



**Public Sector Pension
Investment Board**

Special Examination Report—2011



Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

Deloitte.

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To the Board of Directors of the Public Sector Pension Investment Board:

We have completed the special examination of the Public Sector Pension Investment Board in accordance with the plan presented to the Audit Committee of the Board of Directors on 5 August 2010. As required by section 139 of the *Financial Administration Act* (FAA), we are pleased to provide the attached final special examination report to the Board of Directors.

We will be pleased to respond to any comments or questions you may have concerning our report at your meeting on 12 May 2011.

I would like to take this opportunity to express my appreciation to the Board members, management, and the Corporation's staff for the excellent co-operation and assistance offered to us during the examination.

Yours sincerely,

Lissa Lamarche, CA
Principal, Office of the Auditor General

OTTAWA, 12 May 2011

Normand Favreau, CA
Partner, Deloitte & Touche LLP

MONTREAL, 12 May 2011

Attach.

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Public Sector Pension Investment Board

Special Examination Report—2011

Main Points

What we examined

The Public Sector Pension Investment Board (PSP Investments or the Corporation) is a Crown corporation created to invest the pension contributions (net of benefit payments made) of the Public Service, Canadian Forces, Royal Canadian Mounted Police, and Reserve Force pension plans (the Plans). Its mandate is to manage and invest these funds in the best interests of the contributors and beneficiaries, with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies and requirements of the pension plans.

We examined whether PSP Investments' systems and practices provide the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. We focused on the areas of governance, risk management, strategic planning, performance measurement, investment management, human resource management, and information technology management. Our examination covered the systems and practices that were in place between June 2010 and November 2010.

Why it's important

Net contributions from the plan members and sponsors which are transferred to PSP Investments represent an important portion of the assets which will serve to pay benefits of plan members upon their retirement. Ineffective systems and practices could lead to diminished returns and erosion of capital, potentially compromising the plans' ability to meet their financial obligations.

What we found

We found no significant deficiencies in the Corporation's systems and practices. This means that the Corporation maintains systems and practices that provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having that reasonable assurance. We noted good practices in most

areas, as well as some areas where PSP Investments would benefit from certain improvements.

- The Corporation has the key elements of a strong governance framework, and its governance practices are consistent with industry practices for stewardship and oversight by boards of directors. However, the lack of the staggering of appointments to the Board of Directors, which is not under the control of PSP Investments, may potentially lead to significant turnover in the Board membership in 2014 and 2015.
- The Corporation's risk management practices, particularly in the area of investment risk, provide for identification, monitoring, management, and reporting of risks to protect its assets from undue risk of loss. The Corporation continues to develop its risk measurement and risk management capabilities, in line with industry practice.
- The Corporation's compensation framework and practices are comparable with those of the industry. Incentives for investment staff are designed to balance the need to attract and retain talented performers with the need to align behaviours with the Corporation's investment strategies, policies, and risk tolerances. Staff engaged in risk and compliance functions are compensated in a manner that maintains their independence from the areas they oversee. The Board plays an active oversight role in the design and operation of compensation practices, and reviews and monitors them independently of management.
- The Corporation regularly benchmarks its practices against those of comparable organizations in the industry. Its practices in most areas are consistent with those of the industry. However, improvements can be made in public reporting of its Responsible Investment activities in order to better align with industry practices in this area.

The Corporation has responded. *The Corporation agrees with all the recommendations. Its responses follow the recommendations throughout the report.*

Special Examination Opinion

To the Board of Directors of the Public Sector Pension Investment Board

1. Under section 131 of the *Financial Administration Act* (FAA), the Public Sector Pension Investment Board is required to maintain financial and management control and information systems and management practices that provide reasonable assurance that its assets are safeguarded and controlled; its financial, human, and physical resources are managed economically and efficiently; and its operations are carried out effectively.

2. Section 138 of the FAA also requires the Corporation to have a special examination of these systems and practices carried out at least once every 10 years.

3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination—from June 2010 to November 2010—there were no significant deficiencies in the Corporation's systems and practices.

4. We based our examination plan on our survey of the Corporation's systems and practices and a risk analysis. On 5 August 2010, we submitted the plan to the Audit and Conflicts Committee of the Board of Directors. The plan identified the systems and practices that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.

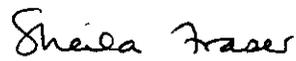
5. The examination plan also included the criteria that we used to examine the Corporation's systems and practices. These criteria were selected for this examination in consultation with the Corporation. The criteria were based on our experience with performance auditing and our knowledge of the subject matter. The criteria and the systems and practices we examined are listed in About the Special Examination at the end of this report.

6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the circumstances. In carrying out the special examination, we relied on the following internal audit reports: Annual Report on Internal

Controls, Internal Audit of Information Technology General Controls, the IT Project Management Audit, and the Internal Audit report on the Control Environment and Corporate Controls.

7. In our opinion, based on the criteria established for the examination, there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the Corporation's systems and practices.

8. The rest of this report provides an overview of the Corporation and more detailed information on our examination observations and recommendations.



Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
10 December 2010



¹Chartered accountant auditor
permit No. 18527

Montreal, Canada
10 December 2010

Overview of the Public Sector Pension Investment Board

9. The Public Sector Pension Investment Board (PSP Investments or the Corporation) is a Crown corporation established by Parliament under the *Public Sector Pension Investment Board Act* in September 1999. Its mandate is to manage and invest amounts transferred to it under the superannuation acts for the Public Service, Canadian Forces, and Royal Canadian Mounted Police pension plans by the plan sponsors (Treasury Board, National Defence, and Public Safety Canada respectively). In February 2007, its mandate was expanded to include the investment of Reserve Force Pension Plan contributions. PSP Investments was created at arm's length from the plan sponsors and provides for the independent investment of the plan assets in a manner that generates a return based on market performance.

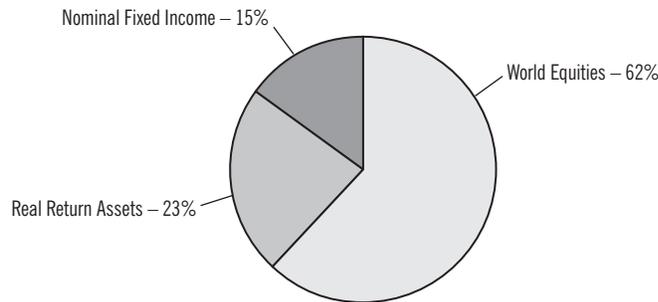
10. Specifically, section 4 of the *Public Sector Pension Investment Board Act* (the PSPIB Act) states that the objects of the Corporation are

- to manage the amounts that are transferred to it under the *Canadian Forces Superannuation Act*, the *Public Service Superannuation Act*, and the *Royal Canadian Mounted Police Superannuation Act*, in the best interests of the contributors and beneficiaries under those Acts; and
- to invest its assets with a view to achieving a maximum rate of return, without undue risk of loss, having regard to the funding, policies, and requirements of the pension plans established under the Acts referred to in paragraph (a) and the ability of those plans to meet their financial obligations.

11. To achieve its mandate, PSP Investments targets a minimum long-term real rate of return of 4.3 percent on the plan assets it manages, which corresponds to the long-term actuarial rate of return used by the Chief Actuary of Canada in the most recent actuarial reports of the plans. To achieve this minimum rate of return, PSP Investments has allocated, in its Statement of Investment Policies, Standards and Procedures (SIP&P), the plan assets to various asset classes (Exhibit 1). This is PSP Investments' Policy Portfolio, which it believes, based on its expectations of long-term market conditions, should achieve this target return. These asset classes include public and private investments such as Canadian and foreign equities, real estate, bonds, and debt securities. One of PSP Investments' competitive advantages is the fact that it expects to receive positive

net inflows over the next 19 years. This flexibility enables it to take advantage of long-term opportunities in less liquid asset classes, such as private market investments, which allows it to further diversify the fund.

Exhibit 1 The Corporation's Policy Portfolio includes different investment asset classes



Source: Public Sector Pension Investment Board 2010 Annual Report

12. In addition to the returns expected from the Policy Portfolio, PSP Investments employs investment management strategies, referred to as active investment management strategies, designed to increase returns, within approved risk limits. These active investment management strategies seek to outperform the Policy Portfolio benchmarks.

13. The Corporation's strategic plan also sets out corporate objectives that support the achievement of the statutory mandate. For the 2010–12 planning period, PSP Investments' strategic plan articulates strategic objectives that include

- further alignment of the Corporation's SIP&P to the plan sponsors' objectives and risk tolerances,
- the continued implementation of its active investment management strategies,
- the achievement of optimal organizational effectiveness and enhanced risk management capabilities, and
- the further enhancement of employee engagement.

14. To achieve its mandate and investment objectives, PSP Investments has a team of investment professionals and support personnel who design investment strategies that are in line with the Corporation's investment objectives and SIP&P, and who identify, manage, and monitor risk and investment performance. PSP

Investments acknowledges that the achievement of its statutory mandate and investment objectives is highly dependent on the quality of its human resources, and that it operates in a very competitive human resource environment, given the high demand in the industry for experienced and competent investment professionals. Thus, its compensation practices aim to attract and retain competent employees, while also ensuring alignment of investment decision making with the Corporation's business strategies, priorities, and risk tolerances.

15. Since the last special examination, which was carried out by Deloitte & Touche and reported on in November 2005, PSP Investments has grown considerably, from an organization of 75 employees and assets under management of \$19.4 billion to an organization of 311 employees and assets under management totalling \$46.3 billion as at 31 March 2010 (Exhibit 2). This growth has led to changes in the organization, such as the development of a diversified investment strategy, the implementation of increasingly complex management information systems, and the need for more sophisticated human resource management systems and practices, particularly in the areas of recruitment and development.

16. PSP Investments' activities are overseen by its Board of Directors, which comprises 11 members, including the Chair. The Board of Directors reports to the President of the Treasury Board, who is responsible for PSP Investments' legislation, as well as to the ministers of National Defence and Public Safety Canada. The Corporation's President and Chief Executive Officer and senior management team oversee its day-to-day activities.

Exhibit 2 The Corporation has grown over the last five years

	2005	2006	2007	2008	2009	2010
Assets under management	\$ 19.4B	\$ 27.6B	\$ 35.0B	\$ 39.0B	\$ 33.8B	\$ 46.3B
Overall increase (decrease)	5.2B	8.2B	7.4B	4.0B	(5.2B)	12.5B
Contributions	3.8B	4.2B	4.0B	4.2B	4.4B	5.0B
Net income (loss)	1.4B	4.0B	3.4B	(0.2B)	(9.6B)	7.5B
Employees	75	133	182	229	297	311
Increase		58	49	47	68	14

Source: Public Sector Pension Investment Board annual reports and information provided by management

Focus of the special examination

17. Our objective is to determine whether PSP Investments' systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively during the period covered by the examination. We focused on the areas of governance, risk management, strategic planning, performance measurement and reporting, investment management, human resources management, and information technology.

18. Further details on the audit objectives, systems and practices, and criteria are provided in **About the Special Examination** at the end of the report.

Observations and Recommendations

Corporate governance

19. Sound corporate governance practices are essential to enable a corporation to meet its mandate and objectives. The division of powers and responsibilities among Parliament, ministers, the board of directors, and management establishes key oversight and accountability mechanisms. In particular, the board of directors oversees the affairs of the corporation to ensure it achieves its mandate and objectives, as set out in the corporation's legislation. We examined whether the Public Sector Pension Investment Board (PSP Investments or the Corporation) has a well-performing corporate governance framework that meets industry practices in board stewardship, oversight, and stakeholder relations.

20. In examining corporate governance, we looked at the following elements:

- the roles and responsibilities of the Board of Directors and its committees, including independence policies and membership of the Board;
- orientation and ongoing training practices offered to the directors; and
- information provided to the directors, as well as ongoing communications among senior management, the directors, and stakeholders.

21. Overall, we found that PSP Investments has a corporate governance framework that performs well and meets industry practice

expectations for Board stewardship and oversight, and relations and communications with stakeholders (namely the plan sponsors and beneficiaries). However, we noted that the Corporation may need to further engage with the parties responsible for the appointments process to encourage further staggering of appointments to the Board of Directors to avoid potential significant turnover in Board membership in 2014 and 2015. The following sections present our detailed findings on corporate governance.

The Board of Directors has what it needs to provide stewardship and oversight

22. The *Public Sector Pension Investment Board Act* defines the legislative mandate of PSP Investments as well as the roles and responsibilities of its Board of Directors. To assist it in discharging these roles and responsibilities, the Board has established four committees:

- the Investment Committee,
- the Audit and Conflicts Committee,
- the Human Resource and Compensation Committee, and
- the Governance Committee.

23. The Board has clearly defined its roles and responsibilities and those of its committees in their respective terms of reference. The terms of reference of the Board and its committees are reviewed and updated, at least every two years. They are implemented via annual work plans that encompass roles and responsibilities, as well as annual objectives. We found that the Board structure, as well as its Terms of Reference, were comparable to those of the Corporation's peers and aligned with the responsibilities assigned to the Board and the Board committees in the PSPIB Act.

24. The Terms of Reference of the Board's Audit and Conflicts Committee include guidance on oversight of financial reporting, internal controls, and audits, as well as monitoring compliance with the Code of Conduct for officers and employees. The Audit and Conflicts Committee is supported by PSP Investments' Internal Audit function, which provides audit reports on PSP Investments' activities, conducted according to the risk-based internal audit plan.

25. Based on our discussions with directors and a review of information submitted to Board committees, we found that management provides the Board with the information it needs to interpret the Corporation's legislative mandate, provide management with strategic direction, and exercise its oversight responsibilities.

Information on the Corporation's management and results that directors receive on an ongoing basis is timely, comprehensive, and relevant to their oversight responsibilities.

26. Annually, the Corporation holds strategic sessions with its Board of Directors, whereby the Board is directly involved in determining the Corporation's strategic direction and its performance indicators and measures. In addition, the Board discusses and reviews specific aspects of the strategic direction and goals, including implementation progress, throughout the year.

The Corporation manages the skills and independence of its Board, but it should examine how the staggering of the appointments could be improved

27. At the time of the examination, the Board of Directors comprised nine members (out of eleven positions), whose profiles include experience in banking and investment management, insurance, pension management, as well as general corporate management. To ensure the Board collectively possesses required skills and competencies, a Board Competency Profile outlining the required competencies, skills, and experience sought on PSP Investments' Board of Directors has been developed. The Governance Committee regularly assesses the Board's collective skills and competencies against this Board Competency Profile, specifically when terms are expected to expire or when vacancies arise. Any gaps or desired skills or competencies are identified. The competency profile was last updated in June 2010, in order to prepare the candidate profile for the upcoming appointments to fill vacancies and expiring terms. We found that the Board of Directors has consistently used this process to ensure that it collectively has the skills and competencies it believes necessary to discharge its roles and responsibilities.

28. When new directors are appointed, PSP Investments offers them a timely and comprehensive director orientation program. The Corporation also offers an ongoing directors' training program, which provides tailored learning opportunities, including courses, conferences, technical literature, and subscriptions to help directors deepen their understanding of PSP Investments' business and activities.

29. Independence of the Board of Directors is managed through different mechanisms. The PSPIB Act prohibits members of the Senate, the House of Commons, and provincial legislatures, as well as employees of PSP Investments or the federal government and those entitled to benefits under the Plans from being appointed as directors

of the Corporation. PSP Investments' Code of Conduct for Directors is communicated to directors. Directors disclose all potential conflicts of interest and declare their compliance with the Code of Conduct, upon appointment and annually thereafter, to the Corporate Secretary. Exceptions or instances of non-compliance with the Code of Conduct are reported to the Governance Committee and the Chair of the Board. We found that the Corporation complies with the PSPIB Act and its policies regarding independence of its Board of Directors.

30. The President of the Treasury Board recommends candidates for appointment to PSP Investments' Board of Directors to the Governor in Council, who is responsible for these appointments. As per the PSPIB Act, the Treasury Board President's recommendation is made from a list of qualified candidates established by an independent third party Nominating Committee based on the Board Competency Profile provided by PSP Investments' Governance Committee. The Nominating Committee is composed of eight members, seven of which are representatives of the plans. The eighth member is the Committee Chair, who is independent and appointed by the President of the Treasury Board, after consultation with the Minister of National Defence and the Minister of Public Safety.

31. Assuming that members of the Board of Directors continue to be appointed for four-year terms, we noted that 10 terms out of 11 could potentially expire in 2014 and 2015. Such significant turnover in a two-year period could challenge the Board's ability to maintain sufficient corporate knowledge and continuity, and thus compromise its effectiveness. Though this risk can be mitigated through the re-appointment of existing directors and ensuring that sufficient knowledge transfer takes place through the Board orientation process, the Corporation does not control the appointment process, and thus cannot rely on this strategy. It may also need to consider increased communication with, and perhaps recommendations to, the Nominating Committee.

32. Recommendation. To assist in providing an orderly transition of appointments of members to the Board of Directors, the Public Sector Pension Investment Board (PSP Investments) should examine whether a more optimal staggering of Board appointments could be implemented and consider whether it should make recommendations to this effect to the Nominating Committee and the President of the Treasury Board.

The Corporation's response. Agreed. The Board of Directors of PSP Investments is aware of this issue. Recent appointments have been made in

groups, which has led to the limited staggering of the terms of our current directors. Through the Chair of the Board of Directors and the Chair of the Governance Committee, PSP Investments will continue to have dialogue with the President of the Treasury Board and the Nominating Committee to attempt to improve the board appointment process.

The Corporation will be proposing two changes in the appointment process to address this issue. The first change will be to restructure the recommendation process of the Nominating Committee. The Corporation will propose to hold an annual meeting with the Nominating Committee to establish the candidate selection criteria, followed by one further meeting with the Nominating Committee in which the preferred candidates and alternates, based on the agreed criteria, are presented to it for recommendation to the President of the Treasury Board. The second change will be to recommend to the Nominating Committee and the President of the Treasury Board that when appointments are to be made in groups, that they be made for different term lengths to achieve a better staggering of the terms.

The Corporation communicates in a timely manner with stakeholders

33. Based on our review of presentations made to the plan sponsors and correspondence between PSP Investments and the plan sponsors, as well as our discussions with PSP Investments' directors and senior management, dialogue with the key stakeholders is ongoing and open and includes discussions around, for example, investment performance and activities, as well as the sponsors' risk tolerances and the plans' funding principles. For example, in its annual report, the Corporation describes the results for the year and performance relative to its strategic goals. As well, it holds an annual public meeting to present its results for the past fiscal year. Finally, the President and CEO as well as the Chair of the Board of Directors meet at least annually with the advisory committees to the pension plans to report on the Corporation's activities.

Risk management

34. The activities of the Public Sector Pension Investment Board (PSP Investments or the Corporation) involve assuming risk, principally investment risk. The Corporation recognizes that its exposure to risk goes beyond investment risk, and that it needs to consider a full spectrum of risks on an enterprise-wide basis. The Corporation must manage these risks in ways that allow it to meet its statutory mandate and its targeted long-term rate of return, without exposing its assets to undue risk of loss.

35. We examined whether the Corporation has established an enterprise-wide risk management framework supported by a risk culture that promotes the achievement of its mandate, business goals, and objectives, and that it has systems and practices in place to identify, measure, mitigate, monitor, and report on key risks associated with the achievement of its business objectives.

36. We looked at the following elements:

- the Corporation’s enterprise risk management framework and policies;
- implementation of these policies around risk measurement, mitigation, and monitoring; and
- risk management reporting throughout the organization.

37. The special examination report issued in 2005 included recommendations aimed mainly at helping the Corporation evolve its risk management capabilities to catch up with the growth of its assets. Since the 2005 special examination, the Corporation’s risk management practices have evolved considerably with the creation of the Chief Risk Officer (CRO) position, the implementation of an enterprise risk management framework and program, the enhancement of risk measurement practices, and the monitoring and reporting of key risk indicators.

38. Overall, we found that the Corporation has a well-defined enterprise-wide risk management framework that is supported by a risk culture and processes that promote the achievement of its mandate and business objectives. This framework also provides for identification, measurement, mitigation, monitoring, and reporting on the Corporation’s key risks. The following section presents our detailed findings on risk management.

There is a corporate-wide approach to risk management

39. The Corporation has established an enterprise-wide risk management framework that has been approved by the Board of Directors. The framework is designed to ensure independence, accountability, and appropriate segregation of duties in the oversight and management of corporate-wide risks through different levels of responsibilities, including

- the oversight role of the Board of Directors and Board committees;
- involvement of management committees; and

- independent support and control functions such as the CRO, a Risk Management Group, and an independent Compliance Group.

Roles and responsibilities for risk management have been established, approved, and communicated through employee job descriptions and various policies and procedures. The Enterprise Risk Management (ERM), Investment Risk Management (IRM), and Operational Risk Management (ORM) policies and their supporting procedures provide the framework necessary for identifying, measuring, mitigating, and monitoring significant risks.

Value at Risk (VaR)—A measure of the risk of loss on a portfolio, expressed in basis points (units equal to 1/100th of a percentage point), for a given probability and time horizon.

40. The Corporation has articulated its investment risk tolerance, approved by the Board, as an investment risk budget measured as a **Value at Risk (VaR)** upper limit. It uses this measure to manage and monitor the risk inherent in its investment strategies for the entire portfolio and for different asset classes. The Risk Management Group measures the Corporation's investment risk exposure against established risk limits and reports the results to relevant members of senior management, management committees, and Board committees.

41. Every three years, the Corporation undertakes its Risk and Control Self-Assessment, which is a corporate-wide assessment of the risks that threaten the achievement of corporate objectives and the controls in place to mitigate them. This self-assessment enables the Corporation to identify new and emerging risks as well as to update its current risk profile. The Risk and Control Self-Assessment serves as an important input to PSP Investments' three-year strategic planning process. The 2011 Risk and Control Self-Assessment is currently under way.

42. We found that the Corporation provides a comprehensive set of reports to management, the Board of Directors and Board committees, which include investment risk as well as operational risk measures. Key investment risk indicators and limits are reported weekly to the Management Investment Committee in a risk limit report. Key operational risk indicators, such as employee turnover and information technology system availability, are reported to the Management Investment Committee and to the Investment Committee of the Board in the ERM quarterly report.

43. We found that, while the Corporation has articulated its risk tolerance for investment risk, it has not defined its risk tolerance for non-financial risks, such as operational risk and reputational risk. We encourage management to continue the dialogue with Board members

to further define the Corporation's risk tolerance for each significant risk and to establish a risk tolerance framework to ensure that management decisions are aligned with the Board-approved risk tolerance.

44. While risk is discussed in various committees under their respective mandates and the Enterprise Risk Management Policy, PSP Investments does not have a formal executive-level forum where all significant risks are systematically discussed and considered. As PSP Investments continues to grow and its risk management practices evolve, we encourage senior management to assess the benefits of formally establishing an executive-level forum within its existing committee structure to discuss enterprise-wide risks at a strategic level.

Strategic planning, performance measurement and reporting

45. Strategic planning is important in ensuring that a corporation as a whole can meet its long-term objectives and that its strategies, objectives, tactics, and the allocation of its resources are aligned with the achievement of its statutory mandate, which includes assessing and adjusting an organization's direction in response to a changing environment. Measuring and reporting on performance are important steps in making sound decisions, holding management accountable, and demonstrating the extent to which a corporation has achieved expected results in accordance with its strategic plan. Such information supports accountability and should help drive behaviour toward achievement of the corporation's mandate and objectives.

46. We examined whether the Public Sector Pension Investment Board (PSP Investments or the Corporation) has a clearly defined strategic direction and specific and measurable goals, objectives, and performance indicators to achieve its mandate and statutory objectives. The Corporation's strategic direction and goals need to take into account identified risks, and the need to control and protect its assets and manage its resources economically and effectively. We also examined whether the Corporation's performance reporting provides complete, accurate, timely, and balanced information for decision making and accountability reporting.

47. In examining strategic planning, performance measurement and reporting, we looked at the following elements:

- the Corporation's 2010–2012 Strategic Plan and the process to develop it;
- its assessment of its internal and external environments, as well as of its strengths, weaknesses, opportunities, and threats;

- communication of the strategic direction throughout the organization;
- performance indicators, and the process to select investment performance measures;
- the monitoring and reporting of performance information, including a review of internal performance reports and the annual report; and
- public reporting of performance information.

48. The 2005 special examination report included recommendations around formalizing and documenting PSP Investments' strategic planning process and performance reporting framework, as well as establishing a longer term strategic direction. Since 2005, PSP Investments has responded to these recommendations by developing its planning policy, which formalizes the planning process and performance reporting framework, and provides for the development of a three-year strategic plan.

49. Overall, we found that the Corporation has clearly defined and communicated its strategic direction in its 2010–2012 Strategic Plan. The Plan considers the operating environment; risks threatening the achievement of the statutory mandate; the Corporation's strengths, weaknesses, opportunities, and threats; and the need to control and protect its assets and manage its resources economically and efficiently. In addition, we found that the Corporation produces performance information that enables the Board of Directors and stakeholders to assess its performance, as well as its progress toward the achievement of its mandate, statutory objectives, and key strategic objectives. However, we found that, while the Corporation measures its performance related to its strategic goals and objectives, the measures are focused on tasks rather than outcomes. The following section presents our detailed findings on strategic planning and performance measurement and reporting.

Strategic direction is the result of a comprehensive planning process, but measures of strategic outcomes should be determined

50. PSP Investments' planning policy provides for a systematic and comprehensive approach to the development of a three-year Strategic Plan. The Board of Directors approves the strategic direction and is involved throughout the planning process. PSP Investments' last Strategic Plan was developed and approved in the 2008–09 fiscal year for the 2010–12 planning period. In developing its 2010–2012

Strategic Plan, PSP Investments considered its most recent risk assessment; its external and internal operating environment; and an assessment of its strengths, weaknesses, opportunities, and threats, by investment area. The Board was engaged and provided input at strategic planning sessions.

51. PSP Investments has clearly defined its vision statement, operating and investment principles, and strategic goals and linked them to clear and measurable objectives and tasks, which are specifically assigned to groups and/or individuals. We found that the 2010–2012 Strategic Plan was aligned with and supported the execution of the Corporation’s mandate, as set out in the *Public Sector Pension Investment Board Act*, including the control and protection of its assets by not assuming undue risk of loss.

52. The various groups or individuals to whom the strategic goals are assigned establish more detailed plans, resource requirements, and financial budgets for the three-year planning period, as well as for each year included in the plan. Senior management and the Audit and Conflicts Committee roll up and monitor the various financial budgets and resource requirements, and benchmark this information against industry comparators to ensure that the Corporation’s plans reflect an economic and efficient use of its resources.

53. The Corporation communicates its Strategic Plan in a timely manner throughout the organization using various means, including corporate or group meetings, presentations of business plans by the various groups, and communications through the Corporation’s intranet site or distinct publications. In addition, strategic objectives are incorporated in individual performance objectives and translated into specific tasks, which are monitored as part of the performance management and assessment process at the end of the year, to ensure behaviours throughout the organization align with the Strategic Plan.

54. However, while the Corporation uses measures to assess its performance in areas related to its strategic objectives and goals, the process does not fully enable it to assess its success in the achievement of its strategic goals, as it focuses on execution of tasks, rather than on measures of success related to goals (that is, outcomes). Monitoring and measuring outcomes, in addition to currently tracking the achievement of underlying tasks, is necessary in order to measure success against strategic goals.

55. Recommendation. The Public Sector Pension Investment Board (PSP Investments) should develop and assign measurable outcomes for

its strategic goals, to enable measurement of success for each strategic goal.

The Corporation's response. Agreed. In its next Strategic Plan, PSP Investments will endeavour to develop additional measurable outcomes that are designed to measure the overall achievement of the strategic goals.

The Corporation has established suitable investment performance benchmarks

56. While the Corporation's strategic goals and performance indicators encompass many objectives, central to PSP Investments' mandate is the performance of its investments. To monitor its investment performance, PSP Investments compares its actual investment returns against its Policy Portfolio and specific asset class **benchmark returns**. For its public market asset classes, PSP Investments uses representative publicly available market indices as its asset class benchmarks. For all of its private asset classes, the Corporation has recently decided to move to **cost of capital benchmarks**. Implementation of these new measures is currently under way.

Benchmark return—A rate of return against which the performance of individual asset classes and investment managers is measured.

Cost of capital benchmarks—Target return benchmark based on the long-term market expected return of the asset class.

57. PSP Investments has established a process for selecting these performance benchmarks that includes Board oversight and consultations with internal stakeholders (operations and investment units) and with external advisers. A process is also in place to ensure that portfolio and benchmark performance returns reported are calculated according to the Chartered Financial Analyst Institute Performance Reporting Standards. We found that the Corporation has established practices to ensure that selected performance benchmarks are suitable and relevant for its investment portfolios.

The Corporation monitors and reports its performance

58. PSP Investments' planning policy provides for

- a review of progress made in implementing the three-year Strategic Plan, which becomes an input to the following Strategic Plan;
- a detailed mid-cycle review of the Corporation's progress against Strategic Plan objectives;
- a quarterly review of the divisional results against its objectives; and

- annual performance assessments of management, based on the achievement of the objectives and initiatives set out in the planning documents.

59. In the 2010–11 fiscal year, PSP Investments, with the Board of Directors, undertook its mid-cycle review of progress against the 2010–2012 Strategic Plan. This review included reporting its progress on strategic objectives and tasks, as well as evaluating whether it was on track to meet its strategic goals and objectives. This review also included a survey of the current business environment, changes within PSP Investments, and the results on key performance indicators, to assess whether the Corporation’s strategic objectives were still appropriate and to update strategic objectives and/or underlying tasks based on the current environment. For example, new objectives were included to address some of the observations emerging from the 2009 employee engagement survey. This exercise enabled the Corporation to confirm that its strategic objectives were still appropriate and that it was on track to achieve these objectives.

60. The Finance and Operations group assesses investment performance against the benchmark returns and reports these to the Management Investment Committee on a weekly basis and to the Investment Committee of the Board of Directors quarterly. Long-term performance is measured and assessed annually, during the review of the Corporation’s Statement of Investment Policies, Standards and Procedures (SIP&P), to ensure the Policy Portfolio remains aligned with PSP Investments’ target long-term real rate of return of 4.3 percent. Other performance information, such as progress against various initiatives, is assessed and reported quarterly to the Management Operations Committee and at least annually to the Board of Directors.

61. PSP Investments reports its performance against its strategic objectives and performance targets to its stakeholders via a number of different mechanisms, including its annual report, presentations at the meetings of the pension plan advisory committees, and its annual public meeting. Information provided to stakeholders includes investment performance overall and by asset class, performance of material investments and significant investment activities carried out during the year, and progress on other key strategic goals and objectives. To ensure it continues to provide its stakeholders with relevant and complete information comparable to industry practices in performance reporting, PSP Investments regularly compares its external performance reporting to that of its peers. Such a

benchmarking exercise is currently under way and may impact the information contained in its 2011 Annual Report.

Investment management

62. Investment management is central to achieving the statutory mandate of the Public Sector Pension Investment Board (PSP Investments or the Corporation). The nature of the Corporation's activities exposes it to significant investment risks, such as fluctuations in interest rates, foreign currency exchange rates, and market values for investments. As a result, to meet its statutory mandate, the Corporation needs to have investment management systems and practices that enable it to invest its assets to achieve the targeted return while managing the related investment risk.

63. We examined whether investment decision making and monitoring practices are in place to support the development of investment strategies, the conduct of due diligence, and the monitoring of investment performance. We also examined whether risk arising from investment activities is identified, measured, mitigated, monitored, and reported.

64. In examining investment management, we looked at the following elements:

- investment management policies and procedures;
- investment strategies and decision making, including due diligence activities and consideration of environmental, social, and governance (ESG) imperatives; and
- management, monitoring, and reporting of investment activities and performance.

65. The 2005 special examination report included a number of recommendations in the area of investment management regarding refinements in investment policies, particularly in the area of evaluating, monitoring, and mitigating investment risk. Since 2005, the Corporation has reviewed its systems and practices to address the report's recommendations.

66. Overall, we found that the Corporation has implemented investment management processes and procedures that are aligned with the Corporation's objectives and risk tolerances and support the development of investment strategies; the conduct of due diligence; and the identification, measurement, mitigation, monitoring, and reporting of investment risk activities and performance. However, opportunities for improvement exist in the approval process for new investment activities and public reporting of responsible investing

activities. The following sections present our detailed findings on investment management.

Investment policies and procedures support investment management activities, but opportunities for improvement exist

67. PSP Investments' Statement of Investment Policies, Standards and Procedures (SIP&P) sets out how the Corporation is to carry out its investment activities. The Corporation has a process to ensure that it establishes and implements investment strategies that are compliant with its SIP&P. Namely, the Management Investment Committee reviews and approves the business plans of asset classes, investment strategies, new investment products, and other investment-related activities. For new investment products, the Committee receives a recommendation from the New Product Committee, which assesses the financial and non-financial risks as well as operational impacts of these new investment products. Policies, guidelines, and procedures related to investment activities have been developed and effectively communicated to investment personnel, following senior management and Board approval. The Corporation reviews and updates the SIP&P and its related policies and procedures at least annually.

68. The Corporation's internal compliance function also carries out independent compliance activities to assess whether investments and investment activities comply with the SIP&P and the PSPIB Act and regulations. PSP Investments identifies, reports, and escalates investment compliance issues when they occur and undertakes remediation measures, if required. The Corporation is in the process of acquiring a pre-trade compliance software to improve its existing compliance processes. It will benefit from a more automated compliance review process, particularly as the volume of its transactions increases.

69. PSP Investments appropriately documents, reviews, and executes arrangements with external managers and business partners. It performs due diligence procedures when dealing with potential business partners and external managers to ensure that their investment activities (both fund investments and direct investments) are properly approved and in line with PSP Investments' SIP&P.

70. However, we noted that the New Product Committee will review new investment activities that use approved investment products only when the Management Investment Committee decides it is appropriate. As a result, the process to introduce new investment activities does not systematically assess whether these activities

introduce new or additional risk exposures that were not originally contemplated. As such, these new investment activities are not necessarily subject to the review and approval process, specifically the input of the New Product Committee.

71. Recommendation. The Public Sector Pension Investment Board's (PSP Investments) New Product Committee should systematically review new investment activities using approved investment products to assess whether they introduce new risk exposures. These activities should be subject to the same review and approval process as all new investment products.

The Corporation's response. Agreed. The above concern is implicitly addressed by the Terms of Reference of the Management Investment Committee, which includes the review and approval of the business plans of asset classes, investment activities, new investment products, and other investment-related activities. PSP Investments will amend the New Product Committee's Terms of Reference and its related procedures to expand its scope to include new investment activities using approved products.

Investment risk management activities are managed, monitored, and reported

72. The Corporation's investment activities involve a significant number of transactions each year, as well as significant funds being invested in individual investments, asset classes, investment strategies, or other investment related activities. As a result, in order to ensure its investments activities remain within approved risk tolerances, PSP Investments has developed and implemented policies, procedures, and guidelines to ensure measurement, management, monitoring, mitigation and reporting of investment activities. These policies, procedures, and guidelines outline the review, approval, and monitoring processes to manage investment activities within the Board-approved risk tolerance; they also include pricing and market risk measurement methodologies and guidelines for establishing new valuation models and risk measurement techniques.

73. We found that the Corporation monitors its investment risk according to its risk management policies. It sets investment risk limits as part of the annual risk budgeting process and monitors these on an ongoing basis to ensure they are not exceeded. It establishes asset class ranges and limits to ensure diversification of investment risk according to its SIP&P. It has also established various parameters to monitor and manage other risks, such as risks related to concentrations in various geographical areas or industries.

74. PSP Investments uses various risk mitigation strategies to reduce its exposure to specific risks, where possible, such as certain exposures to foreign currency risks and to the credit risk of counterparties with whom it undertakes transactions. We found that PSP Investments mitigates its exposure to the credit risk of these counterparties through collateral arrangements, where counterparties provide assets to secure the performance of their obligations, and through regular counterparty credit risk monitoring. This includes dealing only with approved counterparties and setting transaction limits with these counterparties. Through the implementation of a new system, PSP Investments is further enhancing the process for measurement and monitoring this risk.

75. Investment risk information, including VaR measures, stress testing, exceptions to risk limits, and the performance of external managers and business partners, are reported to senior management and the Board on a timely basis. Oversight processes are in place for risk management methodologies, assumptions, models, and systems, independent of the investment units. A formal review of **private market proxies** is undertaken at least annually to confirm whether the assumptions remain valid. The results of the review are reported to the Risk Steering Committee and the Management Investment Committee.

Private market proxies—Substitute measures used to represent the broad market or a segment of the market where data limitations exist.

76. In order to validate the continued effectiveness and applicability of its risk measurement methodologies and the assumptions included in its risk measurement models, PSP Investments back-tests its models. Back-testing compares actual portfolio returns to estimates from the risk measurement models to ensure that changes in market values and risk are consistent with market movements and portfolio transactions. Annual reporting to the Board of Directors on the results of back-testing for both public and private markets is in place.

Responsible investment practices are evolving, but more public reporting is necessary

77. Responsible investing (RI) is important for an organization such as PSP Investments, because failure to consider environmental, social, and governance (ESG) risks can compromise value and return on investment and could expose the organization to reputational risks, given the heightened public interest in this area and PSP Investments' status as a federal Crown Corporation. In 2009, PSP Investments updated its RI policy, which requires that it identify, assess, and mitigate ESG issues that are, or could become, material to longer term financial performance. The policy also provides for direct engagement

in public and private market investments and for collaborative engagement with other like-minded organizations. An RI procedure, issued in August 2010, supplements the policy to guide investment managers in their consideration of ESG factors during their due diligence reviews of potential investments, external managers, and fund managers.

78. As the RI policy aims first and foremost to protect portfolio values and investment returns, investment managers are accountable for ESG risks. Investment managers consider ESG risks through their due diligence procedures of potential investments and assessment of the practices of external managers and fund managers in this area. The monitoring of ESG risks in private markets is undertaken through ongoing dialogue with partner investors and senior management of private market investments. For its public market investments, PSP Investments monitors ESG risks with external service providers, who assist the Corporation with casting its voting rights (proxy voting) for its investments and by engaging with companies on ESG factors. PSP Investments also requires external managers it engages to confirm, on a quarterly basis, their compliance with the Corporation's SIP&P, which includes the RI policy.

79. As the development of the RI policy and procedure is a recent initiative, investment managers have received limited training in the consideration of ESG matters in investment decisions and limited detailed guidance and checklists. In addition, the Corporation currently does not employ an expert in responsible investing. The Corporate Secretariat and Legal Affairs provide support to the investment groups in this area. With limited internal expertise or detailed guidance and checklists to support the implementation of the RI policy and procedure, there is a risk that ESG risks will not be identified or properly assessed. As PSP Investments continues to grow, we encourage it to consider enhancing its in-house capacity and training in this area.

80. PSP Investments reports quarterly to the Governance Committee of the Board of Directors on its engagement activities in public markets as well as on its proxy voting activities. For its private market investments, PSP Investments reports on ESG issues as they emerge and are identified. PSP Investments' RI policy and Proxy Voting Guidelines are publicly available on its website and briefly discussed in its Annual Report. However, the Corporation does not report publicly on its responsible investment activities, including its proxy voting activities. Industry practices include reporting on responsible investment activities in an annual RI report or in the

Annual Report, and making detailed proxy voting activities publicly available, which promotes transparency and accountability in this area of heightened public interest.

81. Recommendation. The Public Sector Pension Investment Board should review its public reporting of its responsible investment activities to ensure that they reflect industry practices in this area.

The Corporation's response. Agreed. The Corporation will review its public disclosure practices in the area of responsible investing and proxy voting, and will expand its annual disclosure to better align its practices in these areas with those of its peers.

Human resource management

82. The success of the Public Sector Pension Investment Board (PSP Investments or the Corporation) in achieving its statutory mandate depends largely on the quality of its human resources and its ability to attract, retain, and develop skilled and experienced employees. The Corporation has undergone significant growth since the last special examination; its staff complement has increased from 75 to 311 over the last six years.

83. We examined whether human resource management systems and practices provide the Corporation with the human resource capacity and work environment it needs to achieve its goals and objectives. We also examined whether the Corporation has aligned its compensation practices with prudent risk-taking and relevant industry practices.

84. When examining human resource management, we looked at the following elements:

- human resource policies and procedures in planning, recruiting, and allocating staff;
- performance management;
- learning and development;
- succession planning; and
- compensation.

85. The 2005 special examination report included a number of observations in the area of human resource management systems and practices, aimed at managing the Corporation's growth in this area. Since then, the Corporation has implemented numerous systems and practices to address these observations, including the implementation of a recruitment and talent management methodology called the

Topgrading[®] Talent Management Strategy, as well as the implementation of an internal communication plan in response to the Corporation's most recent employee engagement survey.

86. Overall, we found that PSP Investments has a human resource management framework in place that provides the Corporation with assurance that it has the human resource capacity and work environment it needs to achieve its goals and objectives, and that its compensation framework rewards behaviours that are aligned with prudent risk taking and relevant industry practices. The following sections present our detailed findings on human resource management.

The Corporation has implemented rigorous hiring practices

87. PSP Investments has a Human Resource Strategic Plan as well as a human resource management policy that are aligned with the Corporation's strategic plan. They ensure that the Corporation identifies and addresses human resource needs resulting from the implementation of the Strategic Plan. The objectives of the Human Resource Strategic Plan are incorporated in the Human Resource First Vice President's annual objectives.

88. In the past five years, PSP Investments has implemented the Topgrading[®] methodology for recruitment, performance management, and talent development. The Topgrading[®] methodology includes rigorous processes for recruiting staff, including a detailed definition of the position and skills required, as well as for their subsequent performance measurement and talent development. In addition, the Corporation assesses and classifies its employees according to their performance and potential, as per the methodology, which helps it design tailored development plans and provides inputs to its succession plan.

89. Using this methodology, PSP Investments has established rigorous hiring and performance management practices in order to obtain the human resource capacity it needs. The Corporation tracks its hiring success by assessing hired candidates three months after their hire. It also reassesses, measures, and reports performance levels as well as the potential of its employees as part of the annual performance management process.

Compensation practices align behaviours while maintaining competitiveness

- 90.** PSP Investments recognizes that, while compensation is important to attract and retain competent staff, it also plays an important role in aligning behaviours with the Corporation's strategic objectives and risk tolerances. PSP Investments' total compensation framework thus provides for base salary, short-term and long-term incentives, and benefits. As they are based on the Corporation's performance metrics, the short-term and long-term incentives enable PSP Investments to reward behaviours that are aligned with the Corporation's strategic objectives and investment policies.
- 91.** The short-term incentive plan recognizes performance for the current and the previous three years. The long-term incentive plan is based on four-year performance periods with payouts after four years. The Corporation also offers a discretionary Restricted Fund Unit plan to its senior management, for which the annual amount paid is adjusted by the fund's performance over three years. This long-term compensation horizon, combined with capping of potential payouts, reduces the potential for excessive risk-taking by limiting the opportunities for investment managers to benefit from significant short-term gains that could expose the Corporation to longer term risks.
- 92.** The Corporation compensates its risk, compliance, financial reporting, and audit functions in a manner that preserves their independence from specific investment managers. Their incentive compensation is not driven by specific asset class performances.
- 93.** To maintain its competitiveness, PSP Investments' compensation policy provides that annual base compensation be within the industry median; however, incentive compensation provides for superior potential payouts for superior performance. PSP Investments uses external service providers to benchmark its base and incentive compensation to those of its peers on an annual basis.
- 94.** We found that the Corporation's current compensation framework is comparable to industry practices. The Corporation describes its compensation practices in its Annual Report and discloses the base and incentive compensation of its five highest earners each year, as well as their potential payouts upon termination. In addition, the Board of Directors plays an active role in the review and oversight of the Corporation's compensation practices, through, among other things, the commissioning of an independent review and comparison to industry practices.

Talent is managed and developed

95. PSP Investments' talent management and development policy provides for the development of a "scorecard" for each employee. We found that scorecards include skills, competencies, roles, and responsibilities, as well as the employee's objectives for the year, including development objectives. Annual performance objectives assigned to staff originate from the Strategic Plan and are aligned with the strategic objectives. Performance against these annual objectives is measured as part of the employee's annual performance assessment. PSP Investments has tailored its approach to employee development to the individual's needs and objectives in the context of his or her role in the organization.

96. PSP Investments' performance management system, which establishes who its top performers and high potential individuals are, contributes to the Corporation's succession plan. For each key senior management position, the Corporation identifies potential internal successors and assesses their level of readiness. These individuals' development plans are designed to help them acquire the skills and competencies required for the position for which they are being prepared. Where immediate candidates are not available, the Corporation identifies alternative plans (for example, external hiring, internal reorganization, and so on).

The Corporation monitors and reports on human resource engagement

97. The Human Resources First Vice President reports annually and semi-annually to the Board's Human Resources and Compensation Committee on the Corporation's human resource activities, including specifically the succession plan, and its performance against key performance indicators such as turnover, employee development, hiring metrics, Topgrading[®] assessment of employees, and so on.

98. In addition, every two years, the Corporation contracts an external firm to conduct an employee engagement survey. The results of this survey are reported corporate-wide and to the Board of Directors. While the last engagement survey, conducted in 2009, indicated opportunities for improvement in areas such as leadership and work processes, PSP Investments had strong results in such areas as the physical work environment, benefits, and employee health and well-being. The Human Resources Group developed and implemented an action plan to address observations from this employee engagement survey, and regularly monitors its implementation.

Information technology

99. The Public Sector Pension Investment Board (PSP Investments or the Corporation) operates in an automated environment where technology is essential to its effective operations, and thus its ability to meet its objectives. Over the last couple of years, the Corporation has redesigned its information technology infrastructure, and it is currently implementing new core applications to increase workflow automation. System and data integrity and availability are crucial to ensuring the Corporation's continued operational effectiveness.

100. We examined whether the planning, development, implementation, and management of information technology and information management systems support the organization's strategic and operational objectives, ensure business continuity, and satisfy informational needs at an acceptable cost and on a timely basis.

101. In examining information technology management, we looked at the following elements:

- the Corporation's alignment of its information technology activities with its Strategic Plan,
- policies and procedures around security and access controls,
- business continuity planning, and
- project management.

102. Overall, we found that the Corporation's information technology management supports its strategic and operational objectives, ensures business continuity, and satisfies information needs at an acceptable cost and on a timely basis. The following sections present our detailed findings on information technology.

Information technology is aligned with the Corporation's needs

103. We found that the Corporation has aligned its information technology strategic and operational plans with its Strategic Plan and operational and information needs. Within the plans, PSP Investments' information technology group has described the Corporation's operational and information needs, its risk tolerance regarding its information technology systems, new developments in information technology, and the Corporation's ability to take advantage of these new opportunities to enhance the effectiveness of its operations and management information.

104. The Corporation's users and stakeholders are appropriately identified in implementation business cases for information technology systems, and their needs are clearly understood. In order to ensure that

user needs are well integrated into system development, the information technology group surveys and reports on user satisfaction.

105. The Corporation's information technology access and change controls (such as security protocols, passwords, and authorizations for system changes) ensure appropriate access to systems and data, data and processing accuracy, and the processing of only authorized transactions and system changes. In addition, the Corporation has business continuity plans in place that are regularly tested to ensure they remain effective.

106. The Corporation has identified a number of performance metrics that are aligned with its strategic objectives and needs, including system availability, client satisfaction, data accuracy, system security, and system malfunction. The Information Technology group measures and reports these performance metrics on a quarterly basis to the Management Operations Committee and semi-annually to the Audit and Conflicts Committee of the Board of Directors.

The Corporation has implemented information technology project management practices

107. PSP Investments has implemented a standard project development methodology that provides clear accountabilities and a systematic approach to identifying user needs, evaluating technology options, and contributing to risk-based decision making. We found that the Corporation consistently applies its project development methodology. Appropriate testing takes place before implementing new systems or making changes to systems. To ensure that it undertakes information technology activities at an acceptable cost and on a timely basis, the Corporation establishes an annual budget for information technology activities and projects during its overall budgeting process. It also monitors its information technology activities and projects against the related timelines and budgets. The Corporation reports monthly on these activities and projects at Management Operations Committee meetings and semi-annually to the Audit and Conflicts Committee of the Board of Directors.

Conclusion

108. Based on the work performed in the Special Examination of the Public Sector Pension Investment Board's systems and practices, we conclude that there is reasonable assurance that the Corporation has maintained systems and practices to provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

About the Special Examination

All of the audit work in this report was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While we adopted these standards as the minimum requirement for our examination, we also drew upon the standards and practices of other disciplines.

Objective

Under section 138 of the *Financial Administration Act* (FAA), federal Crown corporations are subject to a special examination once every 10 years. Special examinations of Crown corporations are a form of performance audit where the scope is set by the FAA to include the entire corporation. In special examinations, the examiner provides an opinion on the management of the corporation as a whole. The opinion for this special examination is found on page 3 of this report.

Special examinations answer the question: Do the Corporation's systems and practices provide reasonable assurance that assets are safeguarded and controlled, resources are managed economically and efficiently, and operations are carried out effectively? A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having reasonable assurance that its assets are safeguarded and controlled, its resources are managed efficiently and economically, and its operations are carried out effectively.

Key systems and practices examined and criteria

At the start of this special examination, we presented the Corporation's Audit and Conflicts Committee with an audit plan that identified the systems and practices, and related criteria, that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. These are the systems and practices and criteria that we used for our special examination.

These criteria were selected for this examination in consultation with the Corporation. They were based on our experience with performance auditing—in particular with our special examinations of Crown corporations—and on our knowledge of the subject matter. Management reviewed and accepted the suitability of the criteria used in the special examination.

Key system and practice examined	Criteria
1. Corporate governance	To maximize the Corporation's effectiveness and its ability to meet its objectives, the Corporation should have a well-performing corporate governance framework that meets industry practices in Board oversight, stewardship, and stakeholder relationships.
2. Risk management	<ul style="list-style-type: none"> • The Corporation has established an enterprise-wide risk management framework supported by a risk culture that promotes the achievement of its mandate, business goals, and objectives. • The Corporation has systems and practices in place to identify, measure, mitigate, monitor, and report on key risks associated with the achievement of its business objectives.
3. Strategic planning, performance measurement and reporting	<p>The Corporation has a clearly defined strategic direction and specific and measurable goals and objectives to achieve its mandate. Its strategic direction and goals take into account identified risks, and the need to control and protect its assets and manage its resources economically and efficiently.</p> <p>The Corporation has identified performance indicators to measure the performance of its investments and achievement of its mandate and statutory objectives. It also has reports that provide complete, accurate, timely, and balanced information for decision making and accountability reporting.</p>
4. Investment management	<ul style="list-style-type: none"> • The Corporation has investment decision-making and monitoring processes and procedures in place to support the development of investment strategies, conduct of due diligence, and monitoring of investment performance. • The Corporation has systems and practices that support the identification, measurement, mitigation, management, and reporting of risks inherent to investment activities, including environment, social, and governance risks.
5. Human resource management	<ul style="list-style-type: none"> • Human resources are managed in a manner that provides the Corporation with the human resource capacity and the work environment it needs to achieve its goals and objectives. • The Corporation has established compensation practices that are aligned with prudent risk-taking and relevant industry practices.
6. Information technology	The planning, development, implementation, and management of information technology and information management systems support the Corporation's strategic and operational objectives, ensure business continuity, and satisfy information needs at an acceptable cost and on a timely basis.

Period covered by the special examination

Audit work for this special examination was substantially completed on 10 December 2010. It covered the systems and practices that were in place between June 2010 and November 2010.

Audit team

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Appendix List of recommendations

The following is a list of recommendations found in the Special Examination Report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Corporate governance	
<p>32. To assist in providing an orderly transition of appointments of members to the Board of Directors, the Public Sector Pension Investment Board (PSP Investments) should examine whether a more optimal staggering of Board appointments could be implemented and consider whether it should make recommendations to this effect to the Nominating Committee and the President of the Treasury Board. (19–31)</p>	<p>Agreed. The Board of Directors of PSP Investments is aware of this issue. Recent appointments have been made in groups, which has led to the limited staggering of the terms of our current directors. Through the Chair of the Board of Directors and the Chair of the Governance Committee, PSP Investments will continue to have dialogue with the President of the Treasury Board and the Nominating Committee to attempt to improve the board appointment process.</p> <p>The Corporation will be proposing two changes in the appointment process to address this issue. The first change will be to restructure the recommendation process of the Nominating Committee. The Corporation will propose to hold an annual meeting with the Nominating Committee to establish the candidate selection criteria, followed by one further meeting with the Nominating Committee in which the preferred candidates and alternates, based on the agreed criteria, are presented to it for recommendation to the President of the Treasury Board. The second change will be to recommend to the Nominating Committee and the President of the Treasury Board that when appointments are to be made in groups, that they be made for different term lengths to achieve a better staggering of the terms.</p>
Strategic planning, performance measurement and reporting	
<p>55. The Public Sector Pension Investment Board (PSP Investments) should develop and assign measurable outcomes for its strategic goals, to enable measurement of success for each strategic goal. (45–54)</p>	<p>Agreed. In its next Strategic Plan, PSP Investments will endeavour to develop additional measurable outcomes that are designed to measure the overall achievement of the strategic goals.</p>

Recommendation	Response
<p>Investment management</p> <p>71. The Public Sector Pension Investment Board's (PSP Investments) New Product Committee should systematically review new investment activities using approved investment products to assess whether they introduce new risk exposures. These activities should be subject to the same review and approval process as all new investment products. (62–70)</p> <p>81. The Public Sector Pension Investment Board should review its public reporting of its responsible investment activities to ensure that they reflect industry practices in this area. (77–80)</p>	<p>Agreed. The above concern is implicitly addressed by the Terms of Reference of the Management Investment Committee, which includes the review and approval of the business plans of asset classes, investment activities, new investment products, and other investment-related activities. PSP Investments will amend the New Product Committee's Terms of Reference and its related procedures to expand its scope to include new investment activities using approved products.</p> <p>Agreed. The Corporation will review its public disclosure practices in the area of responsible investing and proxy voting, and will expand its annual disclosure to better align its practices in these areas with those of its peers.</p>