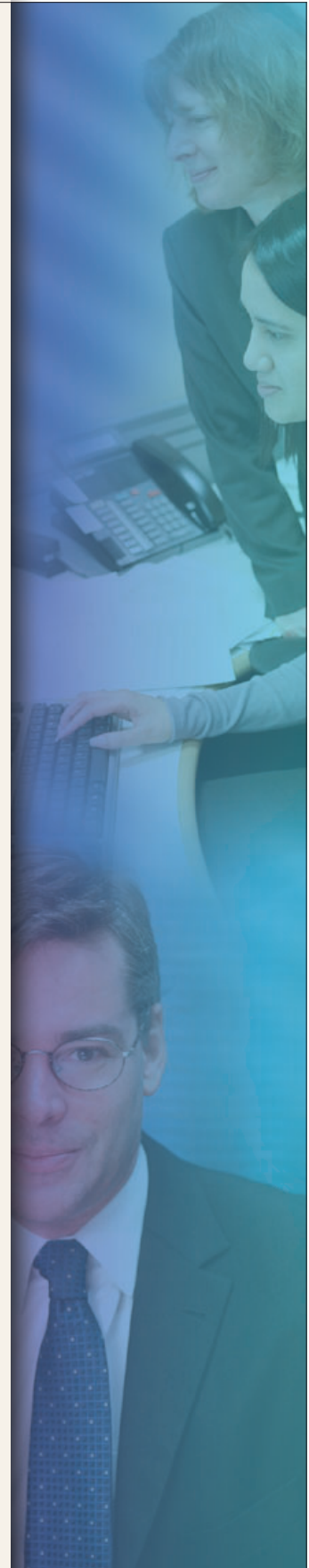
This transfer of assets and responsibilities is a signal event. It is another sign that Canada's federal and provincial finance ministers remain committed to their original vision of the CPP Investment Board as an organization that would professionally manage all of the assets of the CPP at arm's length from government.

It is also a vote of confidence, a gratifying endorsement of the strategies, organization, infrastructure and capabilities that have been put in place at the CPP Investment Board.

**On to a New Era** There is rarely a "right time" to step down from a leadership position, but for me fiscal 2005 will be as close to that magic moment as one can reasonably hope for.

We have just completed a fiscal year with excellent investment results. As discussed earlier in this report our Investment Framework is operative and informing all our investment decisions, our portfolio management capabilities, both internal and external, are growing and we have attracted a superlative management and professional team. Excellent management systems that can grow with our expansion have been established. The constructive culture we want to nurture has germinated. There is increasing and positive recognition of the CPP Investment Board. Canada's finance ministers have affirmed our organization by expanding our mandate. In short, the goals of our start-up phase have largely been accomplished.

We are presently in the final stages of transitioning from start-up to a period of long-term growth that will continue until approximately 2021. A logical part of this process is the identification of a new leader for the era that lies ahead.



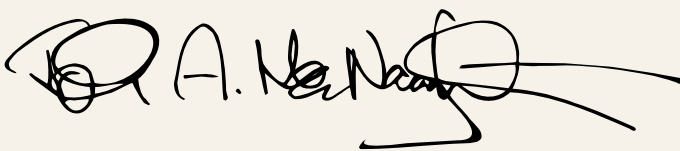
## BUILDING OUR PORTFOLIO AND OUR ORGANIZATION

The search for that individual will be conducted by our Board of Directors. I am committed to supporting the board and then facilitating the successful launch of the chosen individual. Until that occurs, I remain focused on building our organization, wisely investing the approximately \$10 billion in net new cash we will receive over the coming months, and working to ensure the successful completion of both the first special examination of the CPP Investment Board's management systems and practices and also the upcoming triennial review of our legislation and regulations by Canada's finance ministers.

I cannot overstate how deeply I have appreciated the privilege of serving as founding president and chief executive officer of the CPP Investment Board. I thank our dedicated Board of Directors, first for the invitation to serve during our challenging early years and second for their support and wise counsel. I especially thank our capable and thoughtful Chairperson Gail Cook-Bennett. We have worked closely together with the shared goal of building an institution that Canadians can trust and be proud of for decades to come.

The accomplishments profiled in this annual report are the product of the abilities and efforts of many people. The CPP Investment Board has been blessed during its early days by its success in attracting exceptional officers and employees who were eager to be part of a Canadian innovation, professionals committed to applying their varied talents to the benefit of their fellow citizens.

A sincere thank you to all.

A handwritten signature in black ink, appearing to read "John A. MacNaughton". The signature is stylized with large, sweeping loops and a long horizontal stroke at the end.

JOHN A. MACNAUGHTON,  
PRESIDENT AND CHIEF EXECUTIVE OFFICER