Securing the Future: The First 10 Years of the Canada Pension Plan Investment Board

Notes for remarks by

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In times like this, the topic of today's conference -- 'securing the future' – can seem like a tall order indeed. But I am pleased to report that at least insofar as the CPP is concerned, it *has* been done, and that's a very good thing for the 17 million Canadians who participate in the Plan and, indeed for Canada.

One of the biggest stories of the past year has been the collapse of the US subprime market and the global credit crisis that has ensued. Canada has felt its share of the pain, particularly in the market for asset-backed commercial paper. But Canada's experience pales in comparison to what is happening in the United States and overseas.

In recent months, many of the world's largest and most respected financial institutions have been forced to write off billions of dollars worth of assets …with more expected to come.

Equally astounding has been the seemingly sudden emergence of Sovereign Wealth Funds as foreign direct investors on a scale we have simply not seen before. These funds have provided billions of dollars of investment to recapitalize Merrill Lynch, Citigroup, UBS and others. These investments have been welcomed as important contributions to the health of these firms, whose continued wellbeing has profound implications for the health of the entire financial system.

However, other investments by the Sovereign Funds have sparked concern that has given rise to protectionist sentiment. Included among these investments are outright acquisitions of large companies in sensitive industries such as financial services, transportation infrastructure, telecommunications and energy.

This sentiment has the potential to result in a number of countries imposing new restrictions on foreign direct investment. Needless to say, that would have a negative impact on the free flow of capital, as well as on our collective ability to access the broadest possible set of investment opportunities.

So where does that leave the CPP Investment Board?

It leaves us with an interesting challenge. By all rights, this should be – and in fact, it is – a time of great opportunity for us. Asset values in many key geographies outside of Canada are depressed and many other investors are capital-constrained. By contrast, we have ample capital on hand, the required investment capabilities and a very long investment horizon.

While pursuing these opportunities, we are also working to inform key international policy-making institutions, governments and regulators about our model to ensure these opportunities remain as open to us as they are to any other commercially-motivated investor.

Like many large Canadian pension funds, we must invest actively in global markets in order to diversity our risk and to earn the returns needed to help sustain the pensions of millions of Canadians.

While the CPP Fund currently has approximately 65 billion dollars or 54% of its assets invested in Canada, global diversification is essential in order to sustain a flow of income back into Canada to help pay pensions. For a fund of our size – our assets were approximately $120 billion at December 31st – we must also seek out the best opportunities globally.

In a way, this discussion about foreign access for the CPP Investment Board is quite extraordinary.

Ten years ago, nearly everyone in this room would have been concerned about the long-term solvency and sustainability of the CPP. Now here we are discussing to what degree we will be able to freely invest sufficient capital abroad. This remarkable transformation is a testament to the far-sighted reformers of the CPP.

The story of the CPP Investment Board is a story of:

- First, courageous policy reforms.

- Second, the creation of an ingenious governance structure that balances independence and accountability, and which is a prerequisite to our success, and

- Third, the development of a 370 person strong investment organization working to help sustain the CPP on behalf of 17 million Canadians.

I'll begin the rest of the story in the middle, with the issue of Sovereign Wealth Funds that I touched on a moment ago. I do so because this issue provides a very useful lens with which to look back at the development of our governance platform, and to look forward to our investment strategy and the long-term sustainability of the Canada Pension Plan.

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We have been accustomed over the past nine years to receiving delegations from Singapore, Japan, Russia, Brazil, Norway, South Korea, New Zealand and other countries who have flown to Toronto to find out how the Canadian model for national pension plan reform might work for them.

But more recently, international policymakers have also sought to learn more about our model for a different reason. They are seeking insights into how our model might hold prescriptions for addressing concerns expressed about Sovereign Wealth Funds.

These concerns centre on sovereign wealth funds' control by governments, potential use of their financial clout to pursue non-commercial objectives and less than transparent activities.

As you can appreciate, we are particularly sensitive to this issue because even though we have "Canada" in our name, we are not a Sovereign Fund. Indeed, the CPP Investment Board is fortunate to have been recognized by the likes of the World Bank, the OECD, the IMF and others as the standard for independence from governments, clarity of mandate and transparency. In recent months, we have been asked to speak before meetings of the OECD in Paris, the IMF in Washington and a U.S. Congressional subcommittee to describe our model.

The response has been overwhelmingly positive, and the result of these and other efforts has been growing and official recognition of our status that has enabled us to start differentiating ourselves more broadly from Sovereign Wealth Funds. By doing so, we help safeguard our access to global infrastructure and private equity investment opportunities.

The key point is this: Policymakers are concerned that Sovereign Wealth Funds may be used to further political or national aims. The CPP Investment Board's governance model was designed precisely to prevent political interference and provide the clarity and transparency the Sovereign Funds often lack.

The Canadian designers of this program – politicians, themselves -- anticipated that problem and devised a creative solution. And that takes me to our governance platform.

The Governance Platform

The CPP Investment Board's governance platform originated with a far-sighted group of policy makers – public servants and politicians from federal and provincial governments working together to rescue the Canada Pension Plan ten years ago.

In 1996, the CPP was heading for a crisis. That year it received $11 billion in contributions and paid out $17 billion in benefits. Actuarial projections showed that even with scheduled contribution rate increases, the Plan would be unable to fully pay benefits by 2015.

But the funding crisis was not the only challenge. As Canadians told the reformers more than a decade ago-- any attempt to build up a pool of capital to partially pre-fund the pension plan, must be accompanied by a structure to protect the organization – including its board, its management, its assets and its investment decisions – from political interference.

To deliver on this requirement, the reformers of the CPP crafted a simple, yet powerful governance platform. They called for a clear and unequivocal investment-only mandate.

To quote from our legislation, we are mandated to achieve “a maximum rate of return without undue risk of loss”. The legislation goes further. It stipulates that we must not pursue other objectives that are inconsistent with that investment mandate. And it ensures that investment decisions are made by investment professionals at arm’s-length from governments.

So for example, there is no pressure or obligation for the CPP Investment Board to invest in Canada, buy government debt, make loans to state-owned firms, provide credit to governments, invest in politicians’ special projects or invest with a view to any particular social policy agenda.

The reforms also called for management to report not to governments but to an independent board of qualified directors with strong credentials in business, finance, actuarial science, portfolio management and other relevant disciplines.

Moreover, it is the board of directors, not governments, that approves investment policies, determines with management the organization’s strategic direction and makes critical operational decision such as hiring the CEO and determining executive compensation.

The policymakers also ensured that the legislation require a high level of transparency.

Finally, having enshrined our mandate and its supporting governance model in legislation, the reformers barred the door against short-term political expediency by ensuring our governing legislation can only be amended by the federal government *and* two-thirds of the provinces representing two-thirds of the population.

To put this in perspective, this is an even higher level of agreement than the threshold required to amend Canada’s Constitution.

<u>Looking Back</u>

Of course it’s one thing to have a maximum strength governance platform and quite another to bring it to life. When the 12 founding directors of the CPP Investment Board held our first board meeting in November 1998 there was no office, no management team and no blueprint for creating an organization.

The CPP Investment Board was born in an atmosphere of crisis and skepticism. Many observers had profound doubts that the Plan could be saved and few believed that governments could refrain from interfering in investment decisions.

The founding Board of Directors recognized immediately both the need to earn a reputation worthy of the trust placed in us and the obligations that came with our independence. We understood that Canadians needed to see the standards we set for ourselves as fiduciaries to safeguard their future pensions. And we understood that building public trust and confidence would be the Board's best protection against the political interference about which Canadians -and the reformers of the CPP themselves - were rightly concerned.

By the time of our third board meeting, we had begun to lay the foundation for a culture of integrity. I recall those first governance committee meetings, in which my fellow directors painstakingly drafted a Code of Conduct uniquely suited to the demands of this new type of Crown organization with private sector operations and public sector accountability. Without getting into detail, this Code includes a positive duty to report immediately any attempted political interference on hiring, investment, procurement or other decisions. I am pleased to report that we have always been able to report “no interference”, just as our stewards had intended.

Later, we created the position of external Conduct Review Advisor to serve as a confidential resource for directors and employees on conduct issues.

Our early board meetings also focused on another founding principle: transparency. Operating behind a veil of secrecy was unacceptable. To that end, our Board and management have voluntarily raised transparency far beyond our demanding legislated requirements. Early in the life of the CPP Investment Board, the board of Directors adopted a disclosure policy that states:

“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.”

This disclosure policy has served us well. Transparency has neither conflicted with nor limited our ability to achieve our investment goals – and it has contributed to our earning the trust and confidence we sought in those early days, just as we do today. We have seen the returns on our investment in transparency at home and abroad.

<u>The Active Investing Decision</u>

The governance model devised by the CPP reformers has been central to our investment success.

With the core attributes of transparency and integrity in place, and the startup phase of the investment program behind it, the CPP Investment Board made the strategic decision, in late 2005, to expand the range of investment programs with a view to exceeding the returns otherwise available from a low-cost, low-complexity passive investment portfolio.

This included pursuing greater diversification by geography and moving into new asset classes, such as infrastructure and other active strategies, to accompany our fledgling real estate and private equity portfolios. Our objective was to be a more active, value-added investor seeking opportunities in global markets.

This strategy played to our inherent strengths of size and a long time horizon. It also responded directly to our legislated mandate to "maximize investment returns without undue risk of loss."

Shortly after adopting the value-added approach, we introduced what we call the CPP Reference Portfolio – a low-cost, low-complexity model to serve as our investment benchmark. It is the yardstick by which we evaluate strategic decisions and measure our own performance. It also enables the Board to tie compensation directly to value-added performance and add a further layer of accountability.

It is still early days and markets fluctuate, but so far the results of this strategy have been both positive and significant. In fiscal 2007, the last year for which results have been disclosed, we delivered $13.1 billion in investment income of which $2.4 billion were our value-added returns over and above our relevant market based benchmark.

Sustainability

I said earlier the initial skepticism regarding the Investment Board took two forms. I've addressed the first – we have not experienced any political interference. As to the second – the CPP's sustainability – I can also report success.

Today the CPP Fund stands at approximately $120 billion. While we have yet to report the full year-end results, over the past four fiscal years, we have delivered $43 billion in investment gains, for an 11.7% annual rate of real return. This is comfortably above the 4.2% rate of real return that Canada's Chief Actuary estimates is necessary to sustain the plan at current contribution levels. The Chief Actuary projects that the CPP Fund will be approximately $322 billion by 2020. In fact, Canada's Chief Actuary says the CPP is sound and sustainable throughout the 75-year period of his forecast.

After ten years of operations, our investment professionals are working with – and competing against – the most sophisticated investors in the world. The organization has delivered billions of dollars of investment gains to help secure the future of the Canada Pension Plan. We have an exceptional management team, a sophisticated approach to risk and portfolio management, a growing reputation for integrity and intelligence, and a Board that has the expertise and experience to undertake effective oversight.

Furthermore, our governance platform positions us firmly in the **non-**Sovereign Wealth Fund camp.

The Canada Pension Plan Investment Board looks forward to playing our part in securing the future for Canadians for the next decade and well beyond.