



Management Compensation Backgrounder

Introduction

This background paper summarizes the approach by the Board of Directors of the CPP Investment Board to management compensation.

Overview

The CPP Investment Board's mandate is to invest the assets of the Canada Pension Plan in a way that maximizes investment returns without undue risk of loss. The goal of the CPPIB is to help ensure the future CPP benefits of 17 million Canadians. The Canada Pension Plan is unique within Canada – it has a multi-generational timeframe and the income from the CPP Fund will not be required to help pay pensions for another 10 years. Consequently, we model and design the Fund to generate returns over comparably long periods, literally over decades.

The CPP Investment Board was specifically designed by the federal and provincial finance ministers in 1997 to operate at arm's length from government in the private sector world of financial markets, but with significant public accountability. The role of the CPPIB is to successfully invest a \$123.9 billion portfolio, 57 percent of which is invested in international markets. Our focus is to build an organization with the capabilities to successfully manage the largest pension fund in Canada and one of the largest in the world.

In just over 10 years since the CPPIB began investing in April 1999, the CPPIB has generated \$39.4 billion in investment income for the Fund reflecting an annualized rate of return of 5.3 per cent.

In the three years since adopting the CPP Reference Portfolio as the market-based benchmark against which total fund performance is measured, the CPPIB has generated cumulative value added returns of 487 basis points, representing approximately \$5.3 billion in additional investment income over the Fund's market-based benchmark, the CPP Reference Portfolio.

For the six-month fiscal year-to-date period, the CPP Fund has increased by \$18.4 billion from the \$105.5 billion level of the prior fiscal year-end of March 31, 2009. This increase in assets after operating expenses is comprised of \$3.4 billion in CPP contributions and \$15.0 billion in investment income reflecting a 14.0 per cent rate of return.

The CPPIB's compensation framework, policies and practices clearly meet and in many cases exceed the standards set out in the G-20 Principles on Compensation in Financial Services. The CPPIB's compensation structure, which has been in place for almost four years, meets best practice standards not just for institutional investors, but for financial institutions and public companies globally.

Compensation Framework

There are three key principles that serve as the foundation for the CPP Investment Board's Management Compensation Framework:

- Management compensation is determined by an independent and qualified Board of Directors.
 - In order for the CPP Investment Board to fulfill its mandate as a global investor, the Board of Directors believes it is essential to provide a compensation opportunity that will enable the organization to compete with other investors to attract and retain talented investment and management professionals.
- Management compensation is based on investment performance over 4-year periods.
 - The CPP Investment Board has a pay-for-performance approach that rewards employees for achieving results that contribute to the sustainability of the CPP. The compensation system measures performance against market-based benchmarks over rolling four-year periods. This longer-term focus is consistent with the nature of the CPP Investment Board's mandate and places the organization at the forefront of current best practice for management compensation.
- Management Compensation is based upon two key performance criteria:
 - Investment income generated above market-based benchmarks (\$5.3 billion over the last three fiscal years).
 - Overall total fund returns

Compensation Plan – Principles

- Compensation is based on a clear set of objectives that are well understood and consistent with our investment risk limits;
- Performance is measured against specific, pre-defined market based benchmarks that reflect the long-term nature of our investment strategy;
- Incentive compensation is tied directly to performance over multi-year periods and will vary significantly depending on longer term performance.
- Incentive compensation is subject to caps, on both the upside and down, to ensure that it remains fair and moderates the impact of any one year's investment performance.
- Incentives are only paid when value is created above the market based benchmark, based on the value-added gains remaining after operating costs are covered and factor in the absolute CPP Fund return over the same rolling four-year period

Summary of Compensation Paid at Year-End Fiscal 2009

- Recognizing the economic environment, the board has decided not to award the CEO and the three investment officers the individual component of the Short-Term Incentive Plan (STIP), which is the portion of STIP that is not tied to four-year returns. In addition, officers will not receive salary increases for fiscal 2010.
- This decision, combined with the impact of the four-year investment performance on incentive compensation, results in a 31.4% year-over-year decline in total compensation for these officers.
- The Board considers this decision appropriate, but it is not a reflection of the individual performance of these officers in fiscal 2009. The board remains very confident in the abilities of the CEO and the investment officers to lead the investment programs and successfully implement the long-term investment strategy to help sustain the CPP for decades and generations.
- All short-term incentives awarded to the 4 top investment professionals this year were tied to four-year portfolio performance.
- As shown in the chart below, management compensation is based on cumulative results over rolling four-year periods.
- Looking back, the strong returns of 15.5% in fiscal 2006 and 12.9% in fiscal 2007, as well as \$5.3 billion in value-added returns above the market-based benchmark, continued to have a positive impact on incentive compensation awards paid this year.
- Looking forward to fiscal 2010, the 15.5% return will drop away whereas the 12.9%, -0.3% and -18.6% returns will continue to be factored into rolling four-year results for an additional one, two and three years respectively and will negatively affect incentive compensation awards through 2012 accordingly.

		INVESTMENT RETURNS BY FISCAL YEAR						
		2006	2007	2008	2009	2010	2011	2012
FOUR-YEAR PERIOD USED TO CALCULATE MANAGEMENT COMPENSATION	Fiscal 2009	15.5%	12.9%	-0.29%	-18.6%			
	Fiscal 2010	15.5%	12.9%	-0.29%	-18.6%	x		
	Fiscal 2011	15.5%	12.9%	-0.29%	-18.6%	x	y	
	Fiscal 2012	15.5%	12.9%	-0.29%	-18.6%	x	y	z

Quotes from Bob Astley, Chair of the Board of Directors, CPP Investment Board:

- *“The CPPIB does not have an annual compensation model. We have a four-year compensation model that enables us to compete with private sector investors for talent, while compensating our people based on long-term performance metrics that match the long-term objectives of the CPP Fund.”*
- *“We believe the compensation paid to our team during Fiscal 2009 properly reflects the value created over the past four years as well as the obvious challenges faced by the CPP Fund – and all investors – in 2009.”*
- *“Our role is to successfully invest a \$123.9 billion portfolio, 57 per cent of which is invested in international markets. A global portfolio needs global talent. We have hired top investment professionals from the US, UK, Germany, China and Australia as well as Canada to manage the Fund on behalf of Canadian contributors. We must pay competitively to operate in these international markets to attract the right people with the right skills.”*