



CPP  
INVESTMENT  
BOARD

**The Canada Pension Promise:  
Maintaining Trust with Canadians**

By

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**CHECK AGAINST DELIVERY**

Thank you for the invitation to address the Empire and Canadian Clubs, to speak about the crown corporation I am privileged to lead: the Canada Pension Plan Investment Board.

Crown corporations exist to implement various dimensions of public policies. They are important instruments of Canada's system of governance. And, like that system of governance, they must earn and retain public confidence.

We take that seriously at the Canada Pension Plan Investment Board, which is why I am here today.

We live in a suspicious age. Anywhere you look in the public sector and private sector ... in Canada and elsewhere ... the integrity of governments and corporations is under siege.

There is widespread concern about the ethical standards of those charged with acting in the best interests of others. Fiduciaries ... whether pension fund trustees or corporate directors ... deserve close scrutiny. After all, it's not *their* own assets they manage; they're *your* assets.

As scrutiny proceeds, the debate inevitably comes to that ubiquitous phrase – corporate governance.

At its core, the corporate governance framework sets out the duties of fiduciaries ... and the relationship of those who govern to those who manage.

But what is the most appropriate governance model? Different organizations with different mandates have adopted somewhat different governance frameworks. Yet they share common principles, one of which is to earn and maintain public trust.



That means paying attention to ethical matters. So we should ask:

Does the governance model address ethical conduct?

Does the governance model hold people accountable?

Does the governance model prevent and, if necessary, facilitate the expeditious discovery of mistakes, fraud or malfeasance?

Does the governance model ensure that problems and unacceptable behaviour are dealt with promptly?

And if trustees and directors watch over management ... and elected representatives watch over public servants ... who watches over the watchers?

The answer is the citizen electors in the public sector and shareholders in the private sector. But do they have enough reliable information to make informed judgments? In short, is there sufficient transparency?

These concerns relate to all public and private sector corporations. What is different for crown corporations is how their governance model defines the relationship with government, and the public at large.

I am lucky. I work for a young crown corporation that has an unusual – and I suggest a sturdy -- governance model. It has been in place for five years and has served us well thus far in our corporate life.

Our governance model balances responsibilities and accountabilities. It protects confidential and private information in the normal course of business ... while

letting in sufficient light that others can see what is going on. It keeps us at arm's length from governments in our investment, procurement and recruitment decisions while insuring that governments who are the CPP sponsors, and therefore its ultimate stewards, have appropriate oversight.

Still, how can you be sure that we at the CPP Investment Board are operating at arm's length from government while still being held properly accountable? After all, we are a crown corporation ... a product of the political process.

Let me tell you a story that I think will pleasantly surprise you. And I will begin by taking you back a few years ... first to 1966 when the Canada Pension Plan was born ... and then to 1996 when our governance model was ... well, conceived would be the right word ... with birth officially a year later.

The Canada Pension Plan was created in 1966 as a pay-as-you-go scheme. Unlike other pension plans, it was never designed to be fully funded. The basic idea was that current workers would pay the pensions of retired workers. That made sense in the 1960s ... when there were seven workers for every pensioner.

But 30 years later... in 1996 ... the plan was in dire straits. More money was flowing out to pay benefits than was flowing in from contributions.

Meanwhile, Canada had undergone dramatic demographic change. By the mid-1990s, there were only five workers for every retiree. The situation is getting worse. By 2030, there will be only three.

In response, the federal and provincial finance ministers of the day did something admirable. We often accuse politicians of failing to see beyond the next election. But those finance ministers looked deeply into the 21st century and took bold actions.

Among many changes, two stand out. First, they increased the contribution rates of employers and employees from six percent on most wages in 1997 to 9.9 percent effective in 2003. This was a large increase though less than would have been required if they had delayed. Second, they created the CPP Investment Board to invest the plan's financial reserves.

Before I get to the CPP Investment Board, let me draw out three features of the Canada Pension Plan that do not appear to be well known. They help to explain why we have the governance model we have.

First, contrary to popular belief, the Canada Pension Plan is not a federal program ... although it is administered by the federal government. The stewards of the plan are the federal *and* provincial governments. Together, they set the funding policy, contribution rates and benefit levels.

Second, the CPP is not government financed. It is funded solely by workers and their employers. The only financial obligation on governments is to match the CPP contributions of their employees ... just like any other employer.

Third, CPP reserves are not part of consolidated government assets. They sit in segregated accounts and cannot be used for any purpose other than administering the plan and paying pension benefits.

This segregation is a sharp contrast to other jurisdictions. In the United States, for instance, social security contributions are treated as cash flow to the government, and have been since the 1960s. In Canada, we have the lock box that Americans can only dream of.

The chief actuary has stated that the plan is sound on this basis for at least 75 years ... an opinion endorsed by a panel of independent actuaries.

So where does the CPP Investment Board fit in?

Our job is to invest excess contributions until they are required to pay benefits. Today, we are responsible for \$31 billion in public stocks, private equity, real estate and infrastructure assets. Ottawa administers a \$35 billion bond portfolio and cash reserve. These assets will be transferred to our care over the next few years.

The \$66 billion in assets available to the CPP are expected to exceed \$160 billion within a decade. The CPP Investment Board will be a large institutional investor for decades to come.

We have a heavy responsibility. Our legislation directs us to maximize investment returns without undue risk. In doing so, we are conscious of managing assets in a prudent manner in the best interests of the 16 million Canadians who contribute to or benefit from the Canada Pension Plan.

I'm sure you are still thinking ... that's all well and good ... but how can a crown corporation invest a large pool of assets at arm's length from government?

This is where the federal and provincial finance ministers were ingenious in identifying the potential risk and designing safeguards. Let's go to my second milestone date – 1996.

That year, a federal/provincial task force set off across Canada to consult with Canadians on how to revitalize the Canada Pension Plan.

To ensure its long-term stability, the task force had to convince workers and employers to contribute much more. A key factor in gaining acceptance of a higher contribution rate was the commitment to develop a governance structure that ensured contributions would be invested wisely by qualified professionals.

The CPP Investment Board was conceived during the consultations with the public and between the federal and provincial governments.

Let me take you inside that governance model to show how independence from political influence is balanced by a level of accountability to parliament, the provinces and the public unparalleled in Canada.

Like other crown corporations, the CPP Investment Board has its own board of directors and professional management team.

From the beginning, the federal and provincial governments resolved that ours should be an experienced board.

Our legislation requires the board to have (and I quote) “a sufficient number of directors with proven financial ability or relevant work experience”.

The criteria approved by governments identified individuals with experience in a senior capacity in the financial industry ... broad investment knowledge ... experience as a CFO or treasurer of a large corporation or government entity ... pension consulting experience ... or accreditation as an investment professional.

You will be pleased to know, we have all that on our board of directors.

How the directors are appointed is also a departure from the traditional practice for crown corporations. Let me explain.

The finance ministers created a nominating committee chaired by a former private sector chief executive officer. The provinces and federal government each appoint a member to the committee, which identifies and recommends a list of qualified board candidates.

The federal finance minister appoints directors from that list after consulting provincial finance ministers.

This consultation is a check on partisanship because at any particular time federal and provincial governments are led by different political parties. To be appointed to our board of directors an individual needs to be broadly supported in Ottawa and in provincial capitals.

The process has produced a board of independent and independently minded directors with the mix of business, professional and investment experience appropriate to informed oversight of an investment management company.

Some might find it ironic that politicians from conservative, liberal and socialist parties enshrined the principles of board expertise and director independence in 1997 for a crown corporation ... before the outbreak of corporate and accounting scandals forced other legislators and regulators to do the same for public companies. Based on the evidence, Canada's legislators were ahead of the times.

We spend a good deal of time thinking about governance matters at the CPP Investment Board. And we have consciously gone beyond the legislative requirements for such now-routine governance standards as conflict of interest policies, codes of conduct, restricted trading procedures and so forth.



We strive for best governance practices, including a rigorous process for the directors to evaluate themselves collectively and individually... and for the board to evaluate my performance as CEO.

Let me give a small example with big ramifications of how hard we try to do the right thing.

Once a year, our directors evaluate the effectiveness of the board of directors based on a wide range of topics. Among the issues they consider is the statement (and I quote) “there has been no inappropriate pressure brought to bear on the Board, any director or management in the investment, procurement or recruitment decisions of the CPP Investment Board.”

The statement seems innocuous. It isn't. Obliging directors to deal with it formally is a sharp reminder that none in good faith can ignore.

Furthermore, the Board Chair, Gail Cook-Bennett, asks the directors if any federal or provincial politician has tried to influence them. She asks me the same question in front of the board.

In my four-and-a-half years in this job, I can tell you that neither I nor the organization has ever been subject to anything that remotely felt like an attempt at political influence.

Fortunately, our brief history confirms that the political independence of the CPP Investment Board is respected on all sides and in all quarters.

Let me turn now to another cornerstone of good governance – disclosure. Full and timely disclosure is central to our governance model ... and it is unusual in its depth and frequency.

We file our annual report in Parliament through the federal minister of finance ...  
file quarterly financial statements with federal and provincial finance ministers ...  
and hold widely advertised public meetings every two years in the nine provinces  
that participate in the Canada Pension Plan.

Our next meetings are scheduled for June. Our Chair and I will be there and we  
invite you to attend.

In addition to these meetings, we meet with groups interested in the Canada  
Pension Plan and our investment activities. These include parliamentary  
committees as well as federal and provincial government officials with  
responsibilities related to the Canada Pension Plan. We also meet from time to  
time with union leaders, business leaders, students, pensioners, anti-poverty  
groups, regulators, actuaries and financial planners.

As for our financial statements ... we publicly release them every quarter to the  
news media and post them on our web site for public review. We also post our  
investment holdings every quarter.

No other pension fund discloses as much as we do ... let alone quarterly. We do  
it because we believe that good disclosure is part of good governance.

Let me quickly identify some of the governance features that distinguish the CPP  
Investment Board as a crown corporation ... because I think they will increase  
your confidence in our mandate.

The finance ministers accepted that the CPP Investment Board would be a  
commercial venture requiring directors and executives with active business and  
investment experience. They designed our legislation accordingly.

That legislation recognizes that conflicts of interest could arise and requires us to establish policies and procedures to resolve them. We have gone further. Our policies and procedures address not only real conflicts but also potential and perceived conflicts. If you are interested in our policies, you will find them on our web site.

Here's another important distinction. Our board of directors hire, hold accountable and if necessary fire the CEO. They make the choice and then advise government, not the other way around.

Our directors approve our budgets, investment strategies and policies ...not a cabinet minister. Management reports to the board of directors ... not to government.

Like a private sector company, our board appoints our external auditor and our internal auditor. Both report to the board's audit committee.

All these distinctions are solid underpinnings to the arm's length nature of our relationship with governments. Of equal importance, they are essential ingredients of an effective board mandate.

Now you understand why I said earlier that the finance ministers did something admirable in taking bold actions. The finance ministers who designed this governance model had the foresight to understand that public confidence in the CPP Investment Board would require finding and holding the fine balance between operational independence for the organization on the one hand and public accountability on the other.

We were given a strong governance model and we are always searching for ways to make it better. Two years ago, for example, we retained three outside specialists to examine our ethical standards and approach to ethical issues. They liked what they saw, but inevitably found room for improvement. By the way, we published their findings on our web site.

One of their recommendations was that we proceed with our board's idea of appointing an outside independent conduct review advisor. This culminated recently in what we believe is a first for a federal crown corporation – the appointment of a part-time external advisor on conflicts of interest and ethical conduct.

The idea is that directors, employees and relevant third parties, such as external investment managers, have an alternative to the Chair, CEO or general counsel in discussing issues confidentially. In other words, we have opened up an avenue outside our organization for whistleblowers ... and for directors and employees seeking wise counsel in private on ethical questions.

We are delighted that Purdy Crawford ... an expert in corporate, commercial and securities law with a deep legal and business background ... accepted our invitation to serve as our external conduct review advisor. He reports to our Chair.

This appointment is our latest attempt to prepare the CPP Investment Board for an ever-more complex investment world where we, as fiduciaries, have ethical expectations of companies in which we invest ... expectations therefore that we ought to exemplify ourselves.

What is conspicuous about our governance model is that it rests upon a federal and provincial sharing of interests and checks and balances. It is a model that

shows federalism at its best and may have applications in other areas of shared jurisdiction.

Of course, what we do at the CPP Investment Board rests a great deal on public confidence and we track public opinion in areas associated with our mandate.

We know from research that Canadians like the idea that qualified investment professionals make the investment decisions under the watchful eye of qualified independent directors with business, financial and investment expertise.

We also know that Canadians do not want the CPP Investment Board to be beyond the purview of government. They want us to work effectively and respectfully with those public servants in Ottawa and the provinces who have important responsibilities for the design and delivery of the Canada Pension Plan. And we do. They want public accountability. They want ministers and parliamentarians to keep an eye on us. And they do.

The finance ministers undertake a triennial review of all aspects of our legislation and regulations ... and they commission an independent actuarial study of the financial soundness of the Canada Pension Plan.

As well, like other crown corporations, we are subject to what is called a special examination. Every six years, the federal finance minister, in consultation with provincial counterparts, must order an examination of our financial and management control and information systems and management practices.

This examination is currently underway and the examiner is expected to report to finance ministers this fall.



I hope what I have shared with you illustrates the wisdom and strength of our distinctive governance model. It has served Canadians well.

The vision of past federal and provincial finance ministers was a crown corporation that balances independence with accountability in managing billions of dollars that belongs to Canadian workers.

The governance model they constructed is one that reflects positively on the working of our Canadian federation. It is one we believe will continue to serve Canadians for generations to come.

Our accountability to parliament, the provinces and the public is unmatched by any crown corporation or pension fund.

Gail Cook-Bennett and the board of directors she leads and the team of officers and employees I lead are mindful of the responsibilities entrusted to us. We have no illusions that our work is easy or that we are perfect. But I can assure you we are committed to best governance and business practices ... as we do our part to keep the Canada Pension Plan promise to the millions of Canadians who are counting on us to help them retire with the security and the dignity that they deserve.

Thank you.