

# Governance Model

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CPP Investment Board

The Canada Pension Plan Investment Board:

Governance Model

Remarks by

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To the

Pension Investment Association of Canada

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Good morning everyone. And thank you to the organizers for inviting me to be one of the speakers at your annual conference ... or I should say at our annual conference now that the CPP Investment Board is a proud member of the Pension Investment Association of Canada.

The CPP Investment Board is new to the pension fund industry ... and the governance game. In turn, I am new to the CPP Investment Board with only eight months on the job.

So what can I possibly tell you that you haven't heard and dealt with many times before?

I can tell you four things right off the bat that I hope might catch your attention.

First, as a new organization, I believe we are in an ideal position to implement and test new standards of governance. With no history, we have no baggage.

Our founding directors have consciously created a culture of expectations based on governance policies that strive to be best practices. They fully understand that how we begin will shape our values and traditions for many years to come.

Second, we are committed to best governance practices ... to implementing them ... to publishing them ... and to publicly measuring our behavior against them.

As you will see, this commitment goes beyond the requirements of the law ... and the expectations of governance authorities.

Third, we intend to be a forthright public advocate of good governance. Our advocacy includes educating Canadians on the importance of proper governance ... something we will do at all those public meetings we are required to hold across Canada.

And fourth, we believe that good governance is more than process. We accept the premise -- and the evidence -- that good governance policies and practices are a component of superior performance.

Let me tell you how we developed our governance policies ... what they contain that may be interesting or different from your own plan ... and how we will evaluate our governance performance.

To begin, you need to understand distinguishing features of the CPP Investment Board that help to shape our governance.

First, we are solely an investment organization.

It is important to stress -- we have no responsibility for administering the Canada Pension Plan.

The federal and provincial governments are joint stewards of the Canada Pension Plan. Together they set contribution rates, benefit levels and funding policy ... and the federal government alone administers the plan.

The consequence of all this is that we are more analogous to an investment management company than a full-service plan sponsor.

One of our biggest challenges will be getting Canadians to understand that we operate independently of the Canada Pension Plan ... even though our ultimate goal is to increase the value of assets available to the Plan to pay future pensions.

A second distinguishing feature is that we have a focused mandate that is clearly articulated in our legislation. We are charged with:

- Managing the assets entrusted to us in the best interests of the contributors and beneficiaries of the Canada Pension Plan; and
- Maximizing investment returns on the cash flow received from the Plan without incurring undue risk.

This two-pronged emphasis on accountability to plan members and maximizing returns is identical to the mandate of most other pension funds.

A third distinguishing feature that shapes our governance is that the CPP Investment Board operates at arm's length from governments.

Our board of directors is solely responsible for setting policy on all major issues, including investment and financial management.

Certainly as an organization we are accountable to the federal and provincial governments ... as we are also to Canada Pension Plan contributors and beneficiaries.

After all, the CPP Investment Board was created by federal legislation in 1997 ... based on a 1996 agreement between the federal and provincial governments.

But we operate as an independent Crown corporation. I'll talk more about this in a moment.

A fourth distinguishing feature of the CPP Investment Board is our public accountability obligations and undertakings. They are extensive.

We must publish an annual report that must be available from coast to coast.

We are required to publish quarterly financial statements ... something no other plan has to do.

We are required to hold a public meeting in every province at least once every two years ... another first for a pension fund.

In fact, we are the only pension fund accountable to a large portion of the Canadian adult population from coast to coast to coast. As you can appreciate, such exposure and accountability very much influences our attitude to governance.

And it underscores my earlier points of subscribing consciously to best governance practices and developing among Canadians an understanding of why governance is so important.

Furthermore, as part of our public accountability, we are required to publish our success in reaching the prior year's objectives in our annual report ... and to state our objectives for the next year and the foreseeable future.

As well we have committed ourselves to transparency. We will be available to Canadians through public speeches ... participation in private meetings and conferences with interested parties --such as this one -- broadcast and print media interviews ... and communications on our Web site.

This surely is governance at its best – and most demanding.

So these four points directly influence our governance policies ... being solely an investment organization ... focused on maximizing investment returns ... independent of governments ... and accountable to Canadians.

There is a fifth distinguishing feature – how our board of directors is appointed.

The federal and provincial governments together are responsible for the nominating process. For the initial board of directors, it worked like this.

The federal government and the nine participating provinces had one representative each on a nominating committee that consisted of public officials and business leaders, with a private sector executive in the chair.

This nominating committee recommended candidates for appointment by the federal finance minister who then sought input from his provincial finance minister colleagues.

The current directors were appointed in October 1998. The Chair, Dr. Gail Cook-Bennett, was selected in consultation with the provinces and the full board of directors.

Our legislation states that it is desirable to have sufficient directors with proven financial ability or work experience relevant to the goal of maximizing investment returns.

As a result, the nominating committee recommended directors with expertise in investment, business, economics and financial management.

The initial board has staggered terms ... with half the directors serving a two-year term that expires later this year ... and the remainder serving a three-year term that expires late next year.

Each director can be appointed or re-appointed for a three-year term ... and can serve a maximum of three terms, or nine years. The Chair is permitted to serve a fourth term.

Directors up for renewal will be evaluated by the external nominating committee.

Perhaps you are wondering if this process results in a board of directors that is really arm's length from governments. Is there a risk of political interference in our investment decisions?



We think not. Remember that the federal finance minister must consult with provincial counterparts before making board appointments. That alone is a powerful check on any temptation to make narrowly partisan or ideological appointments.

A second check against political intrusion is that any change in our legislated mandate requires the approval of the federal parliament and the agreement of two-thirds of the provinces with two-thirds of the population. In effect, this is a constitutional check, and a powerful one.

Furthermore, our commitment to extensive public accountability ensures that Canadians will be kept current with any proposed changes ... so millions of eyes are watching out for our integrity and independence.

However, make no mistake that as an organization we are accountable to both levels of government ... and both the CPP Investment Board and governments are accountable to CPP contributors and beneficiaries.

Furthermore, the federal finance minister ... in consultation with the participating provinces ... is required to initiate a special examination of our financial and management control, and information systems and management practices, at least once every six years.

Let me be perfectly clear. I believe that we should be accountable to both levels of government in those areas where our legislation requires us to be.

Our accountability to governments is an integral component, in my view, of a well-conceived structure of governance checks and balances.

After all, the Canada Pension Plan is a commitment of governments and an important expression of our nation's capacity to care for one another. The CPP Investment Board has a role to play in securing the plan's long-term financial future ... and helping elderly Canadians to retire with a little more grace.

All in all, we have a lot of checks and balances in our accountability ... governments, the board of directors, management, and millions and millions of Canadians who contribute to and benefit from the Canada Pension Plan.

Central to our governance ... as I am sure it is to the governance of your fund ... is clarity on the relationship between the board of directors and management ... and the division of their respective responsibilities between the two.

Our governance model acknowledges that the board of directors represents the stakeholders ... ensures that all required and appropriate policies are in place ... and holds management accountable for its activities.

For its part ... management implements policies approved by the directors ... develops the investment strategies and annual business plan and budgets ... and manages the day-to-day business.

All this enables the directors to satisfy themselves that management articulates a strategic direction ... and that all business, operational and investment risks are identified and managed properly.

In our case, this governance process also helps to keep in the foreground our primary mission of delivering value to the stakeholders by increasing the long-term value of pension assets available to the Canada Pension Plan.

The expectations of the board of directors are much the same as they are for any pension fund – such as accepting responsibility for the stewardship of the organization ... ensuring accountability by management ... and acting honestly and in good faith with a view to the best interests of the organization and its stakeholders.

Our legislation contains the standard language that directors must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.



However, what is different is that 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.

To carry out its mandate, the board has created four committees. Two ... the investment and audit committees ... are required by our legislation and the investment committee consists of the full board. No surprise there, recognizing that we are a single-purpose organization.

The other two committees ... one on governance and one on human resources and compensation ... advance our governance and operating objectives.

Our governance committee, chaired by Dale Parker, an experienced corporate director from Vancouver, led the development of a comprehensive governance manual that has been reviewed and adopted by our board of directors.

We intend to post the governance manual on our Web site so that our stakeholders can see for themselves the high standards and thoroughness of our governance policies and practices.

The four mandates of these committees are similar to those in your own organizations, so I won't belabor their purpose. What I would add is an observation. Our chair has created a culture that promotes active participation in committees and an expectation that the board of directors will thoroughly discuss and debate committee reports and recommendations, not just rubber stamp them.

To ensure our governance practices are comprehensive and of the highest standards, the directors test them against our legislation and regulations and against external guidelines.

We have developed extensive internal controls based on legislated and regulated governance requirements. At the request of our audit committee, the external auditor, Deloitte Touche, reviews our internal controls every six months.



The governance guideline checklist of the Toronto and Montreal stock exchanges for public companies is, of course, a widely accepted standard for measuring performance.

Of the 14 guidelines, the CPP Investment Board complies with the 13 relevant to our mandate.

These guidelines are a useful reminder that our board should assert its independence from governments and management ... and should formally assume stewardship of the organization, including responsibility for the strategic planning process, risk management policies, senior management succession planning, and communications policy.

The only guideline we do not comply with is the one requiring a board nominating committee. As I discussed, that responsibility rests with the arm's length nominating committee appointed by the finance ministers.

Another emerging standard is the pension plan governance principles developed by PIAC with Association of Canadian Pension Management and the Office of the Superintendent of Financial Institutions.

These principles are also a useful reminder that we should have a clear mission statement, accept fiduciary accountability to stakeholders, publicly disclose measurement of performance, and conduct a governance self-assessment.

We comply with five of the six recommended principles. The exception concerns the qualifications of plan administrators and does not apply to us as we have no plan administration duties.

It is disappointing to see that many organizations have adopted a boilerplate approach to governance ... as if policies and procedures need only to be put in place once with perhaps minor tinkering annually.

We believe that governance should be a dynamic and never-ending process that keeps the board and management on their toes.

One way to ensure that it does remain dynamic is to initiate a thorough evaluation process.

Every year, our directors examine how the board is operating ... comment on its performance and that of its committees ... and suggest improvements.

The first evaluation occurred last February. Each director completed a confidential questionnaire. The responses were summarized by the chair of the Governance Committee, reported to the full board, and discussed at our board meeting in March.

The survey deals with such issues as board organization, including the qualifications of directors ... board orientation and training ... the quality and timeliness of board information ... the development by management of a strategic plan and risk management procedures ... and the quality of board and committee discussions, terms of reference, policies and procedures.

In addition to the formal evaluation process ... we have developed a culture in which the directors are conscious of the need to remind themselves of first principles from time to time.

For example, at the last board meeting in April, the Chair of the CPP Investment Board asked the chair of the governance committee whether a certain process being discussed was in compliance with agreed governance policies. In another case, a director interrupted a discussion to suggest that the issue at hand was management's responsibility and that the board of directors shouldn't intrude.

I have observed this type of dialogue about governance at other board meetings ... underscoring that the directors are attentive to their proper duties.

Just as the directors are attentive to the division of responsibilities between themselves and management ... I too am conscious of ensuring they receive the information they need in a comprehensible form and in a timely manner so that they can discharge their duties properly.

We also have an annual performance evaluation process for the Chief Executive Officer that underscores accountability to the board of directors.

As CEO, I am required to set objectives for the coming year and conduct a self-appraisal for the past year. At the same time, the directors submit their written assessments of my performance to the chair of the human resources and compensation committee and the Chair of the CPP Investment Board. These assessments are summarized and then formally reviewed with me by the board.

Let me now talk about another cornerstone of effective governance -- clear policies on expected behavior.

We have a code of conduct for directors and a more stringent code for officers and employees. The codes are designed to create a corporate culture of trust, honesty and integrity. They deal with such matters as relations with suppliers, personal investments, and confidentiality of third-party proprietary information.

Where a situation is not addressed by written policies it is tested against questions such as – is it legal ... is it in anyway in conflict with the best interests of the CPP Investment Board ... and therefore CPP beneficiaries and contributors ... and will it meet or exceed the standard of behaviour expected by the Canadian public?

I am pleased to report that no situation requiring review has occurred.

Because our board needs directors with financial and investment expertise, conflicts of interest must be expected from time to time and managed appropriately.

A policy statement and procedures are in place to handle potential conflicts concerning the relationship of directors to companies in which the CPP Investment Board invests or firms that are retained as suppliers, such as investment fund managers.

Once again, we think we have been inventive in ensuring our governance practices remain alive. Let me give a couple of examples that may not be common at other pension funds.

First, prior to year end, each director is required to sign and submit a revised resumé highlighting changes in relationships that may give rise to a conflict. The submissions are reviewed by the governance committee.

Second, directors must also 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 CPP Investment Board.

On the surface, these may seem like small items ... but they speak powerfully to the thoroughness of the governance process, and the attention paid to it.

I might also note that our legislation sets conflict-of-interest provisions that are even stronger than those found in the Canada Business Corporations Act and the Bank Act.

Directors are required to make timely disclosure of any investment transactions, and not just material transactions, between the CPP Investment Board and entities in which they have a material interest.

They must abstain from voting on resolutions concerning transactions in which they have a material interest ... and cannot participate in discussions about those transactions.

Our policy states that conflicts of interest must be disclosed in writing and entered into the minutes of board or committee meetings.

Recently, we developed tough conflicts of interest guidelines for officers and employees.

At the moment, we have only one senior executive in addition to myself -- the Vice President of Finance and Operations. We are in the process of hiring other senior executives, plus appropriate support staff.



Our board of directors wanted to make sure that effective conflicts of interest guidelines were in place before the bulk of employees are hired.

You can appreciate how important these rules are when you realize that over the next 10 years, the CPP Investment Board's invested assets will grow from about \$3 billion today to more than \$100 billion.

Managing those assets will inevitably involve exploring a full arsenal of investment strategies ... passive and active investing in public equity and debt securities, merchant banking, private equity and debt, infrastructure projects, venture capital opportunities, real estate investments and derivative contracts.

Our scope and size will make us aware of a great deal of inside information. We intend to be more than just careful.

We have also drafted procedures that restrict insider trading and front running by officers and employees.

Our compliance officer will maintain a restricted list of companies where we are an insider or have special knowledge. The list will include securities that ... should an employee trade them ... could lead to an inference of misuse of confidential information.

Officers and employees will be prohibited from trading securities on the restricted list without the approval of the compliance officer.

In addition, staff are required to provide an annual statement of the securities they hold to our external auditor ... and to provide a monthly report of their securities trades.

We will also build a firewall between management and the board of directors on inside information ... with the goal of insulating directors from confidential third-party material that they do not need to know to fulfil their fiduciary duties.



This completes my review of our governance structure, policies and practices.

I hope that you conclude from my remarks today that we are committed at the CPP Investment Board to setting and meeting the highest standards in pension fund governance.

PIAC is, of course, the organization that will have the greatest impact on setting governance standards for the pension fund industry.

We are committed to meeting those standards ... and working with you to refine and raise them. In addition, we are ready to be counted as a champion of best governance practices and communicating their value to our stakeholders, the Canadian public.

In that respect, we intend to publish our codes of conduct, conflict of interest guidelines, and governance policies on our Web site later this year.

Governance only works if those responsible for it embrace its objectives and live by its principles.

Our hope is that, over time, the commitment of our directors and management to best governance practices will become institutionalized in our culture ... and that our success in implementing best practices will become part of our reputation ... and that our reputation in this regard will be an important ingredient in the CPP Investment Board earning and keeping the trust of Canadians.

Thank you for the invitation to be here today and for the privilege of sharing these thoughts with you. I look forward to your comments and questions.