Canada Pension Plan

ANNUAL REPORT OF THE

Canada Pension Plan

2004-2005

Government of Canada Gouvernement du Canada

Canada

ANNUAL REPORT OF THE CANADA PENSION PLAN

Fiscal Year 2004-2005

ISPB 203-06-06E

Publication of the *2004-2005 Annual Report of the Canada Pension Plan* was delayed due to a number of organizational and governmental changes.

As of February 2006, the legal names of the minister and department responsible for the Canada Pension Plan (CPP) are the Minister of Human Resources and Skills Development and the Department of Human Resources and Skills Development respectively. Operationally, the Department is known as Human Resources and Social Development Canada (HRSDC).

The names of the departments previously responsible for the CPP, namely Human Resources Development Canada (HRDC) and/or Social Development Canada (SDC), are used in this report in a historical context only.

Produced by the the Department of Human Resources and Skills Development Canada, in collaboration with: the Department of Finance, the Canada Revenue Agency, Public Works and Government Services Canada, and the Office of the Superintendent of Financial Institutions.

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Her Excellency
The Governor General of Canada

May it please Your Excellency:

We have the pleasure of submitting the *Annual Report of the Canada Pension Plan* for the fiscal year 2004-2005.

Respectfully,

James M. Flaherty
Minister of Finance

Diane Finley
Minister of
Human Resources and Skills Development

Canada

Contents

This report on the Canada Pension Plan (CPP) consolidates input from all departments involved in the administration of the Plan: Social Development Canada (now Human Resources and Skills Development Canada), the Department of Finance, the Canada Revenue Agency (CRA), Public Works and Government Services Canada (PWGSC), and the Office of the Superintendent of Financial Institutions (OSFI).

2004-2005: The Year at a Glance

IN FISCAL 2004-2005:

- Following extensive consultations with the provinces, the Government of Canada proposed changes to both the disability benefit and the rules governing employer contributions in the 2004 budget. These changes—which include automatic reinstatement, and clarification of the annual amount of employers' contributions—were included in the budget implementation bill that received Royal Assent in May 2004. (CPP changes come into force through an Order-in-Council process with the formal consent of two-thirds of the provinces.)
- Changes to the *Canada Pension Plan Regulations* were implemented on January 1, 2005, to reflect the statutory increase in maximum pensionable earnings ($41,100 for 2005). The contribution rate remained unchanged at 9.9 percent.
- 4.5 million Canadians received benefits from the Canada Pension Plan, with a total value of approximately $23.8 billion.
- About 3.1 million people received $16.8 billion in CPP retirement pensions.
- About 945,000 surviving spouses or common-law partners and 85,000 children of deceased contributors received over $3.5 billion in CPP benefits.
- About 291,000 persons with disabilities and 89,000 of their children received almost $3.2 billion in CPP disability benefits.
- Death benefits amounted to some $0.3 billion.
- 11.4 million people contributed to the CPP in 2004.
- 2.2 million people received Statements of Contributions.
- Administrative costs amounted to approximately $386 million, or 1.62 percent of the $23.8 billion in benefits paid. This compares favourably with administrative costs for other large pension plans and individual RRSPs.
- On March 31, 2005, total CPP assets were valued at approximately $83.4 billion. The assets were held in provincial, territorial and federal government bonds, the Deposit with the Receiver General for Canada, the receivables net of liabilities, domestic and foreign publicly traded equities, as well as private equity, real estate and infrastructure assets. Bonds, equities and real estate and infrastructure are stated at fair value.

The Canada Pension Plan in Brief

Almost everyone who participates in the paid labour force in Canada contributes to the Canada Pension Plan (CPP) or to its sister plan, the Quebec Pension Plan (QPP), and will at some time benefit from their provisions.

Established by an act of Parliament in 1965 and implemented in 1966, the CPP is a jointly managed federal-provincial plan. Quebec manages and administers its own plan, the QPP, and participates in the decision making of the CPP. Benefits from either plan are based on pension credits accumulated under both. The plans are financed through mandatory contributions from employees, employers and self-employed people, as well as from investment income. (Information on the QPP is available from the Régie des rentes du Québec at **www.rrq.gouv.qc.ca**.)

While it is perhaps best known for its retirement pensions, the CPP also provides children's, survivor, disability and death benefits. The CPP administers the largest long-term disability plan in Canada. Vocational rehabilitation services and return to work supports assist some disability beneficiaries to regain their independence by helping them engage in work activities.

Benefit calculations are based on how much and for how long a contributor has paid into the CPP and, in some cases, the age of the beneficiary. Benefits are not paid automatically—everyone must apply and provide proof of eligibility. Benefits are adjusted in January of each year as needed to reflect increases in the average cost of living, as measured by the Consumer Price Index.

Many Canadians live and work in other countries. Others move here after contributing to a public pension plan elsewhere. To help protect their pensions, Canada has entered into social security agreements with several other nations. These agreements enable Canadians to receive public pensions from other countries and to receive CPP payments abroad. They also permit continuity of social security coverage when Canadians are temporarily working outside the country, eliminate duplicate contribution payments, and help them meet eligibility requirements for CPP and for other countries' public pensions.

Ensuring Financial Sustainability

As joint stewards of the CPP, the federal and provincial ministers of Finance review the Plan's financial state every three years and make recommendations as to whether benefits and/or contribution rates should be changed. They base their recommendations on a number of factors, including the results of an examination of the Plan by the Chief Actuary. The Chief Actuary is required under the legislation to produce an actuarial report on the CPP every three years (in the year before the legislated ministerial review of the Plan). The CPP legislation also requires the Chief Actuary to prepare an actuarial report any time a Bill is introduced in Parliament that, in the view of the Chief Actuary, has a material impact on the estimates in the most recent triennial actuarial report. This reporting ensures that the long-term financial implications of proposed Plan changes are given due consideration.

Changes to the CPP legislation governing the general level of benefits, the rate of contributions or the investment policy framework can be made only through an act of Parliament. All such changes require the agreement of at least two thirds of the participating provinces, representing at least two thirds of the population. The changes come into force only after two years' notice, unless there is agreement to waive this requirement, and after Provincial Orders-in-Council confirming the changes have been passed. Quebec participates in decision-making regarding changes to the CPP legislation, even though it administers its own plan. It is important that Quebec be involved in changes to the CPP to ensure the portability of QPP and CPP benefits across Canada.

The legislation requires that federal and provincial ministers make best efforts to complete the next financial review of the Canada Pension Plan by the end of 2005. Ministers will base their review on a number of factors, including the conclusions of the *Twenty-first Actuarial Report* on the Canada Pension Plan, prepared by the Chief Actuary of the Canada Pension Plan for the purpose of the review. The previous triennial financial review of the Plan by ministers was in 2002. In the 2002 review, ministers concluded that the Plan was financially sustainable and agreed to make no changes to the Plan. Further information on this and previous reviews of the Plan can be found at **www.cpp-rpc.gc.ca**.

ACTUARIAL REPORTING

The *Twenty-first Actuarial Report* was tabled in Parliament by the Minister of Finance in December 2004. The report presented the financial status of the Plan as at December 31, 2003 and provides information to evaluate the Plan's financial sustainability over a long period, assuming Plan provisions remain unchanged. The findings of the report are an important element in the federal and provincial finance ministers' triennial financial review of the CPP for 2005. The last triennial financial review of the Plan by ministers was based on the findings of the *Eighteenth Actuarial Report* (as at December 31, 2000). Since this report, the Canada Pension Plan was subject to a series of amendments, whose financial implications were outlined in the *Nineteenth* and *Twentieth Actuarial Reports*.

Federal and provincial finance ministers have endorsed regular peer reviews of triennial actuarial reports. For this purpose, a panel of three independent Canadian actuaries, selected through an arm's length process, reviewed the *Twenty-first Actuarial Report*. The findings of the independent panel indicates that the Report was competently prepared, the Report's assumptions are reasonable and as a result, the conclusions of the Chief Actuary that the CPP is financially stable are well supported. It also stated that the Report meets current professional standards of actuarial practice and uses data and methodologies that are appropriate and reasonable. Canadians can have confidence in the results of the *Twenty-first Actuarial Report* and the conclusions reached by the Chief Actuary about the long-term financial health of the Plan.

In addition to its conclusions, the panel made a number of recommendations regarding the preparation of future actuarial reports. Like previous reviews, the Office of the Chief Actuary will study the panel's recommendations and give them due consideration in the preparation of future triennial actuarial reports. Since 1997, the OCA has developed a strong peer review process for its work. The panel's report and recommendations, as well as the actuarial reports and previous peer reviews can be found at **www.osfi.gc.ca**.

A FAIR APPROACH TO FUNDING

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by a rapid growth in wages and labour-force participation, and low rates of return on investments.

The pay-as-you-go approach also allowed the federal and provincial governments to keep contributions at a reasonable level while beginning to pay full retirement benefits as early as the mid-1970s. This was important—many of the seniors who received benefits at that time had been unable to accumulate sufficient retirement savings. However, demographic and economic developments and changes to benefits in the 30 years that followed resulted in significantly higher costs. When federal and provincial finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again—to 14.2 percent by 2030—to continue to finance the Plan on a pay-as-you-go basis.

Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years down the road, which was deemed unacceptable by the federal and provincial governments. Therefore, in 1997, they agreed instead to change the funding approach of the Plan to a hybrid of pay-as-you-go and full funding. Under full funding, each generation pays for its own benefits.

Steady-state Financing

To reduce the burden on future generations, the federal and provincial governments introduced "steady-state" financing as part of the 1997 reform agreement. This approach requires that contribution rates be set no lower than the lowest rate expected to ensure the long-term financial stability of the Plan without recourse to further rate increases. At the time of the reforms, this was determined to be 9.9 percent. Therefore, under steady-state financing, the contribution rate was scheduled to increase incrementally (from 5.6 percent in 1996) to 9.9 percent in 2003, and to remain at this level thereafter.

According to the Chief Actuary of Canada, steady-state financing will generate a level of contributions that exceeds the benefits paid until 2022. Funds not immediately required to pay benefits will be transferred to the CPP Investment Board for investment.

Plan assets will accumulate rapidly over this period and over time will help pay the growing costs that are expected as more and more «baby boomers» begin to collect their retirement pension.

In 2022 and thereafter, when most of the baby boomers have retired, and benefits paid begin to exceed contributions, investment revenues from the CPP's accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The steady-state financing approach has moved the CPP away from pay-as-you-go financing (with a small reserve) towards fuller funding. By 2025, the Plan is expected to be about 25 percent pre-funded (i.e., Plan assets cover about 25 percent of benefits in pay and earned to that date) compared to about 7 percent funded at the time of the 1997 agreement. The move to steady-state financing and the other changes agreed to in 1997 have reduced the relative size of the Plan's unfunded liability in a manner that is fair across generations. Moving to full-funding, which would have eventually eliminated the unfunded liability would have created unfairness across the generations. During the transition, contributors of some generations would have paid much higher contributions than others—they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. Continuing with a pay-as-you-go approach would also have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades.

According to the *Twenty-first Actuarial Report*, as at December 31, 2003, Plan assets cover about 12 percent of the Plan's current and accrued benefit obligations. The balance of accrued obligations, or $516.3 billion in current dollars, are not backed by assets. The relative size of this liability will decline over time as Plan assets grow more rapidly than Plan liabilities in the next few decades (thereafter Plan assets will grow at least as quickly as Plan liabilities). The projected growth of assets and liabilities and the evolution of the funding level over time are better measures of the long-term financial health of the CPP that is the $516.3 billion in actuarial liabilities not covered by assets.

A partially funded CPP not only balances the two approaches to funding, but also contributes to diversifying the funding of Canada's retirement income system:

- the Old Age Security program, funded by federal government revenues, and
- private savings, including tax-deferred, fully funded employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than are systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs, according to international organizations.

Financial Accountability

Since 1999-2000, the CPP has used the accrual basis of accounting for revenues and expenditures. This method gives administrators a detailed financial picture and allows accurate matching of revenue and expenditures in the year in which they occur.

As at March 31, 2005, total CPP net assets were valued at approximately $83.4 billion. Net Plan assets are contributions and investment income that have accumulated since the Plan's inception in 1966—less benefit and administrative expenditures over the same period. According to the Chief Actuary, Plan assets are expected to increase appreciably over the next 20 years.

CPP ACCOUNT

A separate account, the CPP Account, has been established in the accounts of the Government of Canada to record the financial elements of the Plan: contributions, interest, pensions and other benefits paid, and administrative expenditures. The CPP Account also records the amounts transferred to or received from both the CPP Investment Fund and the CPP Investment Board. Spending authority is limited to the Plan's net assets. The CPP assets are not part of the federal government's revenues and expenditures.

Prior to the coming into force of Bill C-3 (*An Act to Amend the Canada Pension Plan and the Canada Pension Plan Investment Board Act*), the Canada Pension Plan Investment Board was responsible for investing net new funds, while the CPP Account's operating balance and bond portfolio were managed by the Government of Canada. The amended legislation provides for the transfer of CPP assets that were previously administered by the federal government to the CPP Investment Board, beginning in 2004. These assets consist of the bonds held by the CPP Investment Fund and a portion of the deposit with the Receiver General for Canada. The CPP Investment Board and the federal government have signed an agreement governing the transfer of the assets. The bonds will be transferred to the Board over a three-year period beginning in May 2004. Funds on Deposit with the Receiver General for Canada will be transferred over a period of twelve months beginning in September 2004.

CPP INVESTMENT BOARD

The CPP Investment Board was created by an Act of Parliament in December 1997 to invest funds not required by the Canada Pension Plan to pay current benefits.

The Board is independent of the CPP. It operates at arm's length from government and is overseen by an independent board of directors. Its legislated mandate is to manage funds transferred from the CPP in the best interests of the contributors and beneficiaries of the Plan. The Board is to invest CPP assets with a view to achieving a maximum rate of return, without undue risk of loss. It must also consider the factors that affect the Plan's funding and its ability to meet its financial obligations.

The CPP Investment Board has a long-term investment horizon. In his most recent report, the Chief Actuary of Canada estimates that contribution revenues will exceed CPP benefit payments and expenses well into the future, and that the CPP will not need money from investment income until 2022.

Further information on the Board's mandate, governance structure and investment policy can be found at **www.cppib.ca**.

CPP Investments

As at March 31, 2005, CPP investments consisted of $31.7 billion of fixed income securities, $2.9 billion of private equity and $1 billion of real estate and infrastructure and $45.7 billion in publicly traded stocks.

The CPP reserve fund earned $6.1 billion for the fiscal year ending March 31, 2005.

Investing for our future

The CPP Investment Board believes that publicly traded equities will outperform fixed income assets over the long term. Consequently, the Board will continue to invest in publicly traded equities or stocks so that CPP assets are allocated in a way that reflects the long-term funding requirements of the Plan.

Prior to March 31, 2004—the end of the 2003-04 fiscal year—the CPP Investment Board's public equity investments replicated well-known indexes for Canadian, U.S. and non-North American stocks. In fiscal 2004, the CPP Investment Board began to invest its passive portfolio on an economic sector basis from a global perspective. This new approach allows the Board to take into account the nature of Canada Pension Plan liabilities and avoid concentrating risk in certain sectors or individual stocks.

As at March 31, 2005, private equity commitments by the CPPIB were approximately $8.3 billion, of which $3.4 billion had been invested. These commitments involve 57 investments managed by 43 different private equity firms. In general, the CPPIB approach to private equity is to invest through a long-term limited partnership with a professional management firm, or general partner, that manages the private equity portfolio. The CPP Investment Board makes a commitment to the general partner's fund that is gradually drawn down as investments are made.

Like other major pension funds, the CPP Investment Board is looking for opportunities to increase investments in real return assets, such as real estate and infrastructure, because their value over time will likely track and surpass the general rate of inflation.

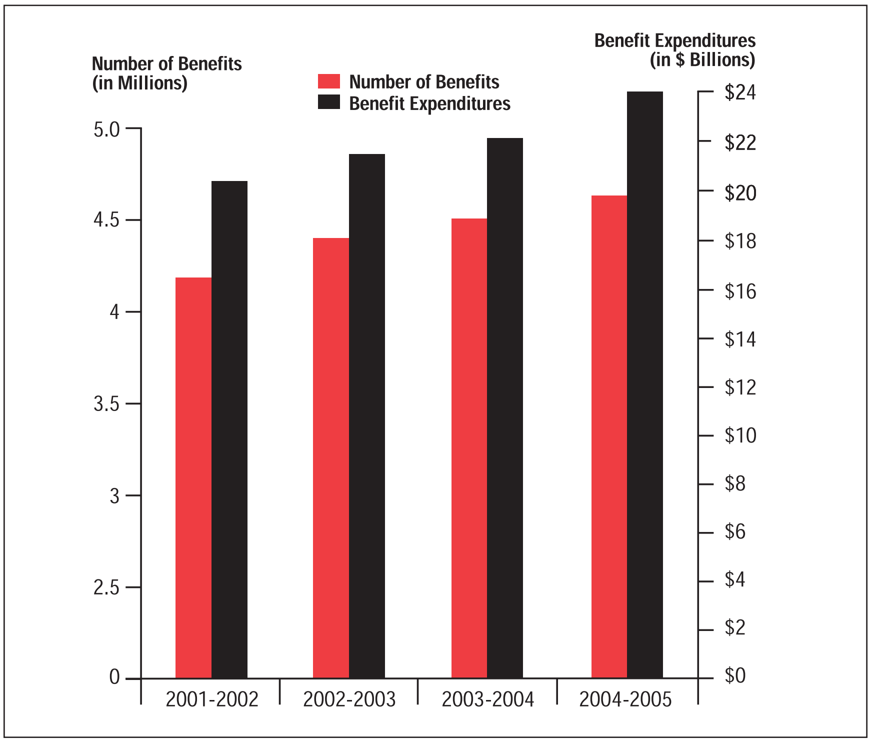
In compliance with its statutory requirement to hold a public meeting in the capital of each participating province at least once every two years, the Board held public meetings in the provincial capitals in January 2001, June 2002 and September and October 2004. The next meetings are scheduled for 2006.

Benefits and Expenditures

The number of people receiving CPP benefits has increased steadily over the past decade. To pay for these benefits, expenditures have also increased.

Figure 1 shows the yearly increases since 2001-02. Figure 2 (page 13) shows the percentage of expenditures by type of benefit.

Figure 1 – BENEFITS AND EXPENDITURES BY FISCAL YEAR



RETIREMENT PENSIONS

Retirement pensions represent 67 percent of the total number of CPP benefits and 71 percent of the total benefit dollars paid out by the CPP in 2004-05. The amount of each contributor's pension depends on how much and how long he or she has contributed and at what age he or she begins to draw the benefits. In March 2005, the monthly maximum retirement pension was $828.75; the average payment was $464.20.

The CPP offers flexibility with respect to the age of retirement. Seniors can take their pension as early as the age of 60 or receive a larger pension if they wait until after they turn 65 to begin receiving it. The CPP permanently reduces the pension by 0.5 percent per month for those who take their pension before their 65th birthday, reflecting the fact that these seniors will, on average, receive their benefits longer than someone who retires at the age of 65. For those who take their pension after their 65th birthday, the CPP permanently increases the pension by 0.5 percent per month (up to a maximum of 30 percent), reflecting the fact that these seniors will receive their benefits for a shorter amount of time on average. The adjustments are intended to ensure that there is no advantage or disadvantage from taking the retirement benefit at a particular age. The Chief Actuary of the Canada Pension Plan completed a study on this issue in March 2003. The study is available at **www.osfi.gc.ca**.

DISABILITY BENEFITS

Disability benefits, paid to eligible contributors and their children, represent 8 percent of the total number of CPP benefits and 13 percent of the total benefit dollars paid out by the CPP in 2004-05. In March 2005, the maximum monthly disability benefit was $1,010.23; the average payment was $756.39. The children's monthly benefit was a flat rate of $195.96.

As part of Bill C-30, an amendment to the *Canada Pension Plan* was passed by Parliament in May 2004 to allow for automatic reinstatement of CPP disability benefits. The required provincial consent was obtained, and the reinstatement amendment came into force January 31, 2005.

This change allows CPP disability clients who return to work to have their benefits quickly restarted if they cannot continue working because their disability recurs. This entitlement is available on application, for two years after CPP disability benefits are stopped because a client returns to regular employment. The provision covers CPP disability clients who report a return to regular employment and whose benefits are stopped on or after January 31, 2005.

SURVIVOR BENEFITS

Survivor benefits, paid to the surviving spouse or common-law partner of the contributor and his/her dependent children, represent 23 percent of the total number of CPP benefits and 15 percent of the total benefit dollars paid out by the CPP in 2004-05. The amount of the monthly survivor benefit varies depending on a number of factors, including the age of the spouse or common-law partner at death and whether the beneficiary also receives other CPP benefits.

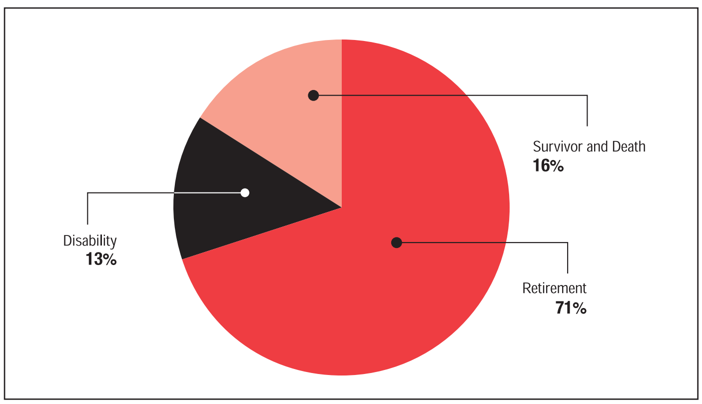
DEATH BENEFITS

Death benefits represent 2 percent of the total number of CPP benefits and 1 percent of the total benefit dollars paid out by the CPP in 2004-05. The death benefit is a one-time payment. The maximum payable is $2,500; the average payment in March 2005 was $2,203.65.

OTHER PROVISIONS

The CPP includes provisions that compensate for periods of low earnings, namely the Child Rearing Provision (CRP) and the 15 percent general drop-out provision. The CRP allows the CPP to drop up to seven years of low or zero earnings (while caring for a child under the age of seven) from the calculation of a contributor's CPP disability, survivor and/or retirement benefit. The 15 percent general drop-out provision is for low or zero earning years and applies to all contributors. The Plan has other provisions under which married or common-law spouses may either share their retirement pensions (where the union is intact) or split their credits (where the union has dissolved).

Figure 2 – PERCENTAGE OF BENEFIT DOLLARS PAID FOR 2004-2005



THE APPEALS PROCESS

There are three opportunities for review of a person's CPP benefit application. Most requests for review concern an application for disability benefits.

The first opportunity involves a request to the Minister of Human Resources and Skills Development (see note on the inside cover of this report) for a reconsideration (or administrative review) of a decision concerning a benefit or a division of pension credits.

A person who is not satisfied with the decision made at the departmental reconsideration level can appeal to a Review Tribunal. A Review Tribunal is an independent body made up of three people chosen by the Commissioner of Review Tribunals from a panel of 100 to 400 part-time members appointed by the Governor-in-Council.

In 2004-05, the Office of the Commissioner of Review Tribunals (OCRT) received 4,072 appeals under the Canada Pension Plan. In that same period, the OCRT issued 3,315 decisions, of which 1,661 (50 percent of the total) were decided in favour of the appellant. In addition, another 385 cases were concluded as a result of settlements offered by Social Development Canada.

The final opportunity for appeal is the Pension Appeals Board, which is an administrative tribunal operating at arm's length from the government. Board members are judges or former judges of the federal court or superior court of a province. Hearings are not automatic. The claimant or the Minister must first request "leave to appeal" and in 2004-05, 83 percent of applications were granted leave. Of the 1044 applications received, 94 percent concerned disability benefits. With respect to all final decisions in all categories, 51 percent were in favour of the claimant. Decisions at this final level of appeal may be sent to the Federal Court for judicial review. The Federal Court may decide to uphold the decision or return it to the Pension Appeals Board for a new decision.

Improved Service Delivery

REACHING OUT TO CANADIANS

During 2004-05, SDC continued its efforts to help Canadians better understand public pensions and the retirement income system, and to encourage them to actively plan and prepare for their own retirement. Information on the CPP is available in print, on the Internet, in person at local offices, by phone, and at electronic kiosks in government offices and public buildings. Personalized contact with clients continued to receive high priority. In 2004-05, SDC issued personal CPP Statements of Contributions to more than 2.2 million contributors between the ages of 18 and 70. The statements were accompanied by information on the retirement income system in Canada.

DELIVERING SERVICE

In 2004-05, SDC continued to modernize CPP program delivery. With the multi-year Information Technology Renewal project, staff now have access to a consolidated view of complete CPP and OAS client and benefit information, benefit payment history and lifetime CPP contributions. In addition, fully automated adjudication (determination of eligibility and calculations of entitlement) has been introduced for CPP retirement benefits. Capabilities for automated adjudication of additional benefits will continue over the next several years. At the same time, the Department continues to focus on maintaining the existing CPP information technology systems.

PROCESSING BENEFITS

CPP services are offered in person, by telephone, online and by mail. In 2004-05, staff received 61,432 disability applications. Decisions on 70 percent of all CPP disability applications, which are complex and require medical information, were made within 120 calendar days of receipt of the completed application. Improved communication with clients and their physicians helped staff make well-informed decisions and helped CPP disability applicants better understand the reasons for decisions. As a result, close to 80 percent of the applications for disability benefits in 2004-05 were finalized in the initial stages.

TABLE 1 – APPLICATION PROCESSING STATISTICS

National measures	Objective	2004-05 National Average
CPP Retirement applications where the benefits were paid on time*	85%	89%
OAS Basic applications where the benefits were paid on time*	90%	93%
CPPD Initial decisions made within 120 calendar days	75%	70%
CPPD Reconsideration decisions made within 120 calendar days	70%	67%

* "On time" refers to the application processed where benefits were paid out within one month of the application being received.

TABLE 2 – TELEPHONE SERVICE STATISTICS

	Objective	2004-05 National Average
Clients served by a service agent within 180 seconds of placing a call*	95%	95.5%

* The objective is to serve clients within 180 seconds for 95 percent of calls.

Managing the CPP

COLLECTING AND RECORDING CONTRIBUTIONS

Contributions to the CPP are paid on earnings between a minimum and a maximum amount. The minimum (which remains constant) is $3,500 and the maximum is adjusted annually to reflect the growth in the average Canadian industrial wage. The maximum amount of pensionable earnings as of January 1, 2005, was $41,100 (up from $40,500 in 2004). Contributions stop once a contributor reaches the age of 70 or begins to receive a CPP retirement pension or disability benefit.

The contribution rates for 2005 are 4.95 percent for employees and 4.95 percent for employers. People who are self-employed pay both portions, for a total of 9.9 percent. Employers and employees make approximately 94 percent of contributions; the remaining 6 percent comes from the self-employed.

All CPP contributions are remitted to the Canada Revenue Agency (CRA). In 2004-05, contributions amounted to $28.9 billion.

CRA also assesses and verifies earnings and contributions, advises employers and employees of their rights and responsibilities, conducts audits, and reconciles reports and T4 slips. To verify that contribution requirements are being met, CRA applies a compliance and enforcement process that can vary from a computerized data match to an on-site audit. There are approximately 1.5 million existing employer accounts. During 2004-05, CRA conducted 53,438 audits, concentrating on files with irregularities.

OVERPAYMENT OF BENEFITS

Consistent with its mandate to manage the CPP effectively, the Department has procedures in place to detect benefit overpayments. During 2004-05, overpayments totaling $46 million were detected. Of this amount, $41 million were recovered and remission was granted on debts totaling $5 million.

CHANGES ANNOUNCED IN BUDGET 2004

In 2004, the rules governing contributions to the Canada Pension Plan were amended. They now allow a new employer who immediately succeeds another as a result of a change in business structure, to take into account the contributions the predecessor employer made for that same employee when determining amounts due. This change was extended to situations where self-employed individuals become employees of a corporation controlled by them or vice versa. The new rules apply for every year after 2003.

Before this change, when a business was restructured—notably as a result of a winding up and immediate reconstitution under a different legal structure (e.g., where a limited partnership is reconstituted as a corporation) or the acquisition of a major portion of the employer's property or of a distinct part of the employer's business (e.g., a distinct division of a business is sold to another enterprise)—employees were treated as if they had new employers. Employers were required to begin withholding CPP contributions anew and they could not take into account the contributions withheld at source by the previous employer—even if there had been no interruption of service by the employee.

Other amendments clarify the annual employers' contributions amount required under the Act and specify that only amounts remitted in excess may be refunded to the employer.

These changes will ensure harmonization of contribution requirements between the Canada Pension Plan and the Quebec Pension Plan. Further information about these changes can be obtained by contacting the Canada Revenue Agency at 1 800 959-5525.

ADMINISTRATIVE COSTS

In 2004-05, it cost approximately $386 million to administer the CPP, with SDC accounting for the largest portion — $263 million (see Table 3 below). CRA required approximately $96 million and Public Works and Government Services Canada (PWGSC) some $16 million, for services to the CPP. The Office of the Superintendent of Financial Institutions (OSFI), where the Office of the Chief Actuary is housed, and the Department of Finance incurred administrative costs of about $1.3 million and $388,000, respectively.

Since the administrative costs of the CPP Investment Board are drawn from the Board's investment income, they are reported in that organization's annual report. This is consistent with the arm's-length administration of the Board. In 2004-05, the CPP Investment Board reported $52.5 million in operating expenses and external investment management fees.

CPP administrative expenses in 2004-05 represent 1.62 percent of the $23.8 billion in benefits paid. This ratio compares very favourably with that of other pension plans. CPP administrative costs also compare favourably with those of RRSPs. Table 3 presents the CPP's administrative expenditures for the last three years.

TABLE 3 – CPP ADMINISTRATIVE COSTS 2002-03 TO 2004-05

	Expenditures (in $ thousands)		
Department/Agency	**2002-03**	**2003-04**	**2004-05**
SDC (formerly included with Human Resources Development Canada (HRDC))			$263,100
Human Resources and Skills Development Canada (HRSDC) – (formerly included with HRDC)*			9,306
Former HRDC	$327,964	$308,923	
CRA	80,229	85,258	96,484
PWGSC	12,823	14,693	15,821
OSFI	690	1,038	1,318
Finance Canada	495	425	388
Total	$422,201	$410,337	$386,417

* This reference is to the Department prior to merging with Social Development Canada. See the note on the inside page of this report for more information.

Looking to the Future

Some 302,000 new CPP applications are received each year and a significant increase is expected as our population ages. The challenge will be to improve service delivery to ensure that Canadians continue to receive timely, accurate and client-focused service. Long-term initiatives aimed at meeting that challenge are now underway.

CPP ONLINE

CPP Online supports the objectives of the federal Government On-Line (GOL) initiative and the commitment to provide Canadians with full electronic access to key federal information and services by 2005. CPP Online initiatives include the implementation of a web-based system that allows a wider range of inquiries and client transactions online and provides more integrated information on related benefits. The importance of strengthening our technological infrastructure is clear, especially since the fastest-growing group of Internet users is the senior population.

The Department has made it a priority to update the systems that help deliver benefits. Evolving over the next four years, the systems will support better decision making by improving the information available to management, clients and staff through faster and more up-to-date technology. The improvements will further reduce the paper burden and the complexity of the application process.

Putting CPP information online is a multi-year project designed to provide Canadians with online access to information, data, and services essential to income security and retirement planning. A comprehensive review of legislation, regulations, policies, and procedures will lay the groundwork for an innovative, leading-edge approach to online services and their policy and program context.

ONLINE SERVICES

By 2007, the Department will offer, in a secure environment, a number of online service options to allow access to information and services that are essential to income security and retirement. These services will include:

View and update personal information

In 2005, CPP clients obtained secure online access to their personal information. Using this service, they can view and update their mailing address and direct deposit information, and view their monthly payment amount. Enhancements will continue to be made, allowing more information to be viewed and updated in coming years.

Streamlined and automated CPP Statement of Contributions

CPP contributors can now submit an online request to receive a copy of their Statement of Contributions by mail. In 2005, they were able to view Statement of Contributions information online.

Tax information slips online

Since 2004, CPP clients have been able to view their CPP T4 slips online, starting with those for the 2003 taxation year. They also have the option to choose to use the online service to access their T4 slips in the future instead of having them sent by mail.

The Department continues to develop its capacity to deliver services online and move from a paper-based organization to an electronically-based organization.

SIMPLIFYING THE APPLICATION PROCESS

Simplifying the application process for the CPP retirement pension is part of the Department's planned service delivery improvements. The goal is to make the application process easier for clients through streamlined, client-driven and more effective services.

Making it easier to apply for the CPP retirement pension will be the first step in building a modern service system that is based on Canadians' needs and expectations. It will allow the use of alternative sources for proof of date of birth. As part of this initiative, services are being introduced that allow clients to apply for benefits online.

Since July 2003, a simplified CPP retirement application has been available for clients to fill out online. In March 2004, simplified OAS applications were also made available online. While clients could fill out these forms on the computer, they had to be printed, signed and mailed to SDC along with proof of birth. In 2005, SDC removed the requirement for the majority of clients to provide documentary proof of birth when the client's age and identity can be validated with the Social Insurance Register electronically.

In March 2004, SDC launched its first benefit application form that can be submitted over the Internet. Clients are now able to fill out a CPP retirement pension application online and submit it electronically. To complete the application process, clients must print, sign and mail a "Signature Page" along with their proof of birth. When client authentication enhancements are completed, clients will be able to sign their applications electronically.

REACHING ALL CANADIANS

Public pension programs help millions of people in Canada every day. The Department's primary objective is that every Canadian will receive the benefits to which he or she is entitled under its programs.

There has been a dramatic decline in the low income rate among Canadian seniors in recent decades. This is due in large part to the existence of public pensions such as the CPP.

Over the past several years, the Department has made a concerted effort to tell Canadians what they can expect from their public pensions and how they should prepare for their own retirement. Striving to communicate as directly as possible, the CPP will continue improving and personalizing its programs to reach its clients.

The Internet has a tremendous ability to reach Canadians. Social Development Canada led the development of a cross-departmental website called Canada Benefits (**www.canadabenefits.gc.ca**). The site's mandate is to provide central access to government-wide benefit programs and services for individuals.

The Canada Benefits site provides access to federal, provincial and territorial programs and services. These include, among others, public pensions, employment insurance benefits, and housing grants. The award-winning website supports the "citizen-first" principle—where information is organized according to the needs of Canadians and not the structures of government. For example, an interactive tool called the "Benefits Finder" provides citizens with a listing of programs and services relevant to their circumstances.

Since its update in January 2003, the Canada Benefits site has experienced significant success, receiving an average of 2,000 visitors every day. Through the Canada Benefits site and other means of communication, SDC was able to reach more Canadians than ever. Based on the firm conviction that all Canadians deserve financial security, the Department strives to make them aware of the benefits available and helps them obtain those to which they are entitled.

Canada Pension Plan

Financial Statements

for the year ended March 31, 2005

Management's responsibility for financial statements

The financial statements of the Canada Pension Plan have been prepared by management of Social Development Canada in accordance with the Canadian generally accepted accounting principles for the public sector.

Management is responsible for the integrity and objectivity of the data in these financial statements, including the amounts which must, of necessity, be based on best estimates and judgements. The financial information presented throughout the Annual Report is consistent with the financial statements.

In support of its responsibilities, management has developed and maintains systems of internal control and supporting procedures. They are designed to provide reasonable assurance that assets are safeguarded, recorded and properly maintained and transactions are properly authorized and are in accordance with the *Canada Pension Plan* and *Financial Administration Act* and accompanying regulations. These controls include the establishment of an organizational structure that provides a well defined division of responsibilities and accountability, the selection and training of qualified staff, and the communication of policies and guidelines throughout the organization. Internal controls are reviewed and evaluated by both internal and external auditors in accordance with its respective audits. Management also reviews the recommendations of its internal and external auditors for improvements in internal controls.

The Auditor General of Canada, the external auditor of the Canada Pension Plan, has conducted an independent audit of the financial statements in accordance with Canadian generally accepted auditing standards and has reported to the Minister of Social Development.

David Baxter
Comptroller
Social Development Canada

Nicole Jauvin
Deputy Minister
Social Development Canada

August 25, 2005

Auditor General of Canada
Vérificatrice générale du Canada

AUDITOR'S REPORT

To the Minister of Social Development

I have audited the statement of net assets of the Canada Pension Plan as at March 31, 2005 and the statements of changes in net assets and cash flow for the year then ended. These financial statements are the responsibility of the management of Social Development Canada. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Canada Pension Plan as at March 31, 2005 and the changes in its net assets and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
August 25, 2005

Statement of Net Assets
as at March 31

	2005	2004
	(in millions of dollars)	
Assets Investments		
CPP Investment Fund – at fair value (Note 4)		
Provincial and Territorial bonds	**16,693**	25,397
Canada bonds	**2,641**	4,070
CPP Investment Board – at fair value (Note 6)	**58,722**	32,894
Cash		
Deposit with Receiver General for Canada	**2,771**	7,483
Receivables		
Contributions	**2,278**	1,946
Accrued Interest	**550**	862
Régime des rentes du Québec	**30**	28
Beneficiaries (Note 7)	**36**	36
	83,721	72,716
Liabilities		
Accounts payable	**32**	55
Accrued pensions and benefits	**52**	51
Taxes due to Canada Customs and Revenue Agency	**84**	-
CPP Investment Board's liabilities, net of its other assets	**142**	99
	310	205
Net Assets	**83,411**	72,511
Net Assets, represented by:		
Canada Pension Plan Investment Fund	**19,334**	29,467
Accumulated transfers to CPP Investment Board (Note 5)	**50,627**	29,824
Accumulated net gain from Investment Board's operations	**7,953**	2,971
Canada Pension Plan Account (Note 8)	**2,771**	7,483
CPP receivables, net of liabilities	**2,726**	2,766
Net Assets	**83,411**	72,511

Contingencies (note 12)
The accompanying notes are an integral part of these financial statements.

Approved by Social Development Canada:

David Baxter
Comptroller
Social Development Canada

Nicole Jauvin
Deputy Minister
Social Development Canada

Statement of Changes in Net Assets
for the year ended March 31

	2005	2004
	(in millions of dollars)	
Net assets, beginning of year	**72,511**	57,251
Increase in assets		
Contributions (Note 9)	**28,941**	28,029
Investment income (Note 10)	**6,108**	10,248
	35,049	38,277
Decrease in assets		
Pensions and benefits		
Retirement	**16,822**	15,880
Survivors	**3,333**	3,194
Disability	**2,926**	2,850
Disabled contributor's child	**258**	257
Death	**249**	255
Orphan	**216**	213
Net overpayments	**(41)**	(42)
	23,763	22,607
Administration costs (Note 11)	**386**	410
	24,149	23,017
Increase in net assets	**10,900**	15,260
Net assets, end of year	**83,411**	72,511

The accompanying notes are an integral part of these financial statements.

Statement of Cash Flow
for the year ended March 31

	2005	2004
	(in millions of dollars)	
Cash Flow Provided by Operating Activities		
Cash Receipts:		
Contributions	**28,609**	27,714
Interest from CPP Investment Fund	**2,071**	2,572
Interest on Deposit with Receiver General for Canada	**135**	188
Recoveries from Régime des rentes du Québec	**265**	288
Recoveries from beneficiaries	**41**	37
	31,121	30,799
Cash Payments:		
Pensions and benefits	**(23,718)**	(22,634)
Repayments to Régime des rentes du Québec	**(268)**	(251)
Administration costs	**(409)**	(430)
	(24,395)	(23,315)
	6,726	7,484
Cash Flow Used in Investing Activities		
Transfers to CPP Investment Board (including interest collected on its behalf)	**(18,668)**	(8,134)
Transfers from CPP Investment Board	**6,669**	-
Disposals of bonds net of reinvestments – CPP Investment Fund	**561**	1,040
	(11,438)	(7,094)
Net Increase (Decrease) in the Deposit with Receiver General for Canada	**(4,712)**	390
Deposit with Receiver General for Canada, beginning of year	**7,483**	7,093
Deposit with Receiver General for Canada, end of year	**2,771**	7,483

The accompanying notes are an integral part of these financial statements.

Notes to financial statements March 31, 2005

1. DESCRIPTION OF THE CANADA PENSION PLAN

a) Description of the CPP

The Canada Pension Plan (CPP) is a federal/provincial plan established by an Act of Parliament in 1965.

The CPP began operations in 1966. It is a compulsory and contributory social insurance program operating in all parts of Canada, except Quebec, which operates the Régime des rentes du Québec, a comparable program. The Plan's objective is to provide a measure of protection to workers and their families against the loss of earnings due to retirement, disability or death.

The Minister of Social Development is responsible for the administration of the *Canada Pension Plan* (the CPP Act); the Minister of National Revenue is responsible for collecting contributions. The Minister of Finance and his provincial counterparts are reponsible for setting CPP contribution rates, pension and benefit levels and funding policy.

The financial activities of the Canada Pension Plan are recorded in the CPP Account (Note 8). The plan assets are held by the CPP Investment Fund (Note 4) and the CPP Investment Board (Note 6). The financial transactions affecting the Account and the Investment Fund are governed by the CPP Act and regulations. The Investment Board's transactions are governed by the *Canada Pension Plan Investment Board Act* and the accompanying regulations.

As stated in the CPP Act, changes to this Act require the approval of at least two-thirds of the provinces having, in the aggregate, not less than two-thirds of the population of all included provinces.

b) Financing

CPP is financed by contributions and investment returns. Employers and employees pay contributions equally to CPP. Self-employed workers pay the full amount.

CPP was designed initially to be financed on a pay-as-you-go basis, which means that the Plan would operate on a current basis with pensions and benefits being paid out of current contributions. With changes made to the Act in 1997, CPP is now intended to be funded on a "steady-state" basis—that is, combined contributions of 9.9% of pensionable earnings will provide a capitalization level of 25% of the Plan's liability within about 15 years.

From 1966 to 1986, the combined employer-employee contribution rate remained at 3.6% of pensionable earnings. In 1987, it was raised to 3.8% and increased yearly by 0.2% to reach 5.6% in 1996. In the years 1997 to 2003, the combined contribution rate was increased annually to reach 9.9%. The maximum combined contribution for 2005 was $3,722 (2004 – $3,663).

The CPP Act provides that an actuarial report shall be prepared every three years for purposes of the review of the financial state of the CPP by the Minister of Finance and his provincial counterparts. The Twenty-first Actuarial Report of the Chief Actuary of the Office of the Superintendent of Financial Institutions was tabled on December 8, 2004. The CPP is financially sound and the 9.9% combined employee-employer contribution rate reached in 2003 is expected to be sufficient to sustain the Plan in the face of an aging population.

A number of assumptions such as long term rate of return on assets, inflation rate, mortality rates, increase in salary and benefit rates, among other things, were used in the 21st CPP actuarial report. These assumptions reflect best estimates of future economic and demographic events. The next actuarial report as at December 31, 2006 is expected to be completed by December 2007.

c) Net assets of the Plan

The net assets of the Plan are composed of the deposit with the Receiver General for Canada and investments held by the CPP Investment Fund and the CPP Investment Board. They represent funds accumulated for the payment of pensions, benefits and administration costs. This amount does not cover the actuarial present value of accrued pensions and benefits. As at March 31, 2005, the net assets of the Plan are of $83 billion (2004 – $72.5 billion). This amount represents approximately 3.5 times the total of pensions and benefits in 2005 (2004 – 3.2 times). According to the 21st Actuarial Report, this is expected to grow to 5.6 times by 2021.

d) Pensions and benefits

Retirement pensions – A retirement pension is payable to each contributor at age 60 or older, according to the provisions of the Act. The monthly amount is equal to 25% of the contributor's average monthly pensionable earnings during the pensionable period. The amount may be reduced or increased depending upon whether the contributor applies for a retirement pension before or after age 65. This adjustment cannot exceed 30%. The maximum new monthly pension payable at age 65 in 2005 is $828.75 (2004 – $814.17).

Disability benefits – A disability benefit is payable to a contributor who is disabled, according to the provisions of the Act. The amount of the disability benefit to be paid includes a flat-rate portion and an amount equal to 75% of the earned retirement pension. The maximum new monthly disability benefit in 2005 is $1,010.23 (2004 – $992.80).

Survivor's benefits – A survivor's benefit is payable to the spouse or common-law partner (the beneficiary) of a deceased contributor, according to the provisions of the Act. For a beneficiary under the age of 65, the benefit consists of a flat-rate portion and an amount equal to 37.5% of the deceased contributor's earned retirement pension. A beneficiary between the ages of 35 and 45 who is not disabled or who has no dependent children receives reduced benefits. For beneficiaries aged 65 and over, the benefit is equal to 60% of the retirement pension granted to the deceased contributor. The maximum new monthly benefit payable to a beneficiary in 2005 is $497.25 (2004 – $488.50).

Disabled contributor's child and orphan benefits – According to the provisions of the Act, each child of a contributor who is receiving disability benefits or who died is entitled to a benefit as long as the child is under the age of 18, or is between the ages of 18 and 25 and attending school full-time. The flat-rate monthly benefit in 2005 is $195.96 (2004 – $192.68).

Death benefits – According to the provisions of the Act, a death benefit is a one-time payment to, or on behalf of, the estate of a contributor. The benefit amounts either to 10% of the maximum pensionable earnings in the year of death or six times the monthly retirement pension granted to the deceased contributor, whichever is less. The maximum death benefit in 2005 is $2,500 (2004 – $2,500).

Pensions and benefits indexation – As required by the Act, pensions and benefits are indexed annually based on the Consumer Price Index for Canada. The rate of indexation for 2005 is 1.7% (2004 – 3.2%).

2. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

These financial statements present the financial position, the changes in net assets and the cash flows of the Canada Pension Plan. They include the financial position of the CPP Investment Board and the results of its operations. These financial statements are prepared in accordance with Canadian generally accepted accounting principles for public sector entities and conform to the disclosure and accounting requirements of the CPP Act.

These financial statements do not provide information on the actuarial estimates required to meet future obligations of the CPP since the CPP Act does not require that the pensions and benefits be pre-funded. The CPP, which is under joint control of the Government of Canada and participating provinces, is not considered to be part of the reporting entity of the Government of Canada. Accordingly, its financial activities are not consolidated with those of the Government.

b) Valuation of investments

Investments are stated at fair value.

Fair value is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Bonds held by the CPP Investment Fund and the CPP Investment Board – The fair value is determined by calculating the present value of bonds' projected cash flows. The discount rate used is based as appropriate on the provincial, territorial or government of Canada market rates. The fair value includes a further discount for the non-marketable, non-transferable, and rollover characteristics of the bonds.

Bonds issued by the provincial and territorial governments can be redeemed prior to maturity at the option of these governments or renewed for another 20 years. There are distinct calculation methods for bonds early redemption or renewal that do not take into consideration the non-marketable and non-transferable characteristics.

Any early redemption or renewal could therefore result in transactions at amounts that differ from the recorded fair value of the bonds.

Other investments held by the CPP Investment Board – The fair value is determined as follows: quoted market prices for publicly traded equities and unit values for pooled funds. Unit values reflect the quoted market prices of the underlying securities.

In the case of private equity investments, where quoted market prices are not available, fair value is determined annually, commencing after the first year of ownership, based on carrying values and other relevant information reported by external managers of the limited partnerships or funds in which the investments are made. These carrying values are determined by the external managers using accepted industry valuation methods. These methods include considerations such as earnings multiples of comparable publicly traded companies, discounted cash flows and third party transactions, or other events which suggest material impairment or improvement in the value of the investment. On a quarterly basis, when, there is evidence of a significant change in fair value, the valuation is adjusted, as appropriate. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for private equity investments and infrastructure funds, unless there is an indication of permanent impairment of value.

The fair value of private market investments in real estate properties is determined annually, commencing after the first year of ownership, using accepted industry valuation methods, such as discounted cash flows and comparable purchase and sales transactions. In the first year of ownership, cost is generally considered to be an appropriate estimate for fair value of real estate unless there is an indication of permanent impairment of value. Debt on real estate investments is valued using discounted cash flows based on current market yields for instruments with similar characteristics.

Fair value for over-the-counter derivatives such as swaps and forward contracts is determined based on market prices for underlying assets. Fair value of exchange-traded futures is based on quoted market prices.

Money market securities are recorded at cost which, together with accrued interest income, approximates fair value.

c) Contributions

Contributions include CPP contributions earned for the year. The Canada Customs and Revenue Agency collects contributions and measures them using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed, and makes an estimate for contributions related to tax returns not yet assessed. This estimate is subject to review and adjustments. Adjustments, if any, are recorded as contributions in the year they are known.

d) Investment income recognition

CPP Investment Fund income is recorded on the accrual basis and includes unrealized gains and losses on bonds held at the end of the year.

CPP Investment Board's net income from operations represents the Investment Board's investment income, less investment and administrative expenses. Investment income is recorded on the accrual basis and includes realized gains and losses on disposal of investments, unrealized gains and losses on investments held at the end of the year, dividend income (recognized on ex-dividend date), interest income, distributions from partnerships and trusts, and net operating income from private market real estate investments.

Realized gains and losses on investments sold during the year represent the difference between sale proceeds and cost, less related costs of disposition. Unrealized gains and losses represent in the difference between the fair value and cost of investments. The current year unrealized gains and losses represent the year-over-year change in this difference.

e) Translation of foreign currencies

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the transaction date. Investments denominated in foreign currencies and held at the year end are translated at exchange rates in effect at the year end date. The resulting realized and unrealized gains and losses are included in investment income.

f) Pensions and benefits

Pensions and benefits are recorded when payable.

g) Net overpayments

Net overpayments are composed of overpayments of pensions and benefits that were established during the year less remissions of debts granted.

h) Administration costs

Administration costs are recorded in the year to which they relate.

i) Use of estimates

The preparation of financial statements in accordance with the Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the financial statements and revenue and expenses for the year. Actual results could differ from these estimates. The most significant estimates are related to contributions, allowance for doubtful accounts, the fair value of the bonds held by the CPP Investment Fund and the fair value of investments held by the CPP Investment Board.

3. IMPLEMENTATION OF THE LEGISLATIVE AMENDMENT

Legislation to amend the Canada Pension Plan and the *Canada Pension Plan Investment Board Act* came into force on April 1, 2004. The amended legislation and a related administrative agreement provide for the transfer of CPP assets, that were administered by the federal government, to the CPP Investment Board, beginning in 2004. These assets consist of the bonds held by the CPP Investment Fund and a portion of the Deposit with the Receiver General of Canada. The CPP Investment Board, and the federal government have signed an agreement governing the process for the transfer of the assets.

The bonds will be transferred to the CPP Investment Board over a three year period beginning in May 2004. Funds on Deposit with the Receiver General for Canada will be transferred over a period of twelve months beginning in September 2004.

The amended legislation and related administrative agreement also provide for the weekly transfer of any amounts held in the Canada Pension Plan Account to the CPP Investment Board that exceed the immediate obligations of the CPP.

4. INVESTMENTS HELD BY THE CPP INVESTMENT FUND

The Canada Pension Plan Investment Fund was established in the accounts of Canada by the CPP Act to record the Plan's investments in bonds of the provinces, territories and Canada. The CPP Investment Fund's bond portfolio is administered by the federal Department of Finance.

Until the end of 1997, the investments in provincial, territorial and federal government bonds were made with the cash on hand in excess of the Plan's forecast three-month operating requirement. These bonds were not marketable and had a 20-year term (or less) as fixed by the Minister of Finance on the recommendation of the Chief Actuary of the Office of the Superintendent of Financial Institutions. The interest rate on the bonds was determined by the Minister of Finance based on the average yield to maturity of all outstanding Government of Canada obligations with terms of 20 years or more. When these bonds matured, funds not required for payment of pensions and benefits were re-invested in new bonds.

Since 1998, a maturing provincial or territorial bond may be re-invested in a new bond only once for a term of 20 years, if both the issuer asks to do so and the operating balance is sufficient to pay current pensions and benefits. Excess funds not re-invested are transferred to the CPP Investment Board.

The re-invested bonds remain not marketable and bear interest at a rate fixed by the Minister of Finance. The interest rate is substantially the same rate that the province would pay if it were to borrow the same amount for the same term through the issuance of a bond on the public capital markets. Interest earned on the investments is paid semi-annually to the CPP Account.

During the year, all disposals of bonds were made, at maturity date, at face value. The bonds are redeemable in whole or in part before maturity. Since January 31, 2001, the provinces and territories are permitted to redeem their bonds held by the CPP Investment Fund prior to their maturity at a value equivalent to market value. No bonds were redeemed by the provinces and the territories prior to maturity during the year ended March 31, 2005 (2004 – none).

In accordance with the amended legislation and the related administrative agreement, the bonds held by the CPP Investment Fund will be transferred to the CPP Investment Board on a monthly basis as explained in note 3. As at March 31, 2005, 11/36th of the Investment Fund was transferred (approximately $8.8 billion).

The bonds held by the CPP Investment Fund are exposed to interest rate risk. Interest rate risk refers to the risk of an adverse change in the fair value of the bonds as a result of an unfavourable movement in market interest rates.

The following table provides information on disposals, re-investments, unrealized gains/ (losses) of bonds as well as bonds transferred to the CPP Investment Board and the remaining balance held by the CPP Investment Fund:

CPP Investment Fund

(in millions of dollars)

	March 31, 2004 at cost	Disposals	Re-Investments	**March 31, 2005 at cost**	**March 31, 2005 at fair value**	March 31, 2004 at fair value
Newfoundland and Labrador	633	47	47	**633**	**698**	714
Prince Edward Island	140	11	11	**140**	**155**	159
Nova Scotia	1,079	86	86	**1,079**	**1,196**	1,232
New Brunswick	834	67	67	**834**	**921**	940
Quebec	96	5	5	**96**	**108**	111
Ontario	10,233	1,133	1,133	**10,233**	**11,377**	11,687
Manitoba	1,002	119	–	**883**	**997**	1,167
Saskatchewan	1,082	104	–	**978**	**1,095**	1,241
Alberta	3,144	339	78	**2,883**	**3,253**	3,661
British Columbia	3,934	355	199	**3,778**	**4,234**	4,481
Yukon Territory	4	–	–	**4**	**4**	4
	22,181	2,266	1,626	**21,541**	**24,038**	25,397
Canada	3,352	17	–	**3,335**	**3,803**	4,070
	25,533	2,283	1,626	**24,876**	**27,841**	29,467
CPP Investment Board's share	*0	(237)	(141)	**(7,601)**	**(8,507)**	–
CPP's share	**25,533**	**2,046**	**1,485**	**17,275**	**19,334**	**29,467**

** CPP transferred to CPP Investment Board bonds with a cost of $7,697 during the year ending March 31, 2005.*

In order to reflect the non-marketable and non-transferable characteristics of the bonds, an additional discount factor has been used in determining the fair value. The use of this additional discount factor reduced the reported fair value by $1.19 billion ($1.26 billion in 2004). The following schedule presents the fair value of the bonds by maturity dates and the average annual rate of return on bonds currently held based on current effective yields for similar type bonds.

	2005	(in millions of dollars)	2004	
	Investments at fair value	**Effective yield**	Investments at fair value	Effective yield
Investments maturing				
Within 1 year	**1,620**	**5.26%**	2,254	5.31%
1 – 5 years	**7,268**	**5.01%**	10,812	4.62%
Over 5 years	**10,446**	**5.54%**	16,401	5.35%
Total – Investments	**19,334**		29,467	
Average effective yield on investments		**5.32%**		5.08%

5. ACCUMULATED TRANSFERS TO THE CPP INVESTMENT BOARD

	2005	2004
	(in millions of dollars)	
Accumulated transfers, beginning of year	**29,824**	21,690
Transfers of bonds titles and accrued interest	***8,804**	–
Transfers of funds to CPPIB	**18,668**	8,134
Transfers of funds from CPPIB	**(6,669)**	–
	50,627	29,824

** Based on fair market value at the time of transfer.*

6. INVESTMENTS HELD BY THE CPP INVESTMENT BOARD

The Canada Pension Plan Investment Board (CPPIB) was established by an Act of Parliament in 1997. The *Canada Pension Plan Investment Board Act* came into force on April 1, 1998. The purpose of the Board is to invest the funds transferred by the CPP in a diversified portfolio of investments.

The Board is designed to operate at arm's length from the government. It is required to be accountable to the public, Parliament (through the federal Minister of Finance), and the provinces and provides regular reports of its activities and the results achieved.

The following schedule provides information on the Board's investments as at March 31:

	2005	2004
	(in millions of dollars)	
Canadian equities, at fair value		
Public Markets	**21,044**	18,046
Private Markets	**512**	282
	21,556	18,328
Non-Canadian equities, at fair value		
Public Markets	**12,646**	7,552
Private Markets	**2,394**	1,530
	15,040	9,082
Total Equities		
(Cost 2005 – $32,141; 2004 – $25,034)	**36,596**	27,410
Real Return Assets		
Public markets real estate	**384**	350
Private markets real estate	**638**	432
Private markets infrastructure	**230**	22
Total Real Return Assets (Cost 2005 – $1,222; 2004 – $829)	**1,252**	804
Nominal Fixed Income		
Bonds transferred from the CPP Investment Fund	**8,507**	–
Money Market Securities (Cost 2005 – $20,614; 2004 – $4,784)	**12,067**	4,777
Total Nominal Fixed Income	**20,574**	4,777
Investment Receivables (Cost 2005 – $340; 2004 – $68)	**339**	68
Derivatives Receivable	**240**	35
Investments Liabilities (Cost 2005 – $234; 2004 – $170)	**(242)**	(171)
Derivatives Liabilities	**(37)**	(29)
Total Net Investments	**58,722**	32,894

The CPP Investment Board has established investment policies which set out the manner in which assets shall be invested. In determining its target asset weights, the CPP Investment Board takes into consideration certain assets of the CPP which are held outside the CPP Investment Board.

Private equity investments

Private equity investments are generally made by buying interests in limited partnerships with a typical term of 10 years. The private equity limited partnership's underlying investments represent equity ownerships or investments with the risk and return characteristics of equity.

The CPP Investment Board advances capital to the limited partnerships, a portion of which, commonly referred to as management fees, is used by general partners to select and provide ongoing management support to the underlying companies. Management fees generally vary between 1 per cent to 2 per cent of the total amount committed to the limited partnerships, and are included as part of the CPP Investment Board's cost of the investments. During the year ended March 31, 2005, management fees totalling $70 million (2004 – $64 million) were included in the capital advanced to the limited partnerships and recorded as part of the cost of the investment. As discussed more fully in note 2b), the carrying values of these investments are reviewed at least annually and any resulting adjustments are reflected as unrealized gains or losses in investments income.

Real return assets

As at March 31, 2005, investments total $780,448,000 in real estate investments (March 31, 2004 – $611,531,000) and $230,125,000 in private market infrastructure (March 31, 2004 – $22,013,000).

The CPP Invesment Board obtains exposure to real estate through investments in publicly traded securities and privately held real estate. Private real estate investments are held by a subsidiary and are managed on behalf of the CPP Investment Board by external advisors and managers through co-ownership arrangements. As at March 31, 2005, the subsidiary's share of these investments includes assets of $638,200,000 (March 31, 2004 – $431,848,000) and $241,752,000 of liabilities related to mortgage debt (March 31, 2004 – $170,797,000), with a weighted average fixed interest rate of 7.64 per cent and terms to maturity of two to 16 years.

The CPP investment Board currently uses limited partnership arrangements to invest in infrastructure. The underlying investments of these limited partnerships represent equity ownerships in entities that invest in infrastructure assets which are expected to provide predictable cash flows. Management fees for infrastructure investments are treated similar to private equity management fees as discussed in the previous section. During the year ended March 31, 2005, management fees included in the capital advanced to the limited partnerships were $1,777,000 (2004 – $214,000).

Derivative Contracts

A derivative is a financial contract, the value of which is derived from the value of underlying assets, indexes, interest rates or currency exchange rates.

The CPP Investment Board uses derivatives primarily to replicate the return of Canadian and Non-Canadian equities and to manage asset weights and currency exposure. The CPP Investment Board has equity swaps outstanding to exchange money market interest payments for equity returns. The CPP Investment Board also uses exchange-traded futures contracts and foreign exchange forwards to either buy or sell a specified index or currency at a specificied price and date in the future. Futures are used to achieve the desired market exposure to equity markets, and foreign exchange forwards to manage currency exposure.

All derivative contracts have a term to maturity of one year or less. Notional amounts of derivative contracts are used to compute the cash flows and for determining the fair value of the contracts. Notional amounts are not recorded as assets or liabilities on CPP's Statement of net assets.

The notional amounts and fair value of derivative contracts held as at March 31 are as follows:

	2005		2004	
	(in millions of dollars)			
	Notional Amount	**Fair Value**	Notional Amount	Fair Value
Equity swaps	**5,918**	**206**	4,034	9
Equity futures	**6,061**	**(6)**	448	(3)
Foreign exchange forwards	**2,093**	**3**	–	–
Total	14,072	**203**	4,482	6

Securities Lending

The CPP Investment Board participates in a securities lending program to enhance portfolio returns. Credit risk associated with the securities lending program is mitigated by requiring the borrower to provide daily collateral in the form of readily marketable investments of greater market value than the securities loaned. As at March 31, 2005, the CPP Investment Board's investments include loaned securities with an estimated fair value of $1.4 billion (2004 – 721 million). The fair value of collateral received in respect of these loans is $1.5 billion (2004 – 758 million).

CPP Investment Board's Investment Risks

Invesments, investments receivables and investments liabilities may be exposed to one or more of the following risks:

Currency Risk

The CPP Investment Board is exposed to currency risk through holdings of investments, investment receivables and investment liabilities in various currencies. The net underlying currency exposures, after allocating foreign currency derivatives, as at March 31, 2005 are as follows:.

	2005		2004	
	(in millions of dollars)			
	Net Exposure	**% of Total**	Net Exposure	% of Total
Currency				
Canadian Dollar	**$ 42,339**	**72**	$ 23,280	71
United States Dollar	**7,804**	**13**	5,599	17
Euro	**3,464**	**6**	1,557	5
British Pound Sterling	**2,086**	**3**	932	3
Japanese Yen	**1,256**	**2**	698	2
Australian Dollar	**462**	**1**	137	–
Swiss Franc	**340**	**1**	349	1
Other	**971**	**2**	342	1
	$ 58,722	**100**	$ 32,894	100

Interest Rate Risk

Interest Rate Risk refers to the effect on the fair value of investments and liabilities due to fluctuations of interest rates. The fair value of the CPP Investment Board's bonds and mortgage debt is affected directly by changes in interest rates.

Market Risk

Market Risk is the risk that the value of an investment will be adversely affected by changes in market prices, whether those changes are caused by factors specific to individual investment or factors affecting all securities traded in the market. The CPP Investment Board mitigates market risk through diversification of its investment portfolio, based on asset and risk limits established in the investment policies.

Credit Risk

The CPP Investment Board limits credit risk by dealing with counterparties that have a minimum credit rating of A or R-1 (short term) as determined by a recognized credit rating agency, where available, or as determined through an internal credit rating process. Credit exposure is limited to maximum amounts as specified in the investment policies.

Liquidity Risk

The CPP Investment Board is exposed to liquidity risk through its responsibility for providing cash management services to the CPP. The CPP Investment Board mitigates liquidity risk through its unsecured credit facilities.

Commitments

The CPP Investment Board has committed to enter into investment transactions, which will be funded over the next several years in accordance with the agreed terms and conditions. As at March 31, 2005, these remaining commitments total $5.4 billion (2004 – $3.9 billion). As at March 31, 2005, the organisation has made lease commitments of $20 million (March 31, 2004 – $21 million) over the next nine years.

Other Information

The CPP Investment Board is exempt from Part I tax under paragraph 149 (1) (d) of the *Income Tax Act* (Canada) on the basis that all of the shares of the CPP Investment Board are owned by Her Majesty the Queen in right of Canada. The CPP Investment Board's subsidiaries are exempt from Part I tax under paragraph 149 (1) (d.2) of the *Income Tax Act* (Canada) on the basis that all of the shares of the subsidiaries are owned by a corporation whose shares are owned by Her Majesty the Queen in right of Canada.

The CPP Investment Board's audited financial statements for the year ended March 31, 2005 are publicly available and provide details concerning the Board's investment policy, its investments and portfolio returns.

7. RECEIVABLES FROM BENEFICIARIES

	2005	2004
	(in millions of dollars)	
Balance of pensions and benefits overpayments	**82**	81
Allowance for doubtful accounts	**(46)**	(45)
	36	36

Social Development Canada has procedures to detect overpayments. During the year, overpayments totalling $46 million (2004 – $45 million) were established and remissions of debts totalling $5 million (2004 – $4 million) were granted. A further $41 million was recovered (2004 – $37 million).

8. CANADA PENSION PLAN ACCOUNT

The CPP Account was established in the accounts of Canada by the CPP Act, to record the contributions, interest, pensions, benefits and administration costs of the Plan. It also records the amounts transferred to or received from the CPP Investment Fund and the CPP Investment Board.

In accordance with the amended legislation and the related agreement, funds on deposit with the Receiver General for Canada will be transferred to the CPP Investment Board on a monthly basis as explained in Note 3. As at March 31, 2005, 7/12th of the funds to be transferred (approximately $3.8 billion) have been transferred.

As at March 31, 2005, the Deposit with the Receiver General for Canada is $2,771 million (2004 – $7,483 million).

9. CONTRIBUTIONS

Contributions for the year are measured by Canada Customs and Revenue Agency (CCRA) using the assessment of tax returns. In determining the amount of contributions earned for the year, the Agency considers cash received and contributions assessed and makes an estimate for contributions related to tax returns not yet assessed.

Actual results may differ from these estimates. Actual contribution amounts for calendar years 2004 and 2005 will only be known once CCRA has processed all employer's and self-employed workers' declarations of contributions for these years. An adjustment for the difference between actual and estimated contributions will be recorded in the fiscal year in which the adjustment is known.

10. INVESTMENT INCOME

	2005	2004
	(in millions of dollars)	
CPP Investment Fund income:		
Interest on bonds	**1,941**	2,500
Investment income (loss) on bonds	**(945)**	357
	996	2,857
Interest on deposit with the Receiver General for Canada at a weighted-average annual rate of 2.11% (2004–- 2.59%)	**129**	182
CPP Investment Board net income from operations:		
Net unrealized gains	**2,182**	6,050
Net realized gains	**1,762**	658
Investment income on bonds	**319**	–
Dividend Income	**737**	504
Other investment income	**35**	21
Investment and administrative expenses	**(52)**	(24)
	*** 4,983**	* 7,209
Investment Income	**6,108**	10,248

** Includes foreign exchange losses of $867.4 million (2004 – $392.6 million).*

11. ADMINISTRATION COSTS

	2005	2004
	(in millions of dollars)	
Pension and benefit delivery, accommodation and corporate services		
Social Development Canada	**263**	–
Human Resources and Skills Development Canada	**10**	–
Human Resources Development Canada	**–**	309
Collection of contributions (Canada Customs and Revenue Agency)	**96**	85
Cheque issue and computer services (Public Works and Government Services Canada)	**16**	15
Actuarial services (Office of the Superintendent of Financial Institutions)	**1**	1
	386	410

Administration costs of the CPP represent the cost of services received from a number of federal government departments and an agency. Those costs are based on estimated allocations of costs and are charged to the CPP in accordance with the memoranda of understanding. For the year ended March 31, 2005, pension and benefit delivery, accommodation and corporate services, formerly provided by HRDC, are now provided by SDC and HRSDC following the creation of the two new departments.

12. CONTINGENCIES

At March 31, 2005, there were 8,331 (4,403 in 2004) appeals relating to the payment of CPP pensions and benefits. These contingencies are estimated at an amount of $33 million ($22 million in 2004). Any award made in favour of beneficiaries will be accounted for as an expense of the period in which the amount becomes determinable.

A class action was filed against the CPP for discrimination against survivors whose same-sex common-law partners died on or after April 17, 1985 and before January 1, 1998. On November 26, 2004, the Court of Appeal for Ontario ruled that eligible class members, whose partners died between April 17, 1985 and January 1, 1998, will be entitled to receive pension payments. On January 25, 2005, both the government and counsel for the class members sought leave to appeal to the Supreme Court of Canada. Both requests for leave were granted on June 23, 2005. At the time of the preparation of the financial statements the Supreme Court of Canada had not yet set a hearing date.

On July 12, 2005, the Ontario Superior Court endorsed the agreement of the Government of Canada and the counsel for the class members to pay interim Survivor's Pensions to class members who currently have an active and complete application with the department. Where the CPP eligibility criteria are met, the interim payment may have a maximum retroactive date of January 1st, 2003. In the event that the Supreme Court of Canada ultimately reverses the decisions of the lower courts, these interim payments would have to be reimbursed to the CPP. The ultimate contingency involved in this class action is still estimated at an amount between $71 and $132 million.

13. RELATED PARTY TRANSACTIONS

In addition to the transactions disclosed in the other notes to the financial statements, the CPP has $2,278 million (2004 – $1,946 million) of contributions receivable from the Canada Customs and Revenue Agency and accounts payable of $32 million (2004 – $55 million) to the Government of Canada for the administration of the Plan.

The CPP enters into transactions with the Government of Canada in the normal course of business at exchange value.

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