TEACHERS' PENSION PLAN ONTARIO

Funding • Pension service • News briefs

pensionwise

A Newsletter for Ontario Teachers • Spring 2009 • Issue 23

Everyone's talking pensions

YOUR QUESTIONS ANSWERED PAGE 2

INSIDE THIS ISSUE

Interest in pension security grows as recession deepens

Talking about your pension in the lunchroom will no longer leave you sitting alone. Pension security is big news today and employees are paying attention to their pension like never before.

In this issue of *Pensionwise,* you'll find information on pension security, answers to key questions stemming from the release of our financial results in April, an overview of the plan's funding status and details on how we're managing investments for the long term.

PENSION SECURITY

What is the financial status of the pension plan?

The pension plan began the year with a projected $2.5 billion funding shortfall. The shortfall stems from investment losses, low real (after inflation) interest rates and rising pension obligations. The shortfall is expected to grow unless the investment climate turns sharply positive. The Ontario Teachers' Federation (OTF) and the Ontario government, which jointly sponsor the Teachers' pension plan, have several options for dealing with funding shortfalls.

For more information on the plan's funding status and what it means to you, see page 6.

Is my pension safe?

Yes. Legislation protects the value of pension benefits both working and retired members have already earned. However, contribution rates and pension benefits to be earned in future years can be adjusted during a teacher's career in response to funding surpluses or shortfalls.

For example, several years ago, benefits were enhanced using surplus funds. In recent years, contributions were increased to address a funding shortfall.

It's important to remember that your Teachers' pension is not dependent on any one year's investment results or the value of the pension fund when you retire. Your pension is defined by a formula based on years of service and average earnings.

Could the government change the legislation that protects the benefits I've already earned?

We cannot speculate on that. Only the government can change legislation. We have not heard about any plan to change the provisions of Ontario's Pension Benefits Act that protect the value of accrued pension benefits for Ontario workers.

Keep in mind that the Ontario Teachers' Federation (OTF) and the Ontario government, which jointly sponsor the pension plan, have the following options for dealing with funding shortfalls: increase contributions; change benefits members will earn in the future; or use a combination of these options.

Is there enough money to pay pensions?

Yes. At the end of 2008, the pension plan had $87.4 billion in net assets. It pays a little more than $4 billion a year in benefits and receives about $2 billion annually in contributions. That means the plan has enough money to pay pensions for many years. However, legislation requires pension plans to show, through periodic funding valuations, that they have sufficient assets to pay pensions to current members who may be collecting benefits 50, 60, 70 or more years from now.

Should I retire early to protect my pension?

No. Don't rush into retirement because of fears of losing inflation protection or other benefits. Legislation protects the benefits you have already earned. However, benefits to be earned in future years could change in response to a funding shortfall.

INVESTMENTS

How long will it take to earn back what was lost in 2008?

We can't predict how long it will take to earn back 2008's losses. The global economic crisis is serious and continuing. We expect recovery will be gradual. A large part of our losses result from solid investments we still hold that are marked down in the current market climate. We're a long-term investor and can hold on to our investments until markets recover.

Have you changed your investment strategy in response to the current investment climate?

Our long-term investment strategy has not changed, but we are taking a defensive stance in light of current market uncertainties.

We believe a diversified portfolio of high-quality assets is appropriate for earning the returns to pay pension benefits over the long term. We continue to be a long-term investor in equities, fixed income and inflation-sensitive assets, which includes real estate, infrastructure and real-return bonds. However, we have reduced investment risk by lowering exposure to equity and credit markets to levels appropriate for today's market conditions. We have also increased our liquidity requirement (cash on hand) to ensure we can meet all our payment obligations and take advantage of new opportunities that meet the plan's long-term risk-and-return profile.

KEY FACTS

about our 2008 performance

The fund's investment return was -18 per cent in 2008, in line with other large Canadian pension funds.

Net assets declined $19 billion to $87.4 billion at year-end 2008, primarily because of unprecedented declines in almost every market.

A $2.5 billion funding shortfall was projected at Jan. 1, 2009, and the shortfall is likely to grow unless the investment climate turns sharply positive.

Since we started investing in financial markets in 1990, our annual return has averaged 9.6 per cent.

Despite the loss and world-wide economic crisis, your accrued pension is secure.

EXECUTIVE COMPENSATION

Why did Teachers' executives receive bonuses when the fund lost money last year?

Our compensation program is based on a fixed base salary, combined with a variable incentive element. There are long and short term variable components, and both are based on four-year performance periods.

This year's payments result from three years of performing significantly better than the markets (2005, 2006 and 2007) and one year (2008) of poor performance. The poor 2008 performance had a large negative impact on this year's incentive payments and will significantly reduce compensation levels for the next three years.

Total incentive compensation for investment staff dropped by 40 per cent, while payments for the five senior executives named in our annual report were half of last year's level. For more information, read the Chair's message and the compensation section of our annual report, which includes details on compensation paid to top executives. The report is accessible from the home page of our website at www.otpp.com. ■

More information at www.otpp.com

- Read the *Report to Members* or the full *2008 Annual Report*
- View an archived webcast of our annual meeting
- Consult detailed Q&As

How the Teachers' fund adjusted to 2008 investment losses

There's no doubt that 2008 took a big toll on the fund's investments. In the recent *Report to Members,* we outlined how the pension fund's assets fell to $87.4 billion at the end of 2008 (from $108.5 billion in 2007) when global markets for stocks, real estate and other assets dropped.

We take every dollar lost seriously, but we can't prevent market crashes from occurring. What we can do – and have done – is position the portfolio so that when financial markets do eventually recover, the fund will benefit.

The fund's $19 billion loss last year amounted to an investment loss of 18 per cent, which was in the middle of the pack for large Canadian pension plans. It compared to a 33 per cent loss in the S&P/TSX Composite Index, the Toronto Stock Exchange's main index.

It's important to know that a large portion of the losses we reported were "unrealized." That is, we still own the stocks or bonds or real estate, but we reported them at their fair market value, or the price we could sell them for on Dec. 31, 2008. It's called marked-to-market accounting. The value went down, producing a paper loss even though we didn't sell the assets.

Think of your own house or condo: its value has probably gone down in the past year. But if you still own it, you have not locked into or "realized" that paper loss. The price is just different today than it was yesterday and will be tomorrow. You expect your home's price to rise over time, and we feel the same way about our high-quality investments: we know their prices will rebound in normal market conditions.

"We are long-term investors and we have the luxury of time on our side," Neil Petroff, Executive Vice-President of Investments and Chief Investment Officer, told members at the annual meeting in Toronto on April 3.

The Teachers' fund remains a solidly built, well-diversified portfolio of valuable assets, he noted.

"The investment team ensured we had adequate liquidity throughout the year to pay for trade settlements and make pension payments. At no point did we have to consider selling good investments at a loss."

Neil also outlined how investment managers have responded to rocky markets.

First, most of the 2008 loss that was reported came from stocks. We reduced our allocation to equities (stocks) to 40 per cent of the total fund for 2009, compared to 45 per cent in 2008.

Second, credit markets virtually froze last year. When these markets began to shut down, investments that previously produced gains abruptly produced significant losses. We could not reduce risk as quickly as we wanted. We did change the leadership of the fixed income group and adopted more conservative strategies.

Third, our real estate portfolio, managed by our subsidiary company Cadillac Fairview, represents nearly 20 per cent of our holdings. The portfolio value declined along with the broader real estate market. We will keep investing in upgrades to our properties, which include well-known shopping centres and office complexes. And even though property values are down at the moment, the rents we collect from tenants are up.

President and CEO Jim Leech delivers the 2008 results at the annual meeting.

Despite the recession and swings in financial markets, we're looking for new investments to help pay teachers' future pensions.

"We are in a defensive posture but as I like to say, it's a Bobby Orr kind of defence," Neil said at the annual meeting, referring to the legendary defenseman's ability to see openings and rush up the ice to score goals. "Your investment team will continue to score opportunistically on our members' behalf." ■

Budget measure may allow Teachers' pension plan to serve new clients

The Ontario government's March 2009 budget contained a preliminary step that could lead to new revenue opportunities and lower costs for your pension plan.

The omnibus budget bill includes a proposed amendment to the Teachers' Pension Act that, if passed, would expand our mandate by allowing us to manage investments and administer pensions on behalf of other institutions. The Ontario Teachers' Federation, which jointly sponsors the pension plan with the Ontario government, has expressed support for an expanded mandate.

"While details have still to be ironed out, we consider the proposal to be an encouraging step toward pension reform for our plan members, as well as thousands of other Ontarians," said Jim Leech, President and CEO of the Teachers' pension plan.

The Ontario Expert Commission on Pensions, led by Dr. Harry Arthurs, noted in its final report that large pension plans have many advantages over small plans. The cumulative advantage is significant. If interested, you can view the full Arthurs report online at www.pensionreview.on.ca.

The advantages of larger plans include: lower investment fees; greater in-house investment expertise; private placement capabilities; the ability to spread investment risk through diversification; lower administrative unit costs; and the enhanced availability of education, information and service.

"That means small plans would benefit from tapping into our expertise – but our organization would also benefit from increased scale," Jim said.

"Any change in our mandate would not distract us from our job of administering teachers' pensions and managing their pension fund."

Pensionwise will keep you fully informed as developments occur. ■

Funding shortfall will grow unless markets improve

The Teachers' pension plan began 2009 with a projected $2.5 billion funding shortfall. This shortfall is expected to grow unless the investment climate turns sharply positive.

That's because only 20 per cent of our 2008 investment losses have been recognized in the 2009 preliminary valuation. The remaining 80 per cent has been held back and 20 per cent will be recognized in each of the next four years. If we had recognized all 2008 losses immediately, our projected funding shortfall would have been about $22 billion at the beginning of the year.

Smoothing investment losses (or gains) over five years is a common practice for pension plans because they pay and invest for the long term. Without smoothing, pension plans would be faced with the impractical task of adjusting contributions or benefit levels frequently because of changes in investment returns.

ADDRESSING A SHORTFALL

The Ontario Teachers' Federation (OTF) and the Ontario government, which sponsor the pension plan, must address any shortfall before they file a funding valuation with the provincial pension regulator. The next valuation can be filed any time by Oct. 1, 2011.

To eliminate a shortfall, the OTF and government can:

- increase contribution rates;
- reduce benefits to be earned in future years; or
- use a combination of these options.

FUNDING CHALLENGES

While investment losses contributed to the projected 2009 shortfall, real interest rates and pension costs remain key factors in determining the plan's financial health.

Real (above inflation) interest rates are used to estimate the cost of future pensions. If real interest rates remain low, as we predict they will, the cost of future pensions will remain high. This is because the pension plan needs more money today to earn the amount required to pay pensions in the future.

For example, securing a typical $40,000 pension requires about $855,000 when real interest rates are at two per cent, roughly where they were at the beginning of the year. If real interest rates climb to three per cent, about $745,000 is needed.

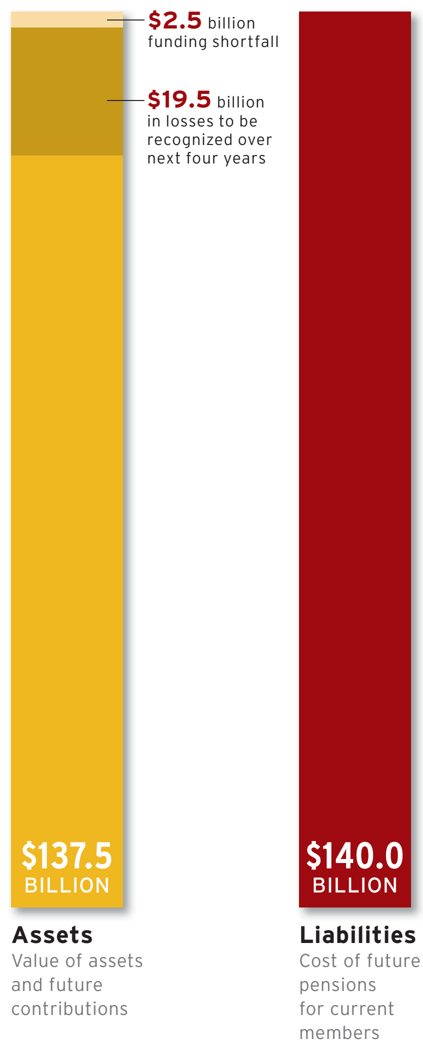
Low real interest rates were a major factor behind previous funding shortfalls which surfaced while the plan had positive rates of return. The introduction of conditional inflation protection resolved the $12.7 billion shortfall in 2008, while contribution rate increases addressed the 2005 $6.1-billion shortfall.

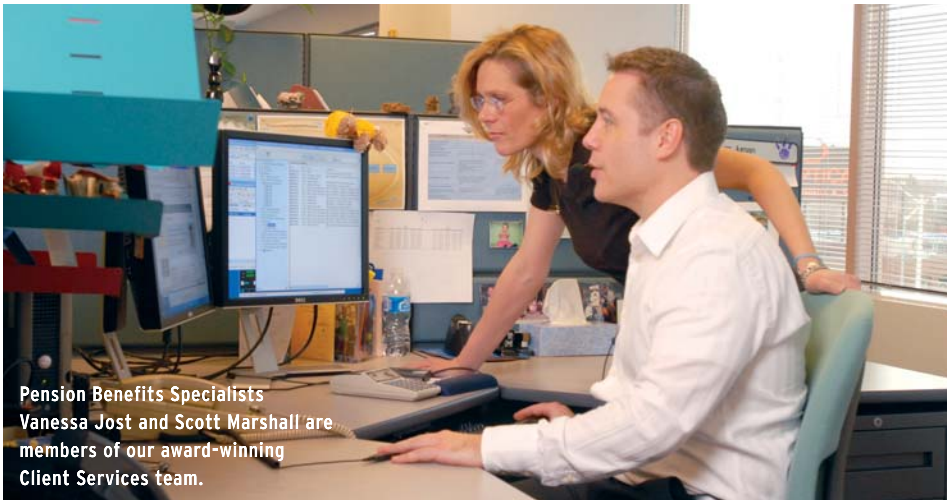
Another key reason for continued funding challenges is plan maturity. There are currently 1.6 working members to each retiree in the plan and the ratio is projected to fall. As a result, a declining proportion of the membership carries increased responsibility for meeting the plan's funding requirements.

The low ratio of contributing teachers to retirees makes it more difficult to overcome funding shortfalls with contribution increases alone. Over time, conditional inflation protection, which will apply only to pension credit after 2009, will help to address this situation because both working teachers and future retirees will play a role in resolving funding shortfalls.

While conditional inflation protection will act as a safety valve to help manage funding challenges, it cannot keep shortfalls from occurring if the cost of future pensions grows faster than plan assets. ■

2009 Funding Shortfall





Pension Benefits Specialists Vanessa Jost and Scott Marshall are members of our award-winning Client Services team.

Unwavering commitment to service

Markets may be down, but service quality continues to go up.

A continuous focus on improvement and innovative technology enables your plan to provide unparalleled service.

Last year, your pension plan was ranked first among its peers for pension service. We also received our highest satisfaction rate ever in one of our key service areas: 65 per cent of members who retired last year gave us a perfect 10 out of 10. Since 2005, we have maintained an overall score of 9 out of 10.

How do we accomplish this? By continuing to deliver the service you need and value, while pursuing the latest advances in technology, especially easy-to-navigate and easy-to-calculate web services.

LEADING THE WAY ONLINE

*i*Access Web, the secure members' section of our website, allows you to learn about your entitlements and calculate your benefits online. In 2008, members went online over 179,000 times! In addition, an astounding 78 per cent of retirement applications were submitted through *i*Access.

"Technology enables us to engage members in ways we couldn't before," said Rosemarie McClean, Senior Vice-President, Member Services. "Each year, we process billions of dollars of contributions and manage millions of pieces of personal information. Technology allows us to do this efficiently while keeping a lid on costs, and yet maintaining that personal touch – it's always a fine balance."

FOCUS ON IMPROVING AND CUSTOMIZING YOUR EXPERIENCE

With the acceptance of online service, your plan can focus more and more on customizing your experience. Personalized counselling is something members have long requested because the benefits and rules of the plan can be complex.

"Members often need thoughtful guidance in making critical decisions about their benefits," said Rosemarie. "We're laying the foundations to enable our pension benefit specialists to gain a deeper understanding of each member's circumstances. Rather than simply disclosing your benefit options, they will be able to assist you in making informed decisions." ■

HOW WE MEASURE OUR SERVICE

In addition to unsolicited feedback directly from members, we have a regular surveying process to find out what you think about us. A quality service index (QSI) measures the impact of our service and communications. Surveys are conducted throughout the year by an independent Canadian firm.

How it works

1. Members are randomly contacted by the surveying company after we complete a service (e.g., pension estimate, general phone inquiry, etc.) and/or deliver communications (e.g., newsletters and *Report to Members*).
2. Our quarterly "report card" is compiled based on responses.
3. Results are analyzed and we look for areas to improve. ■

Sitting on top of the world

Your pension plan was recently ranked first in its peer group for pension service by CEM Benchmarking Inc. The evaluation is based on 11 service categories, ranging from how long members wait to get service over the phone to the availability of the website.

The plan also tied for first internationally beating out 58 other plans. CEM annually measures performance at leading pension plans in Canada, the United States, the Netherlands and Australia. ■

BOARD CHAIR MERCIER RECEIVES AWARD

Eileen Mercier, who recently began a second, two-year term as Chair of the Ontario Teachers' Pension Plan Board, was one of four recipients of a 2009 ICD Fellowship Award from the Institute of Corporate Directors. The awards honour individuals who bring exceptional leadership to boardrooms throughout the country and are considered role models for excellence in governance. She will receive her award in June.

TEACHERS' PRIVATE CAPITAL TOPS IN CANADA ONCE AGAIN

Teachers' Private Capital was chosen as the Best Private Equity Firm in Canada for the second consecutive year in the annual Private Equity International Awards.

The Private Equity International Awards are independent awards, based on votes gathered by the industry and readers of Private Equity International and Private Equity Online.

Pensionwise™ is published for members of the Ontario Teachers' Pension Plan.

We appreciate your comments about anything you read in Pensionwise. Please contact Linda Keon at (416) 730-5357 or 1-877-812-7989, or e-mail: lkeon@otpp.com

Ontario Teachers' Pension Plan
5650 Yonge Street
Toronto, Ontario M2M 4H5

Client Services
Telephone: 416-226-2700 or 1-800-668-0105
Fax: 416-730-7807 or 1-800-949-8208
E-mail: inquiry@otpp.com
Website: www.otpp.com

Ce bulletin est disponible également en français.

TEACHERS' PENSION PLAN ONTARIO

Printed on recycled stock
ISSN 1706-0214

DOUBLE HONOUR FOR LAMOUREUX

Claude Lamoureux, who retired in 2007 as the Teachers' pension plan's founding President and CEO, was appointed an Officer of the Order of Canada for his leadership of the plan and contributions to promoting strong corporate governance. He was later named to the Order of Ontario.

TEACHERS' ZVAN NAMED ONE OF CANADA'S BEST

Barbara Zvan, Senior Vice-President, Asset Mix & Risk, has recently been honoured as one of Canada's Top 40 Under 40™ for 2008. The annual award recognizes the achievements of 40 Canadians in the private, public and not-for-profit sectors under the age of 40.

Ms. Zvan, who joined Teachers' in 1995, was selected from over 1,100 nominees by an independent advisory board. Comprised of 25 business leaders from across Canada, the board selects honourees based on five criteria: vision and leadership; innovation and achievement; impact; community involvement and contribution; and strategy for growth.

LET'S MAKE A DEAL

Teachers' Infrastructure team received a 2008 Canadian Dealmakers award in recognition of its joint acquisition of Chilean electricity distribution, transmission and generation company SAESA Group. The US$1.29 billion joint acquisition of SAESA Group with Teachers' partner Morgan Stanley Infrastructure closed in July 2008.

The Canadian Dealmakers program honours Canadian companies and individuals for excellence in mergers and acquisitions in a variety of categories, based on factors that include value creation and deal complexity. Teachers' won the Utilities Award.

WATCH ANNUAL MEETING CLIPS AT WWW.OTPP.COM

Interested in more details on the plan's 2008 investment and service performance? You can view a webcast of the pension plan's annual meeting online at www.otpp.com. Follow the link from the home page to watch presentations from the April 3 annual meeting. ■

Return undeliverable Canadian addresses to: **PM# 40062973**

Ontario Teachers' Pension Plan
5650 Yonge Street
Toronto, Ontario
M2M 4H5