



Building Excellence

CPP Investment Board

Canada Pension Plan Investment Board:

Building Excellence in Governance, Management and Accountability in the Public Sector

Remarks by

John A. MacNaughton

President and Chief Executive Officer

Canada Pension Plan Investment Board

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INTRODUCTION

Good day ladies and gentlemen. I welcome the opportunity to share some thoughts on good governance in Crown corporations from the perspective of the Canada Pension Plan Investment Board.

I want to begin by thanking the organizers of this important conference for making it possible for me to address you through this video. Their creativity has allowed me to participate in your deliberations even though I am unable to attend in person. Truth to tell, I am presently with my family on the beach in Cuba so, in fact, their creativity has enabled me to enjoy the sun while you are toiling in Ottawa. Lucky me.

Good governance in the public sector has been a topic of considerable media attention recently thanks to the report of the Auditor General. In my view the importance of good governance is central not just to better checks and balances and improved performance, but also to greater public confidence in corporations, whether in the public or private sector.

As a new Crown Corporation, we at the CPP Investment Board are in an ideal position to implement and test new standards of governance. We have no internal history to wrestle with – we have no negative baggage to discard. Furthermore, we are governed by a legislation that sets the blueprint for the highest standards of accountability and ethical behaviour.

During my address today I plan to review the following three topics:

- first, so you can put my remarks in context, I am going to provide a brief summary of the background and role of the CPP Investment Board;

- second, I am going to describe the features of our governance model, such as:
 - the expertise of our Board of Directors

 - its role



- our Board committees
 - dealing with potential conflicts of interest, and
 - our public reporting and communications with Canadians.
- Finally, I want to comment briefly on the recent suggestions by the Auditor General on the “Governance of Crown Corporations”.

WHO WE ARE

Since some of you in attendance may not be familiar with why the CPP Investment Board was created and what our mandate is, allow me to give you a brief overview of who we are.

First, by way of background, the Canada Pension Plan itself was created in 1966 as a pay-as-you-go pension scheme, with compulsory contributions by both employers and employees. The idea was that the current contributions of one generation would pay the current benefits of the previous generation. In the early years it worked as planned.

Thirty years later, in 1996, the federal and provincial governments who are the joint stewards of the CPP realised this equation would not work in the long term and decided to conduct an extensive review of the Canada Pension Plan to put it on a firmer financial footing. This led to three major decisions:

- first the ministers of finance agreed to gradually increase the contribution rate until it reaches 9.9 percent of the employee’s pensionable earnings in 2003;
- secondly, they decided that the excess funds generated by the increases in contributions should be invested in capital markets; and
- thirdly, they decided to create a Crown corporation under professional management and independent of government to make the investment decisions.

And that is why the CPP Investment Board was created by an Act of Parliament in December 1997. Our first directors were appointed in October 1998, making our organization a about two and a half years old.

Let me stress that we are solely an investment organization. We are separate from and independent of the Canada Pension Plan, and we are not involved in the administration of its policies, contribution rates and benefits.

As a new Crown corporation at arm's length from government we are helping deliver the long-term pension promise to Canadians by building a diversified portfolio of assets that is part of the aggregate CPP portfolio

Let me turn now to how the CPP Investment Board Act has been part of setting new standards for Crown corporations in the field of governance policies and practices.

BOARD SKILLS, ABILITIES AND RESPONSIBILITIES

Several distinguishing features of the CPP Investment Board are reflected in the section of our Act relating to the choice of directors and the role and responsibilities of the Board.

First, our directors are required by law to not only be “representative of the various regions of Canada” but to have the “proven financial ability or relevant work experience” to be able to “effectively achieve the objects” of the CPP Investment Board. These objects are: to invest in the best interests of contributors and beneficiaries and to maximize returns without undue risk.

Our Board consists of individuals with the necessary expertise to discharge these responsibilities. They are experienced in such areas as accounting, economics, actuarial science, investing, banking and business generally.



Another distinguishing feature is how our initial Board of directors was appointed and how re-appointments and new appointments will be made in the future.

The nomination process began with the federal and provincial finance ministers naming one member each to a nominating committee that consisted of public officials and business leaders, with a private sector executive in the chair.

The nominating committee identified candidates who fulfilled the criteria set out in advance by the governments based on the requirements of the Act and submitted its short list to the federal Finance Minister. The federal Finance Minister made the appointments after consultation with the provincial finance ministers.

Our initial Board had staggered terms with half the directors serving a two-year term that expired late last year and the remainder serving a three-year term that will expire later this 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 have been evaluated by the external nominating committee along with new nominees to replace the directors who are not seeking reappointment. We are expecting to hear the list of reappointed and new directors shortly.

Our current directors were appointed in October 1998. All directors remain in office until their successors are appointed, unless they are removed for cause.

The Chair, Dr. Gail Cook-Bennett, was appointed by the Governor-in-Council after consultation with the provinces and the full board of directors.



ROLE OF THE BOARD

Furthermore, central to our governance, as I am sure it is to the governance of most pension funds, 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 our stakeholders, the 16 million Canadians who contribute to and benefit from the Canada Pension Plan. To do so, it must ensure that all required and appropriate policies are in place.

The directors do not manage the CPP Investment Board on a day-to-day basis. The Board's goal is to make sure that the CPP Investment Board is managed competently, that the corporation acts with integrity, and that all efforts are focused on building long-term value to help pay future CPP pensions.

Our directors approve strategic plans, annual business plans and budgets, as well as investment and risk management policies and controls.

Our Board, pursuant to its authority under our legislation, appoints the President and CEO of the CPP Investment Board and approves his appointment of officers. This is a key element at keeping our organization at arm's length from governments and establishing the accountability of management to the Board.

For its part, management is responsible for implementation of all Board approved strategies, plans and policies and is accountable to the Board for doing so.

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 our 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.

One important final point on the role of our Board.

The CPP Investment Board Act also mandates our board of directors to appoint our auditor. In our case the firm selected was Deloitte & Touche. The responsibility for appointing the auditor is a demonstration of the authority invested in our Board and another clear example that those who designed and approved our legislation intended the CPP Investment Board to be at arm's length from governments.

COMMITTEES OF THE BOARD

Now let's consider for a moment board committees. Our Board has created four committees. 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 the other on human resources and compensation, advance our governance and operating objectives.

Our governance committee, chaired by an experienced corporate director, led the development of a comprehensive governance manual that has been reviewed and adopted by our Board.



Our Chair has created a culture that promotes active participation in committees and an expectation that the Board will thoroughly discuss and debate committee reports and recommendations, not just rubber stamp them.

CODE OF CONDUCT AND CONFLICT OF INTEREST

And of course we also have a code of conduct for directors and an even 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, does it in anyway 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.

We also have tough conflicts of interest guidelines for officers and employees. Their codes of conduct and conflict of interest guidelines are published on our Web.

We make these documents readily available because we appreciate the importance of these rules given that over the next 10 years, the CPP Investment Board's invested assets will grow from about \$7 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 drafted procedures that restrict insider trading and front running by officers and employees.

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

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

In addition, all 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 have also built 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.

All in all, we have a lot of checks and balances in our accountability: the Board of Directors, private sector auditors, governments and millions and millions of Canadians who contribute to and benefit from the Canada Pension Plan and are vigilant in scrutinizing our conduct and performance.

COMPARISON TO BEST PRACTICES

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.

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

These principles are 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.

PUBLIC REPORTING AND COMMUNICATIONS WITH CANADIANS

Another feature of our legislation calls for an unprecedented level of transparency in reporting our financial results. As far as we know, we are the only pension fund that is required by law to produce quarterly financial reports that must be delivered to the federal and provincial ministers of finance within 45 days after the end of the three month period to which they relate. We must also deliver an annual report within 90 days after the end of each financial year to the finance ministers and make copies of the report available to the public.

Though we are not required to make quarterly reports public, we have chosen to do so and release them both through the media and by posting them on our Web site. We strongly believe in the importance of offering Canadian stakeholders the broadest possible information on the financial results of investments made from their contributions.

Our legislation has other sections that ensure Canadians are well informed on our activities. It requires that we hold a public meeting once every two years, in each of the nine participating

province, to discuss our most recent annual report and to give interested citizens an opportunity to comment on it. We held our first series of national public meetings across Canada in January of this year.

THE AUDITOR GENERAL'S RECOMMENDATIONS

I now want to move to my third and final topic: how do the governance standards and practices of the CPP Investment Board compare to the three areas the Auditor General identified in Chapter 18 of his December 2000 Annual Report as needing special attention.

Here are the three areas he focused on:

- the need for the Board to have the skills and abilities to carry out their responsibilities and to have the power to select the chair and the chief executive officer;

- the need for effective audit committees who can play a crucial role in financial reporting, risk management and internal control; and

- the need for governments to challenge and review corporate plans which form the basis of accountability and performance measurement.

While I welcome the opportunity to comment on each, I do want to point out that the CPP Investment Board is not subject to the Financial Administration Act. The reason for this will become apparent in a moment. Now to specific responses on the items.

As it relates to the first, I am sure it is obvious to you that we qualify doubly. Our legislation requires our Board to be populated with individuals with relevant skills and experiences. Our actual Board is composed of outstanding individuals whose resumés demonstrate clearly that



they exceed the desired standard. It is difficult to envision what a more able and dedicated Board would look like.

Our Chair is appointed by the Governor-in-Council after consultation with the provinces and the full Board. As for myself, I was appointed by the Board and am accountable to it. In fact the ministers only learned of my appointment after it had been made and was being announced on the news wires.

On the matter of an audit committee, the same prevails. Our legislation requires us to have an audit committee, and it is a strong one with explicit terms of reference covering such topics as purpose, composition and operations, duties and responsibilities, risk management, internal control and information systems, internal audit, external audit, special examinations, accountability and timetable.

Its Chair is a chartered accountant and its members all bring relevant skills and experience, and their inquiring minds, to the table.

Let me now address the Auditor General's final concern: that governments are insufficiently involved in reviewing and challenging the corporate plans of Crown corporations.

Here we absolutely do not meet the recommended practice. In fact, we are careful to avoid meeting it or even creating the appearance of trying. Why so? Some background will help you understand.

INDEPENDANCE

When the federal and provincial ministers of finance developed the legislation that created CPP Investment Board they were diligent in ensuring this new Crown corporation, that was to be responsible for the investment of large amounts of capital, could in no way be subject to political intervention or influence.



In fact I would go so far as to say that unless federal and provincial finance ministers and the Canadian public had been convinced that the CPP Investment Board would be able to operate at arm's length from government, it would never have been born.

And we experienced first hand the public craving for demonstrated independence of our corporation from political intervention when we held our first series of public meetings across Canada in January.

Canadians everywhere expressed their fear that government will some day covet these funds and want to use them for purposes other than securing the long-term pension security of contributors and beneficiaries. They want repeated and continuing assurances it will never happen.

CONCLUSION

That completes my tour de force on governance, and if you have stayed with me this long, and resisted hitting the fast forward button, I am flattered.

In conclusion, I believe it is fair to say that the CPP Investment Board meets the highest governance standards.

We strongly believe that good governance only works if those responsible for it embrace its objectives and live by its principles, and we do.

Our hope is that, over time, 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 join you by video and best wishes for a successful conference. I look forward to any comments and questions you may want to send to me. I can be reached at 416-868-4077 and I would be delighted to hear from you.