Check Against Delivery

The CPP Investment Board:
10 Years, 5 Questions

Notes for remarks by

David Denison
President and CEO
Canada Pension Plan Investment Board

to

The Halifax Chamber of Commerce

June 2, 2008

Reading Copy

Thank you… It’s a pleasure to be here with you today in Halifax for this lunch and as well later today for the start of a series of public meetings that will take us across Canada over the course of the next few weeks.

These meetings are something we do every two years in each of the nine Provinces that participate in the CPP. They give us a great opportunity to speak directly to Canadians about our activities in managing the CPP Fund, and for Canadians to put their questions to us.

While the questions posed at each of these meetings reflect the perspectives and interests of the attendees, from our recent experience in a variety of interactive forums, we have identified five questions that tend to recur frequently and so I can safely predict that some variations of them will be posed in these meetings starting in Halifax this evening.

So I thought I would focus my comments today on our “FAQ” or frequently asked questions list.

For a long time, many Canadians had only **one question** about the CPP and that was: Will my pension be there for me when I retire? Thanks to the reforms of the mid-1990s, the answer to that question is a resounding Yes.

At the time of the CPP reforms in the mid-90s, Canada’s Chief Actuary forecasted that the CPP would be insolvent by 2015. Under his latest forecast based on data from 2006, the Plan is sustainable for the entire 75 year period covered by his forecast.

To put that in dollar terms, at the point that the CPP Investment Board took responsibility for managing the CPP Fund in 1999, the Fund had assets of $44 billion which were diminishing rapidly. As of March 31, 2008, the Fund had assets of approximately $123 billion, and is expected to grow past $310 billion by 2019.

That’s the good news – the unfortunate reality though is that a majority of Canadians don’t know it.

In fact, public opinion research conducted last month shows that almost two-thirds of Canadians are still unaware that the CPP was successfully reformed 10 years ago. This same percentage of Canadians is also unaware that there is a huge and growing pool of assets being invested to help sustain the CPP for generations to come.

I think it’s safe to say Canadians would rest easier about the health of the CPP if they were more aware of this success story – particularly now, when challenging financial market conditions are front page news.

And so not surprisingly, one of the questions we are frequently asked these days is: What impact has the global credit crisis and market volatility had on the CPP Fund?

The answer comes in two parts. In the near-term, it has resulted in marginally negative investment returns for 2008, largely due to a decline in the public equity markets of more than 10% during the last 8 months of our fiscal year.

Longer term, however, these same market dislocations have created significant opportunities for us. As a well-capitalized investor with a long time horizon, world-class investment partners and deep capabilities of our own, we have been very well positioned to take advantage of the current turmoil to buy a range of securities at very attractive prices.

We always strive to perform well, even in down markets, but our focus is on building long-term value to help sustain the Plan. In that respect, the news to date is good. Over the past four years, the Fund has generated an annualized return of 9% for an aggregate $32.2 billion in investment income, well in excess of what is required to sustain the CPP at current contribution levels.

The second question on our list is one that is posed not just by Canadians but by people from many other countries who have studied the CPP Investment Board model and that is: "Can you *really* make investment decisions independently from government?" Here again, the answer is an unequivocal yes.

Back at the time of the CPP reforms, Canadians agreed to accept benefit reductions and contribution increases, but insisted that the Federal and Provincial governments would entrust their CPP funds to a professional investment organization operating at arm's length and according to an iron-clad, "investment-only" mandate.

This was the defining moment in the reforms of the CPP and led to the creation of the governance model for the CPP Investment Board. The Canada Pension Plan Investment Board Act contained specific measures to ensure that we could operate as a private sector investment firm while maintaining key elements of public sector accountability that the reformers had promised to Canadians.

So the CPPIB was created with a unique governance model that strikes an effective balance between independence and accountability.

In terms of our independence, the first point to emphasize is that the money in the CPP belongs to the participants in the Plan and *not* to government.

Next, we operate according to a clear, singular and legislated mandate. The mandate states that we will invest the funds not needed to pay current benefits to maximize return without undue risk of loss. In case there was any doubt, the legislation goes on to say that we must not pursue any objectives that are inconsistent with our mandate, and that this money cannot be used for any purpose other than to pay benefits, invest in future growth and administer the fund.

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.

It is the board of directors -- not government -- that determines with management the organization's strategic direction and makes critical operational decisions such as hiring the CEO and approving investment, risk management, compensation and other policies.

Having enshrined our mandate and its supporting governance model in legislation, the reformers went a step further by ensuring our governing legislation can only be amended by agreement of the federal government *and* two-thirds of the provinces representing two-thirds of the population.

Lest the significance of this be lost, this is an even higher level of consensus than what is required to amend Canada's constitution.

That addresses independence, but we can't speak of independence without also addressing accountability.

The CPPIB is accountable to Canadians through the Federal Finance Minister and the Finance Ministers of each of the participating provinces, otherwise known as the stewards of the CPPIB. The Stewards provide oversight in a number of ways, including through independent audits. I can say without qualification that they have fulfilled this oversight role effectively without ever attempting to influence our investment decisions. And of course, our public meetings, that I referred to earlier, are also an important part of our accountability framework.

The CPPIB's founding Board of Directors understood that our ability to properly fulfill our mandate was dependent on more than just legal protections. It also required earning the trust and confidence of Canadians. To that end, they instituted a disclosure policy, which 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 policy has served us very well, both at home and abroad, where foreign governments and international policymaking bodies like the IMF, OECD, and others have cited our governance model and transparency as an international model for public fund governance.

And as any visit to our website will show, our policy has produced an extraordinary degree of transparency, including a complete list of our investment partners and portfolio holdings.

And visitors to our website can also see extensive and regularly updated information on the make-up of our investment portfolio.

Which often gives rise to **question number 3**: Why do we invest so much of the portfolio outside of Canada, especially when the Canadian economy is doing better than many other countries?

The first point to make here is that, in fact, we currently have approximately $65 billion invested in Canada. This includes ownership positions in more than 700 public companies, and a commercial real estate portfolio that includes landmark buildings in major cities. And with more than $600 million invested in Canadian venture capital funds, the CPPIB is also one of the largest venture capital investors in Canada.

So Canada will always be an important area of investment for us and a large proportion of the portfolio. Having said that, our primary goal is to invest where we think the risk-adjusted returns are greatest and best meet the needs of our portfolio. And that means that we will be increasing our international investments over time as a key part of our diversification and risk management strategy.

Investing in international markets supports our mission in three primary ways:

- Given that Canada represents less than 3 percent of global capital markets, investing internationally gives us access to market sectors like technology, health care and consumer goods that aren't well-represented in Canada's markets which are heavily concentrated in a few sectors, such as natural resources and financial services.

- Second, the flow of contributions into the CPP varies directly with the health of the Canadian economy. Global diversification offers a source of returns for those times when the Canadian economy -- and correspondingly, CPP contributions – might be weak.

- Third, prudent investments in rapidly growing regions will enable us to generate investment income abroad that can be used to help pay pensions for Canadians here at home.

When you boil it all down, what I'm saying is that diversification – both by geography and asset class – helps us reduce risk and increase returns.

The mention of risk brings me to **question number 4:** As Canadians notice that we are involved in higher profile direct investments such as our bid for the Auckland airport or the Washington State power utility called Puget Energy, they sometimes ask: Why get involved in active investments like private equity, real estate or infrastructure when you could just invest the CPP Fund in lower risk passive, indexed investments?

The answer is that while a passive portfolio of indexed investments might enable us to sustain the plan, active strategies should enable us to do better. To sustain the Plan, Canada’s Chief Actuary has estimated we need to deliver a 4.2% return – after inflation – over a long period of time. Now it is indeed possible to generate that return with a passive portfolio given reasonable capital market assumptions – and in fact a portion of the assets in the Fund are actually managed in just this way.

Active strategies, however, provide another means of portfolio diversification, and have the potential to generate above-market returns which, for a fund our size, can translate into billions of dollars of additional assets.

Accordingly, in late 2005, the CPP Investment Board made the strategic decision to become a more active investor, seeking value-added returns in a broader range of asset classes, such as infrastructure, real estate and private equity, and implementing a broad range of internal and external active investment programs.

We believe that this strategy is consistent with our legislated mandate to “maximize investment returns without undue risk of loss” and takes advantage of our inherent strengths of size and long investment horizon.

In conjunction with the adoption of this value-added approach, we introduced a model reference portfolio that we use as the yardstick against which we evaluate strategic decisions and measure our own performance. It also enables the Board to tie compensation directly to value-added performance, adding yet another layer of accountability while enabling us to compete for the best investment professionals in the market which in turn is critical to our ability to succeed as an active investor.

It is still early days, but so far the results of our value-added strategy have been both positive and significant. Over the last two fiscal years, we have delivered $5.3 billion in value-added returns over and above our market based benchmark.

We recognize that two years is a very short time frame, particularly for us, but we are confident that we can continue to add significant value to the CPP Fund over time through this strategy.

I'll now turn to **question number 5** which is: What are you doing in the area of responsible investing?

The short answer here is: a significant amount, in respect of how these kinds of issues affect risk and return factors in our portfolio.

Within our Public Markets Investment group which manages more than $100 billion invested in publicly-traded stocks, bonds and other securities, we have a team that has primary responsibility for implementing our *Policy on Responsible Investing*. At the core of this policy which we adopted in 2005 are two key beliefs:

1. That responsible behaviour with respect to environmental, social and governance factors – ESG, for short -- can generally have a positive influence on long-term corporate financial performance; and

2. That engagement is an effective strategy to encourage improved disclosure of and performance on ESG issues, particularly for large institutional investors with a long investment horizon like us.

Our approach is consistent with the United Nations Principles for Responsible Investment – principles we actually helped to formulate – and has received positive recognition from the Social Investment Organization in a comprehensive review of responsible investment in Canada.

This policy leads us to engage with companies on issues we believe have the potential to affect investment risk and return. Currently, our engagement activities focus on three areas: climate change, extractive industries (oil, gas and mining) and executive compensation.

One of the ways in which we achieve engagement is through coalitions of like-minded investors. The Carbon Disclosure Project, of which we are a signatory and active supporter, is a good example. With 385 investors representing over $57 trillion in assets, the CDP is one of the world's largest investor coalitions. Together, we are seeking improved disclosure from more than 3,000 public companies around the world on climate change related risks and their strategies to deal with a rapidly changing regulatory environment with respect to carbon emissions.

In addition to our work with coalitions, we voted on 15,000 proxy items on a broad range of issues last year in support of our beliefs, and beyond voting also initiated dialogue directly with managements and boards. In almost all cases, our engagement has resulted in productive discussions with senior management. In many cases it has contributed to positive and concrete actions by these companies. Our experience to date has been that we can be more effective in private conversations than through public campaigns, and so we seldom disclose the targets of our engagement. That doesn't mean we won't go public if we feel we have to – and that is a clear point of leverage in our discussions with management and boards.

……………………..

So let me briefly recap our story of ten years and five questions:

- The CPP is strong and sustainable

- We have the balance of independence and accountability the reformers intended, and we are recognized around the world as setting the standard for public fund governance.

- We are a very large investor in Canada’s public and private markets, with a growing international portfolio that should be a long-term source of returns to help fund pensions here at home.

- The CPP Fund today is a broadly diversified portfolio with approximately $123 billion in assets and a strong track record of delivering value-added returns.

- We are implementing our *Policy on Responsible Investing* because we believe that Environmental, Social and Governance factors can contribute to investment returns.

To these points I would simply add that we are working very hard to build a world-class investment organization. We are proud of what we have accomplished so far, but we have a lot more work to do – and we intend to do it with an overriding commitment to integrity, performance and transparency as we work to deliver the investment returns needed to help sustain the CPP on behalf of 17 million Canadians.

It’s a privilege for me to be here today. I hope you have found my remarks informative and feel more secure about your retirement plans as a result.

Thank you.