



**CPP  
INVESTMENT  
BOARD**

**STATEMENT OF INVESTMENT OBJECTIVES, POLICIES,  
RETURN EXPECTATIONS AND RISK MANAGEMENT  
FOR THE INVESTMENT PORTFOLIO OF THE  
CANADA PENSION PLAN**

**August 10, 2010**

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### 1.0 PURPOSE

- 1.1 This Statement of Investment Objectives, Policies, Return Expectations and Risk Management (the “Investment Statement”) documents the key investment objectives, policies, standards and procedures approved by the Board of Directors<sup>1</sup> (the “Board”) of the Canada Pension Plan Investment Board (“CPPIB”) for the assets of the long-horizon CPP Investment Portfolio (the “Fund”).
- 1.2 The Investment Statement has been prepared in accordance with the Canada Pension Plan Investment Board Act (the “Act”) and the Canada Pension Plan Investment Board Regulations (the “Regulations”).
- 1.3 The Investment Statement has been prepared with six stakeholder audiences in mind: Canada Pension Plan (“CPP”) contributors and beneficiaries; federal-provincial CPP stewards; CPPIB Board of Directors; CPPIB employees; CPPIB agents engaged to manage and administer CPP assets; and the Chief Actuary of Canada.
- 1.4 The Investment Statement is supported by proprietary documents that govern the day-to-day management of the Fund including decision authorities, risk management policies and standards, performance standards and reporting protocols.
- 1.5 The Board reviews and confirms or amends the Investment Statement at least once every fiscal year.

### 2.0 INVESTMENT OBJECTIVES

- 2.1 The Act specifies three objectives for CPPIB in relation to the Fund:
  - (a) Assist the CPP in meeting its obligations to contributors and beneficiaries;
  - (b) Manage assets in the best interests of CPP contributors and beneficiaries; and
  - (c) Invest assets to achieve a maximum rate of return, without undue risk of loss, having regard to the factors that may affect the funding of the CPP and the ability of the CPP to meet its financial obligations on any given business day.
- 2.2 The policies documented in the Investment Statement and in a companion statement that governs the smaller CPPIB Cash for Benefits Portfolio have been designed to achieve these three objectives.

### 3.0 FACTORS AFFECTING THE ABILITY OF THE CPP TO MEET ITS OBLIGATIONS

- 3.1 The CPP is a partially funded defined benefit plan using a combination of steady-state funding and incremental full funding to determine the minimum contribution rate. The CPP is designed to be self-sustaining with benefits financed

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<sup>1</sup> Terms explained in the Glossary are underlined when they first appear in the text.

by employee-employer contributions and Fund investment earnings. If the best estimate assumptions in the 23rd Actuarial Report (the “Actuarial Report”) on the CPP are realized, the current 9.9% employee-employer contribution rate and investment earnings will be sufficient to pay benefits as currently defined over the 75-year projection period.

- 3.2 It is estimated in the 24<sup>th</sup> Actuarial Report that CPP contributions will exceed benefit payments until 2021<sup>2</sup>. This allows CPPIB to re-invest investment earnings to build capital to help pay benefits in subsequent years. By 2021, a growing percentage of investment earnings will be used to pay benefits. By 2025, it is estimated that 19% of investment earnings will be required to pay benefits. This increases to 31% of investment earnings in 2050. The funded ratio stabilizes at approximately 25% at about 2025.
- 3.3 Future CPP benefits and contributions will be driven by a mix of demographic, economic and investment factors, each of which could increase or decrease future CPP contribution rates and/or benefits if their future values differ materially from those assumed in the Actuarial Report. The estimated impacts of changes in these factors are contained in the Actuarial Report.
- 3.4 Fertility, retirement and life expectancy are the key demographic factors. Lower than expected fertility could increase CPP contribution rates. Retiring earlier than expected could increase CPP contribution rates. Unexpected increases in life expectancy could also increase CPP contribution rates.
- 3.5 Because the CPP is partially funded, real wage growth is the economic factor that most affects future contribution rates. Lower than expected real wage growth over the projection period whether from lower productivity or lower inflation, could increase future contribution rates.
- 3.6 Interest rates and risk premiums are the investment factors that most affect future contributions. Lower than projected interest rates or lower than expected risk premiums could increase future contribution rates.
- 3.7 While the factors affecting future contribution rates are beyond the control of CPPIB, their potential impacts on contribution rates are considered by CPPIB when evaluating alternative investment policies. To the extent possible, CPPIB adopts investment policies that will mitigate the impact of unfavourable changes in these factors. This mitigation is summarized in Section 4.0.
- 3.8 CPPIB decisions do affect Fund investment earnings, especially active management returns. However, the investment returns of a diversified portfolio are determined primarily by overall capital market returns, which are driven by economic activity.
- 3.9 If the Chief Actuary determines that the current 9.9% contribution rate, in combination with future investment earnings, is not sufficient to pay benefits, the contribution rate may be increased and/or benefits reduced in accordance with

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<sup>2</sup> The 24<sup>th</sup> Actuarial Report is an interim report that does not provide sufficient information to update all the assumptions in the Investment Statement. It is quoted here only to provide the date when investment earnings will be required to pay benefits in order to be consistent with the recently published 2010 Report on Responsible Investing.

amending provisions specified in the Canada Pension Plan Act and Regulations. These provisions ensure the CPP is self-sustaining across future generations.

**4.0 CPP REFERENCE PORTFOLIO**

- 4.1 The CPP Reference Portfolio (the “Reference Portfolio”) summarized in Exhibit 1 is approved by the Board and used to evaluate Fund performance and hold CPPIB accountable for its active management investment decisions.
- 4.2 The Reference Portfolio is a diversified portfolio of publicly traded securities that could be implemented using a low cost passive investing program. It is designed to earn sufficient capital market returns over the long term to keep the CPP contribution rate at or below 9.9%, while also mitigating to some extent the behaviour of CPP net liabilities as estimated by CPPIB.
- 4.3 The composition of the Reference Portfolio recognizes constraints imposed by the liquidity of certain assets (e.g. the Fund’s legacy portfolio of non-marketable federal and provincial bonds).

<b>CPP Reference Portfolio</b>	<b>Exhibit 1</b>
	(%)
<b>Equity</b>	
Foreign Developed Markets	45
Canadian	15
Emerging Markets	5
<b><i>Total Equity</i></b>	<b>65</b>
<b>Debt</b>	
Canadian Real Return Bonds	5
Canadian Nominal Bonds	25
Foreign Sovereign Bonds	5
<b><i>Total Debt</i></b>	<b>35</b>
<b><i>Total</i></b>	<b>100</b>

- 4.4 Using reasonable capital market assumptions, the 65%/35% equity/debt weighting of the Reference Portfolio is expected to earn at least 4.2% real rate of return over the long term. According to the 23rd Actuarial Report on the CPP, an average annual 4.2% real return is required over the 75-year projection period to sustain the plan at a minimum contribution rate of 9.82%, assuming all other assumptions by the Chief Actuary are realized. The equity/debt weighting also embodies the level of risk implied by the CPP stewards when they agreed in 1997 to invest CPP assets in the capital markets.
- 4.5 The 45% foreign developed markets equity weighting reduces the dependence of the Fund on the Canadian economy, which represents less than 5% of the world’s capital markets. It also provides a high expected real return and partially mitigates the risk of lower than expected wage growth in Canada.

- 4.6 The 15% Canadian equity weighting provides a high expected real return and partially mitigates the risk of decreases in Canadian interest rates which are correlated with Canadian equities.
- 4.7 The 5% weighting to emerging markets equity provides a high expected return and recognizes the increasing size of emerging markets as a percentage of the world's equity market. This reduces the Fund's exposure to Canada's relatively small market as the CPP Fund increases in size relative to Canadian capital markets.
- 4.8 The 5% weighting to Canadian real return bonds mitigates the risks of unexpected inflation and decreases in real interest rates. The allocation also reflects the limited supply of real return bonds available to investors, especially large funds like the CPPIB.
- 4.9 The 25% weighting to Canadian nominal bonds recognizes the Fund's legacy exposure to federal and provincial non-marketable bonds and mitigates deflation risk. Nominal bonds are expected to earn a marginally higher return than real return bonds because nominal bond returns include an inflation risk premium.
- 4.10 The 5% weighting to currency hedged foreign sovereign bonds provides a close substitute for Canadian nominal government bonds. This also reduces the Fund's exposure to Canadian capital markets.
- 4.11 The composition of the Reference Portfolio is expected to remain unchanged until at least the end of CPPIB's Fiscal Year 2011, when it will be reviewed in detail and possibly amended to reflect an updated actuarial report expected in the latter half of that fiscal year.

### 5.0 CPPIB OBJECTIVE: OUTPERFORM THE REFERENCE PORTFOLIO

- 5.1 By design, the Reference Portfolio is not exposed to active management investment decisions, which entail higher costs and, if unsuccessful, can underperform a passive investment program.
- 5.2 The Board believes CPPIB can outperform the Reference Portfolio without undue risk of loss by investing in risk-diversifying and return-enhancing asset classes and utilizing investment strategies not represented in the Reference Portfolio. The additional returns would enhance the sustainability of the CPP.
- 5.3 CPPIB uses the Reference Portfolio as a risk-return benchmark to evaluate, select, implement and manage its many performance enhancing investment strategies.

### 6.0 RETURN EXPECTATIONS

- 6.1 Based on historical experience and reasonable future return expectations, the Board believes that the Reference Portfolio has an expected return that will equal or exceed over the long-term the 4.2% real rate of return assumed in the 23<sup>rd</sup> Actuarial Report.

- 6.2 The Board expects that the performance enhancing investment strategies implemented by CPPIB will earn returns above the Reference Portfolio. The Board establishes value-added performance targets and evaluates their continued suitability annually.
- 6.3 The Board recognizes that over short and medium time periods the Fund's real return can and will deviate significantly from long-term expectations – both positively and negatively.

### 7.0 ACTIVE RISK LIMIT

- 7.1 The Board reviews and approves annually a Fund-level active risk limit relative to the Reference Portfolio, integrating market risk and credit risk, within which CPPIB has discretion to make and implement investment decisions with the objective of earning returns above the Reference Portfolio.
- 7.2 The risk limit is large enough to permit CPPIB the flexibility to achieve the total Fund value-added objectives established by the Board, but not so large as to put Fund assets at undue risk of loss relative to the performance of the Reference Portfolio.
- 7.3 At no time can the Fund's active risk exceed the Board-established limit, unless authorized by the Board.
- 7.4 CPPIB monitors, evaluates and manages active market and credit risk exposures relative to the Reference Portfolio and allocates active risk exposures across investment departments as necessary to maximize the Fund's active management returns.
- 7.5 CPPIB reports the active risk exposures to the Board at least quarterly or more frequently as required.

### 8.0 INVESTMENT CATEGORIES

- 8.1 CPPIB can invest in the securities or assets of any issuer or business that would be lawful if carried on in Canada and is domiciled in any country with which Canada maintains normal financial, trade and investment relations, and if the investment is not prohibited by the Act and Regulations. Exhibit 2 is a non-exhaustive list of the range of investment categories in which CPPIB does or could invest.

<b>Illustrative Range of Investment Categories</b>		<b>Exhibit 2</b>
<b>Public Market Investments</b>	<b>Private Real Estate</b>	<b>Private Investments</b>
Developed market equity	Core commercial properties	Venture capital
Emerging market equity	Non-core commercial properties	Leveraged buy-outs
Developed market debt	Undeveloped land	Private Debt
Emerging market debt	Residential developments	Secondary LP purchases
Mortgage-backed securities	Private mortgages	Infrastructure
Hedge funds	Property-lease backs	Timber
Global tactical asset allocation	Farmland	Intellectual property
Currencies		Private Commodities
Commodity futures		
Real estate investment trusts		
Exchange and/or OTC traded derivatives		

**9.0 DEBT ISSUANCE**

- 9.1 From time to time, CPPIB may create, issue, certify and deliver various forms of indebtedness either directly or through a dedicated subsidiary.
- 9.2 From time to time, CPPIB may provide a guarantee in respect of any such indebtedness issued by a dedicated subsidiary.

**10.0 MANAGING MARKET, CREDIT AND OTHER FINANCIAL RISKS**

- 10.1 Market risk is managed by diversifying across different asset classes and investment strategies such that Fund assets are not imprudently exposed to any single unexpected event. In addition, accepted risk management practices and analytical tools, including Value-at-Risk methodologies, are used to measure, monitor and evaluate prospective Fund performance under different market conditions.
- 10.2 Credit exposures are managed by adhering to credit policies and limits developed by CPPIB, and reviewed and approved by the Board at least annually. Exceptions to Board-approved policies or credit limits can be granted by the President and CEO, but are subject to the review of the Board as soon as is practical. Credit risk is measured, monitored and evaluated using accepted risk management practices and analytical tools including contingent exposure and Value-at-Risk methodologies.
- 10.3 Individual private market investments that exceed Board-established dollar limits must be approved by the Board before being implemented. Examples of such private markets investments include private equity, private debt, private infrastructure, private real estate, and private real estate debt.

- 10.4 Wherever possible the risk of private market or non-regularly traded assets is estimated using suitable public market proxies.
- 10.5 CPPIB reports the Fund's exposure to market, credit and other financial risks to the Board at least quarterly or more frequently as required.

### 11.0 VALUATION OF NON-REGULARLY TRADED ASSETS

- 11.1 Fair values of publicly traded liquid assets held by the Fund will be determined using publicly quoted prices.
- 11.2 Fair values of publicly traded illiquid assets held by the Fund will be determined using publicly quoted prices where available. Where publicly quoted prices are not available, fair value estimates will be generated by internal models and be compared with fair value estimates reported by external managers or brokers. Such instruments might include structured instruments or long dated trades.
- 11.3 Valuations of non-traded private assets are reviewed quarterly and adjusted if there is evidence of a significant change in fair value.
- 11.4 CPPIB recognizes that valuations of assets that are not regularly traded are inevitably based on judgment and are therefore inherently uncertain. Where quoted market prices are not available, valuation of non-traded private assets will be primarily based on fair value estimates reported by external asset managers or valuations provided by external parties. Internal valuations will be prepared for all assets that do not require an external valuation. All fair value estimates are determined using accepted industry valuation methods.

### 12.0 PROXY VOTING AND RESPONSIBLE INVESTING

- 12.1 CPPIB is committed to encouraging companies and organizations to adopt policies and practices that enhance their long-term financial performance. In particular, the Board believes that responsible corporate and organizational behaviour with respect to environmental, social and governance ("ESG") factors can have a positive influence on long-term financial performance, recognizing that the importance of ESG factors varies across industries, geography and time.
- 12.2 CPPIB encourages responsible behaviour in our public equity portfolio through engagement, a more effective approach through which shareholders can best effect positive change and enhance long-term financial performance. CPPIB believes engagement is more effective than the rigid screening of securities.
- 12.3 Shareholder voting rights have economic value and share voting can positively impact Fund returns by constructively influencing corporate performance.
- 12.4 CPPIB will exercise its voting rights in a manner that is consistent with its Proxy Voting Principles and Guidelines and its Policy on Responsible Investing. CPPIB may exercise judgment in connection with the voting of any proxy on a case-by-case basis.

- 12.5 CPPIB may engage one or more proxy voting service providers to help CPPIB with its share voting responsibilities.
- 12.6 Where it is not practical for CPPIB to retain responsibility for share voting, CPPIB may delegate voting rights to an external investment manager. Any delegation to an external manager is subject to prior CPPIB review of such manager's share voting principles and guidelines and CPPIB satisfaction that such principles and guidelines are generally in accordance with the Board-approved Proxy Voting Principles and Guidelines.
- 12.7 For more details, see "Proxy Voting Principles and Guidelines" and "Policy on Responsible Investing" both available at [www.cppib.ca](http://www.cppib.ca).

### **13.0 DERIVATIVES**

- 13.1 CPPIB may use derivatives to achieve its investment and financial objectives, including strategies to mitigate risk, reduce costs, increase expected returns, increase cash liquidity or diversify financing and investing alternatives available to the Fund.
- 13.2 Derivative use will comply with the Act and the Regulations.

### **14.0 LIQUIDITY**

- 14.1 CPPIB manages liquidity for the CPP. The CPP provides its monthly liquidity requirements to CPPIB, which manages the Cash for Benefits Portfolio so that the CPP can meet its financial obligations on any given business day.
- 14.2 For more details, see "Statement of Investment Objectives, Policies, Return Expectations, and Risk Management for the Cash for Benefits Portfolio of the Canada Pension Plan" available at [www.cppib.ca](http://www.cppib.ca).

### **15.0 SECURITIES LENDING**

- 15.1 CPPIB may enter into securities lending agreements providing the agreements meet Board-approved conditions.
- 15.2 Where CPPIB invests through pooled funds, mutual funds or insurance contracts, it will inform itself about the securities lending practices of such investment vehicles and satisfy itself that the practices are sound, and sufficient security is provided for any loans.

### **16.0 RELATED PARTY TRANSACTIONS**

- 16.1 Except as specified in section 16.2, CPPIB shall not directly or indirectly enter into a transaction with a related party.
- 16.2 CPPIB may enter into a transaction with a related party if:

- a. The transaction is required for the operation or administration of CPPIB and the terms and conditions of the transaction are not less favourable to CPPIB than market terms and conditions;
- b. The transaction is in securities of the related party and they are acquired on a public exchange; or
- c. The value of the transaction is nominal.

**16.3** In assessing whether the value of a transaction is nominal, reference shall be made to any relevant generally accepted accounting principles that provide guidance on materiality. Two or more transactions with the same related party in any twelve month period shall be considered a single transaction.

### **17.0 SOFT DOLLAR ARRANGEMENTS**

- 17.1** CPPIB supports transparency and disclosure in paying for goods and services, and unbundled pricing of goods and services.
- 17.2** CPPIB will only consider soft dollar arrangements when direct payment for goods and services is not practical or when soft dollar arrangements are judged by management to be in the best interests of the CPPIB.
- 17.3** Soft dollar arrangements will in any event only be used when they conform to the guidelines in the Standards of Practice of the CFA Institute.

**GLOSSARY**

<b>Active Risk Limit</b>	The maximum amount of risk that management can take relative to the Board approved Reference Portfolio.
<b>Actuarial Report</b>	Prepared every three years by the Chief Actuary of Canada to evaluate the sustainability of the CPP over a 75-year projection period..
<b>Board of Directors</b>	The twelve individuals appointed by the federal Minister of Finance to govern the activities of CPPIB. Each director is appointed for a term of three years by the Governor in Council. A director is eligible for reappointment for one or more additional terms.
<b>Canada Pension Plan Investment Board (CPPIB)</b>	Created in 1997 by an act of Parliament, CPPIB is an arm's length Crown Corporation that invests the assets of the Canada Pension Plan (CPP).
<b>Canada Pension Plan (CPP)</b>	A mandatory defined benefit retirement income program established in 1965 and administered by the federal government on behalf of all Canadian provinces and territories, with the exception of Quebec. Quebec administers a parallel Quebec Pension Plan. The CPP pays monthly pensions to retirees who made contributions during their working years. The CPP also pays spousal, orphan, disability and death benefits.
<b>Canadian Equity</b>	Share ownership of Canadian companies listed on recognized Canadian stock exchanges.
<b>Cash for Benefits Portfolio</b>	CPP assets managed by CPPIB to ensure the CPP can meet its payment obligations on any given business day.
<b>CFA Institute</b>	A self-regulating global organization that sets investment industry standards of ethics, education and professional excellence, and advocates fair and transparent capital markets.
<b>Credit and Counterparty Risk</b>	Credit and counterparty risk is the potential for loss due to the failure of a borrower, counterparty, or guarantor to repay a loan or obligation in accordance with agreed terms; or the diminution in the value of a debt instrument due to a change in the credit quality of the borrower, counterparty, guarantor or underlying assets supporting the credit exposure.

<b>Derivative</b>	A financial instrument, either exchange traded or over-the-counter, the price of which is derived from the value of one or more underlying securities or indexes.
<b>Emerging Markets Equity</b>	Share ownership of non-Canadian companies listed on recognized emerging markets stock exchanges.
<b>Fair Value</b>	The price that an interested buyer would be willing to pay and an interested seller would be willing to accept in an arm's length transaction between knowledgeable parties who are under no compulsion to act.
<b>Federal-Provincial CPP Stewards</b>	The federal and provincial Ministers of Finance who review the Plan's financial state every three years and make recommendations as to whether benefits and/or contribution rates should be changed.
<b>Foreign Developed Markets Equity</b>	Share ownership of non-Canadian companies listed on recognized developed markets stock exchanges.
<b>Funded Ratio</b>	The ratio of CPP current assets to CPP accrued liabilities determined by the Chief Actuary.
<b>Incremental Full Funding</b>	As amended by Bill C-36, any changes to the CPP benefits that increase or add new benefits are to be fully funded.
<b>Investment Portfolio</b>	CPP assets managed by CPPIB with a long-term investment horizon.
<b>Liquidity</b>	Exists when an asset is easily converted into cash, or when buying and selling of the asset can occur freely without materially affecting its market price.
<b>Market Risk</b>	Market risk is the risk of loss in portfolio value as result of changes in factors such as interest rates, foreign exchange rates, equity and commodity prices, and volatility.
<b>Minimum Contribution Rate</b>	The proportion of earnings required to sustain the CPP over the 75 year projection period, assuming best estimate actuarial projections.
<b>Net Liabilities</b>	The present value of future CPP benefits minus contributions assuming current provisions of the plan remain unchanged, discounted at a return earned by a net liability mimicking portfolio, currently best proxied by a portfolio of default-free real return bonds.

<b>Nominal Bonds</b>	Bonds that pay interest and principal without contractual adjustments for inflation.
<b>Office of the Chief Actuary (OCA)</b>	Provides actuarial and other services to the Government of Canada and provincial governments who are CPP stakeholders.
<b>Real Rate of Return</b>	The portion of an investment return that exceeds the rate of inflation.
<b>Real Return Bonds</b>	Bonds that contractually adjust interest and principal payments to offset inflation.
<b>Related Party</b>	<p>CPP Investment Board Regulations define related parties as:</p> <ul style="list-style-type: none"><li>(a) a director, officer or employee of CPPIB,</li><li>(b) a person responsible for holding or investing the assets of CPPIB, or any officer, director or employee of the person,</li><li>(c) the spouse or a child of any person referred to in paragraph (a) or (b),</li><li>(d) a corporation that is directly or indirectly controlled by a person referred to in any of paragraphs (a) to (c), or</li><li>(e) an entity in which a person referred to in paragraph (a), (b) or (c) has a substantial investment</li></ul> <p>Related parties do include Her Majesty in right of Canada or of a province, or an agency of either one, or a bank, trust company or other financial institution that holds the assets of the Board.</p>
<b>Risk</b>	The potential for financial loss from exposures to the markets or active management investment decisions.
<b>Risk Premium</b>	The additional return that a risky asset is expected to earn over the return available from a lower-risk asset to compensate investors for the increased possibility of experiencing losses.
<b>Securities Lending</b>	The temporary loan of a security from an institutional investor's portfolio to a broker/dealer or custodian to support that firm's trading activities
<b>Soft Dollars</b>	An arrangement where research or other services are obtained from broker-dealers in exchange for executing trades through that broker.

- Steady-State Funding** The OCA estimates the lowest contribution rate sufficient to sustain the CPP without further contribution increases. The 23rd Actuarial Report estimated a 9.8% steady state contribution rate at December 31, 2006.
- Value-at-Risk (VaR)** An estimate of the potential loss in value of a portfolio or security evaluated at a specific confidence level and over a defined holding period.