



## **Backgrounder on Management Compensation May 20, 2010**

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### **Introduction**

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This background paper summarizes the approach by the Board of Directors of the CPP Investment Board to management compensation. Further details are available in the Report from the Human Resources and Compensation Committee and the Compensation Discussion & Analysis sections of the Fiscal 2010 Annual Report available at [www.cppib.ca](http://www.cppib.ca).

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### **Overview**

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The Canada Pension Plan Investment Board (CPPIB) is an independent, professional investment management organization. Our primary mission is to generate the investment returns needed to help keep the Canada Pension Plan sustainable over many generations.

To successfully manage a \$127.6 billion global diversified portfolio requires a very diverse range of investments in public and private markets and the expertise to manage them. As one of the largest funds of its type globally, we require people with significant experience in investment management, investment research, portfolio design and risk management, investment operations and other skills.

Our compensation program is a key factor in attracting and retaining the talent we need to execute our strategy and achieve our mandate to earn the investment returns needed to help sustain the Canada Pension Plan.

Our in-house capabilities enable us to invest directly, and cost effectively, in private market assets such as real estate, infrastructure, private equity and private debt, which currently make up approximately 25 per cent or \$32 billion of our portfolio. In fiscal 2010, our investment teams invested \$7 billion in private assets. We participated in three of the five largest private investment transactions globally acquiring private market assets that are expected to deliver attractive investment returns over longer investment horizons. We also have internal teams pursuing a wide range of public market investment programs that allow us to capitalize upon our comparative advantages as an investor.

We are committed to a pay-for-performance approach that directly links compensation to investment performance over a four year period. We believe that this approach serves to support:

- The long-term prudent management of the CPP Fund to help sustain the CPP, which is the retirement foundation for 17 million Canadians.
- The active management of a global diversified portfolio of \$127.6 billion growing to approximately \$275 billion in the next 10 years.

It is also consistent with CPPIB's mandate, multi-decade investment horizon and long-term investment strategy designed to help support CPP pensions for decades and generations.

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## **Compensation Framework**

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The CPPIB's compensation framework meets and, in a number of cases, exceeds the Principles for Sound Compensation Practices established by the Financial Stability Board and endorsed by the G20 nations. These principles require a substantial proportion of management compensation to be variable, and for performance to be assessed and rewarded over a prolonged period of time.

In accordance with the pay for performance philosophy and the G20 principles, compensation at the CPPIB is based on investment performance over four-year periods.

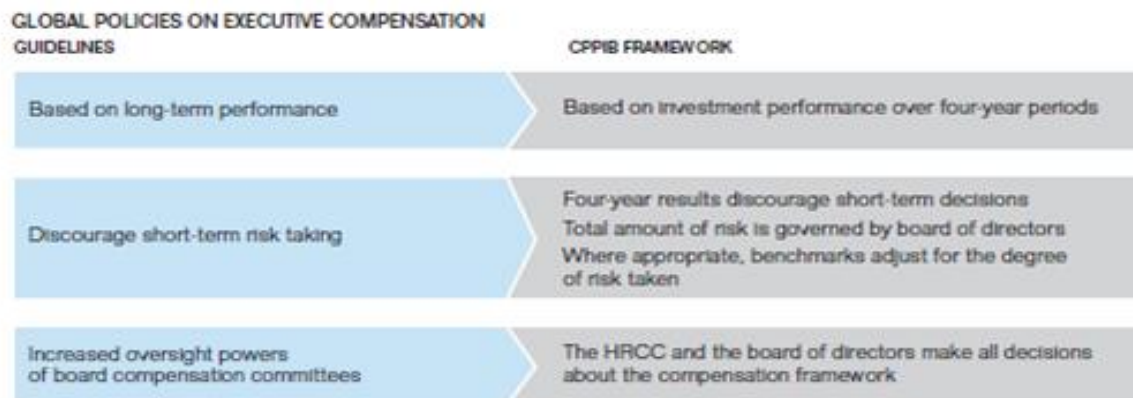
Total compensation depends on three factors:

- CPP Fund returns;
  - Actual investment income generated above market-based benchmarks
  - Performance against predetermined individual objectives.
- Investment returns are compared against the six public market indices that comprise the CPP Reference Portfolio as well as benchmarks relevant to each investment program.
  - Investment returns take into account all operating costs and external manager fees.
  - The only element of compensation shorter than four years is a discretionary component tied to the achievement of annual individual objectives.
  - While shorter than the timeframe for many of our investment programs, the four-year measurement period for investment performance reflects a reasonable length of time for accountability and compensation purposes.
  - The majority of total pay is incentive-based.
  - Annual value-added performance calculations are subject to maximum caps and floors to ensure that we avoid providing incentives for inappropriate risk-taking, that no single year result has undue impact and that maximum achievement levels are appropriate.

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## Comparison with Global Policies on Executive Compensation: G20 Principles

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## Year-End Fiscal 2010 Results and Compensation Summary

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In fiscal 2010, the CPP Fund increased by \$22.1 billion reflecting of one of its highest-ever annual returns – an increase of \$16.1 billion or an investment return of 14.9 per cent. During the year, the CPPIB capitalized on investment opportunities that arose in the aftermath of the financial crisis, acquiring assets in private equity, real estate, infrastructure and private debt.

Private assets have had a short-term negative impact on value added performance against benchmarks. This is because of the valuation lag between these private assets and our public market benchmark. We believe that the embedded value within the private market assets is expected to materialize over the long-term, not within a 12-month period.

- Management compensation in fiscal 2010 was negatively impacted by the negative returns for the year and rolling four-year period.
- The long-term design of our compensation plan means that the negative CPP Fund return in 2009 and the negative value-added performance in fiscal 2010, will continue to impact incentive compensation payouts through 2012 and 2013 respectively.
- In addition, the estimated value of future long-term incentives is reduced by 61 per cent, based upon the assumptions we use to model future compensation.
- As detailed in the CD&A Summary Compensation table, total remuneration for the named executive officers (excluding the CFO who joined in the last quarter of fiscal 2009), is \$9.5 million, up 12% from \$8.5 million last year. This increase is due to:

- The 14.9 per cent investment return or \$16.1 billion increase to the CPP Fund.
- The reinstatement of the individual component of compensation that was not paid last year to reflect the economic environment at that time.
- This 12% percent increase for fiscal 2010 compares with a reduction in compensation of more than 31 per cent last year.
- The portion of incentive compensation tied to investment performance is \$6.2 million, down 10% from \$6.8 million last year.
- For the named executive officers (excluding the CFO who joined in the last quarter of fiscal 2009) compensation for fiscal 2010 is 23% lower than two years ago and investment-related compensation is 33% lower than two years ago.
- In addition to investment returns, the successful execution of a broad range of investment transactions in fiscal 2010 and the continued development of the CPPIB as an investment organization are also among the factors considered in certain of the individual performance payments.

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

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- *“The Board’s approach to management compensation places the CPPIB at the forefront of current best practice for management compensation and enables the organization to attract talented investment and management professionals with the skills and knowledge we need to fulfill our mandate as a global investor.”*
- *“The Board of Directors shares management’s belief that there is significant embedded value in the \$32 billion of private market investments in the CPP Fund. These investments were made consistent with our long investment horizon and will generate value added returns in the years to come.”*