TEACHERS' PENSION PLAN
ONTARIO

Funding • Buybacks • News briefs

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A Newsletter for Ontario Teachers • Spring 2011 • Issue 29

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A conversation with Jim Leech

Teachers' President and CEO Jim Leech recently sat down with Pensionwise to talk about the plan's performance and how it intends to meet the challenge being posed by the current funding shortfall.

PW: How do you feel about the plan's performance in 2010?

Jim: By any measure, 2010 was a fantastic year. The fund earned a 14.3 per cent rate of return, and our net assets rose to $107.5 billion. We earned $4.0 billion in extra returns above standard market performance, the highest in the history of the fund.

We also completed a number of transactions that I think will pay big dividends in the coming years. For example, in partnership with others, we bought the HS1 high-speed rail link in London. We were also successful in acquiring Camelot, the UK's national lottery system.

At the same time, we also focused on improving and customizing our member services. For example, a new web-based process for buying back pension credit was introduced and we implemented changes to the plan's working-after-retirement rules. We continued to receive high scores through our quality surveying initiatives, with our members rating us a 9 out of 10. We also ranked number two in the world in customer service through a third-party evaluation of global pension plans, which was great news.

PW: Why is service such an important factor for the plan's strategy?

Jim: The value we provide to our members goes beyond paying pensions. In addition to managing the money that backs their pension, our members rely on us to provide them with information and advice, so they can maximize their benefits.

Teachers' is a complex plan with rules that are, at times, difficult to understand. It's our obligation to guide our members through what it all means to them. After all, the decisions they make can have lifetime ramifications, not only for them, but for their survivors as well.

It's very important when our members contact us, whether it's through the web, mail, telephone or in person, that they walk away from the experience saying, "Those people know what they are doing and I'm feeling really confident I have made the right decisions about my pension."

PW: How can we have a funding shortfall in the face of such positive returns?

Jim: It's very difficult to reconcile the fact that we had such strong investment returns and yet our preliminary valuation still shows a projected $17.2 billion funding shortfall. There are a few core reasons for this.

The first factor is demographics. Teachers are living longer. They now typically work for 26 years and they can expect to collect a pension for 30 years. To complicate matters further, the growth in the number of active teachers has been leveling off and is expected to decline in the next few years. Keep in mind that in 1990 there were four active teachers for every retiree. Today that ratio is 1.5 to one.

A second factor is the 2008 investment loss. Because we smooth losses, we will continue to absorb the 2008 loss until the end of 2012.

Finally, a third key factor is persistently low interest rates. Real interest rates declined to 1.1 per cent at the end of 2010, down from 1.5 per cent at the start of the year. Long-term real interest rates are a good indicator of

future investment returns and thus act as the starting point to estimate the cost of future pensions. When interest rates fall, as they have in recent years, pension liabilities rise because the plan needs to set more money aside to earn the amount required to pay future pensions.

PW: Are teachers' pensions safe?

Jim: Yes. Current Ontario legislation protects the value of pension benefits already earned by working and retired members. Only contribution rates and pension benefits to be earned in future years can be adjusted during a teacher's career in response to funding shortfalls.

Teachers today should not feel that they need to delay or advance their retirement due to concerns about the plan's funding status. The most important thing to remember is that we are not in financial distress. We have $107 billion worth of assets that are backing the pension promise. That money is not going to dissipate quickly. The issue that we need to address is long-term sustainability.

PW: What are you doing about the shortfall?

Jim: Over the past 18 months, we have been advising the plan partners, the Ontario government and the Ontario Teachers' Federation, and their Sustainability Working Group. This group has examined the systemic issues facing the plan in order to identify necessary solutions.

The partners are considering all variables in order to resolve the preliminary shortfall no later than 2012, so that a balanced funding valuation can be filed. They are currently contemplating an early filing this year. In order to complete the filing, the partners may choose to increase contribution rates, invoke conditional inflation protection on pension credit earned after 2009, reduce benefits that members earn in future years or adopt a combination of these options.

The plan partners know what the issues are. The key is to implement options now so that this plan is sustainable for the long term. A small course correction now will ensure sustainability well into the future. ■

2010: An active year brings strong results

Teachers' Investment Division was busier than ever in 2010, continuing with the strategy of investing for the long term in high-quality assets with an appropriate level of risk.

Surpassing expectations

The fund surpassed expectations in 2010, earning a 14.3 per cent rate of return and over $13 billion in investment income. Net assets rose to $107.5 billion from $96.4 billion at the end of 2009. Almost every asset class outperformed its benchmark and overall, we beat the composite benchmark of 9.8 per cent. This resulted in $4 billion in value-added returns, the largest value-add dollar amount in the fund's history.

Taking risk into account

With the ratio of working-to-retired members in decline, Teachers' is considered to be a mature pension plan. Currently, we have 1.5 working members for every pensioner. It is expected that by 2020, the ratio will be 1.3 to one. As such, our risk tolerance has decreased because there are fewer working members to share contribution increases should the fund experience a significant decrease in value. Our investment managers must limit the degree of risk they can take in order to generate returns.

Adjusting the asset mix

To help better meet the plan's future needs, we've refined our long-term investment strategy over the past few years. In 2010, the Investment Division reclassified some assets and adjusted certain target allocations. For example, some investments that were previously reported in the fixed income asset class are now reported separately.

A year of action

In 2010, Teachers' investment transactions increased alongside the recovering global economy. Teachers' Private Capital (TPC), our private equity arm, divested our interests in CTVglobemedia and GCAN Insurance, while public equities' Relationship Investing team sold its position in Maple Leaf Foods.

TPC also completed several acquisitions in 2010 including Simmons Bedding Company, mortgage insurance company United Guaranty Canada, manufacturer Exal Group and global research company INC Research, Inc.

Our Infrastructure group was awarded, in partnership with others, the contract to operate HS1, the high-speed rail network connecting St. Pancras station in London to the Channel Tunnel. In addition, Long-Term Equities made a successful bid for Camelot Group Ltd., the UK national lottery operator.

2011 and beyond

The coming year promises to hold as much challenge as 2010 did on the investment front. Along with demographics that preclude us from taking on more risk to increase returns, the plan is also dealing with historically low interest rates and a modest economic outlook.

"Notwithstanding all this uncertainty, I believe we have the right team in place. And I know they'll do everything in their control to earn the best risk-adjusted returns for this fund," said Neil Petroff, Executive Vice-President, Investments. "There are a lot of things we can't control, but we work very hard to make the best investment decisions we can." ■

ASSET CLASS RETURNS COMPARED TO BENCHMARKS

ASSET CLASS	1-YEAR RETURN (%)	1-YEAR BENCHMARK (%)
Equities	10.4	7.5
Fixed income	9.9	9.5
Commodities	3.2	3.3
Real assets (real estate, infrastructure, timberland)	13.9	5.5
Total fund return †	14.3	9.8

† The total fund also includes absolute return strategies and money market securities that are employed to enhance the fund's overall returns, and which contributed to the total plan return in 2010. Returns generated by absolute return strategies ($0.8 billion) and money market, previously included in fixed income, are included in the total plan return and not attributed to an asset class.

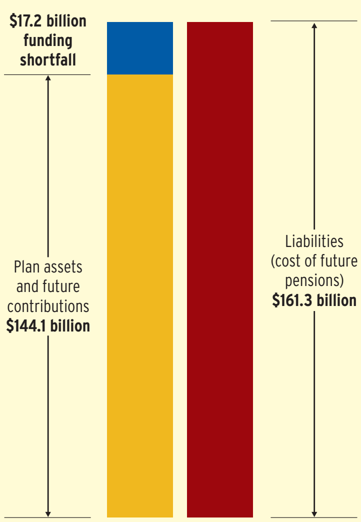
... but the funding challenges continue

Despite the fund's excellent performance in 2010, the most recent preliminary funding valuation shows that plan liabilities continue to grow faster than plan assets.

PRELIMINARY FUNDING VALUATION

(as at Jan. 1, 2011)

As of Jan. 1, 2011, the pension plan has $144.1 billion in assets and projected future contributions. But the projected cost of future pensions is $161.3 billion, leaving a gap or preliminary funding shortfall of $17.2 billion.



YOUR FUNDING QUESTIONS

Q. Why does the pension plan have a shortfall when it made lots of money last year?

A. Despite strong investment returns in 2009 and 2010, the cost of future pensions is growing faster than plan assets. Three key reasons for this are low real (after inflation) interest rates, demographics, and the plan's 2008 investment losses.

Long-term real interest rates are used to estimate the cost of future pensions. When interest rates go down, pension costs rise because more money needs to be set aside to earn the value of future pensions. Real interest rates declined to 1.1 per cent at the end of 2010 from 1.5 per cent at the start of the year.

Longer retirements and longer life expectancy are also factors. The average teacher now contributes to the plan for 26 years and can expect to be on pension for 30 years. A survivor benefit may also have to be paid after the teacher dies.

In addition, the pension fund's 2008 investment loss will continue to be absorbed or "smoothed in" until 2012. Smoothing is a technique commonly used in the pension industry to even out (or smooth) annual investment gains or losses to reduce volatility.

Q. There's been a lot of talk about the shortfall, but when are you going to announce what you are going to do about it?

A. Solutions to the shortfall are required before the next valuation filing, which is due at the latest by 2012. The plan sponsors, the Ontario Teachers' Federation (OTF) and the Ontario government, are determining now whether it would be more advantageous to members to resolve the shortfall in 2011.

Q. What options are being considered to address the shortfall?

A. The OTF and the government have been considering a wide variety of options to resolve the funding shortfall. As soon as they decide what to do, members will be informed.

To eliminate the shortfall, the OTF and the government could increase contribution rates; invoke conditional inflation protection for pension credit earned after 2009; change other pension benefits members will earn in future years; or adopt a combination of these options.

Q. How does the pension plan determine whether it has enough money?

A. The pension plan's board hires an independent actuary to conduct an annual funding valuation. The valuation determines the plan's financial health by comparing plan assets (such as stocks and bonds, as well as future contributions) to liabilities (the projected cost of future pensions).

To determine how much money is required to pay pensions, the actuary makes assumptions about the future inflation rate, future returns on invested assets, future salary increases, age at retirement, life expectancy and other factors.

Q. Is the pension plan running out of money?

A. No, the pension plan has $107.5 billion, enough to pay pensions for many years. But pension plans like Teachers' are required to have enough funds to meet future pension obligations to all current members when looking ahead 70 years or more. ■

MORE INFORMATION

Visit www.FundingYourPension.com to:

- Test your knowledge with the five-minute funding challenge
- View funding presentations
- Learn about key funding facts and financial concepts

Took a break?

If you had a break in service for child care, compassionate reasons or legislative service, read more about your buyback options.

We were recently notified by the Canada Revenue Agency that the terms of the Teachers' Pension Plan that permit buybacks for certain breaks in service are in conflict with the *Income Tax Act.*

As a result, you are no longer eligible to buy back credit for periods after **Dec. 1, 2010**, if you had to resign from employment in education for one of the following reasons:

- *Child care* – caring for a child under age seven.
- *Compassionate* – caring for a disabled family member.
- *Legislative service* – serving in an elected office (municipal, provincial or federal).

IMPORTANT DEADLINES

If you are eligible to buy back credit for your break in service, you will only be able to buy back for the period up to the effective date of the change (Dec. 1, 2010). Here are two important dates you need to mark in your calendar:

Aug. 31, 2011 – Complete your application

If you decide to buy back credit, your supporting documents must be submitted by Aug. 31, 2011. If you are eligible to buy back and are interested in applying, please contact us for more information.

Dec. 30, 2011 – Send us all payments

If you decide to buy back credit, we must receive all payments from you by Dec. 30, 2011.

WHAT'S THE DIFFERENCE?

A break in service is different from a leave of absence. A break in service is a period during which you resigned from employment in education. Periods of leave that have been approved by your employer are **not** affected.

ARE YOU ELIGIBLE?

If five years or more have already passed since your break ended, you are not eligible to buy back credit for a break in service.

If you are currently on a break that began prior to Dec. 1, 2010, or if you took a break that ended within the last five years, review the eligibility criteria below to help determine if you may be eligible. Call us to confirm and find out more about your buyback options.

Child care

- You resigned from employment in education for the sole purpose of being the primary caregiver for a child under the age of seven.
- You were not employed in education on a contractual basis during the period of absence.

Compassionate

- You resigned from employment in education for the purpose of being the primary caregiver of a disabled family member:
  - Disabled – person has a severe mental or physical disability and is incapable of regularly pursuing any substantially gainful occupation. This includes a disabled child under the age of 18.
  - Family member – spouse, child, parent, grandparent, brother, sister, aunt, uncle, nephew, or niece of you or your spouse.
- You were not employed in education on a contractual basis during the period of absence.

Legislative service

- You resigned from employment in education to serve as a member of the Legislative Assembly of Ontario, the House of Commons or the council of a municipality or local board within the meaning of section 1 of the *Municipal Affairs Act*.
- You are not entitled to a pension under another registered pension plan (other than CPP or QPP) in respect of the period of the break in service.
- You were not employed in education on a contractual basis during the period of the absence. ■

CONTACT US TODAY

We encourage you to call us as soon as possible to discuss your situation. We can confirm whether you are eligible to buy back credit and discuss the tax implications if you choose to make the purchase.

Supporting documentation may be required in some cases. Don't delay, start the process immediately to ensure you meet the Aug. 31, 2011, application deadline.

Phone

416.226.2700 or 1.800.668.0105 (toll free)

You asked us...

Q. Is it too late for me to retire as of June 30 and start my pension in July?

A. No it's not too late. You can still go online to *i*Access Web, the secure member website, to apply for a pension that begins in July. Visit the Retirement Centre to see what you need to do to apply for your pension. Your online application should only take minutes, and provided there are no delays sending us the documents we need to finalize the transaction, you should receive your first pension cheque on July 29, 2011. You should also check with your employer regarding any relevant timelines and requirements for notification of retirement.

Q. Once I've applied for my pension, how will I know how much my pension will be?

A. Once you've applied, you can use the *i*Access Web Retirement Centre to track the progress of your application. When your pension calculation is complete, you can view the Pension Statement Details tab that displays your final pension figures.

Some members will also receive a Pension Statement in the mail which outlines pension calculation details and any outstanding documents required.

Q. How do the recent CPP changes affect my CPP contribution amounts while I'm working?

A. The amendments to the Canada Pension Plan (CPP) introduced in 2009 and phased in during the next few years do not include changes to the contribution rates that members make while they are working. The CPP contribution rates will remain at 4.95 per cent of the maximum CPP pensionable earnings. However, the CPP maximum pensionable earnings amount will increase annually. This means that the total amount that you contribute to CPP may increase even though the contribution rate remains unchanged.

The new changes to CPP will affect how your CPP pension is calculated and may influence when you decide to start collecting it. For more information, visit the Service Canada website at www.servicecanada.gc.ca or watch Teachers' Ken Harrison explain the changes in the online edition of *Pension News*, available on our www.otpp.com website.

Q. How does a leave of absence affect my retirement date?

A. As long as you have more than 10 days of credited service in the school year in which the absence occurs, a leave of absence will not affect the date you can retire with an unreduced pension. Remember that you earn one qualifying year for every school year in which you work more than 10 days, and we use these qualifying years to determine your 85 factor.

If you take a full school year off and you choose not to buy back the credit, you will have one less qualifying year used to calculate the earliest date you can retire with an unreduced pension. This date will be pushed six months into the future and your final pension amount will be affected.

Buying back credit can help you to maintain the retirement date you would have had if you had not taken the leave of absence. Check out the Buyback Centre on *i*Access Web for more information.

Q. I've forgotten my user ID and my password for *i*Access Web. How can I get a new one?

A. You can retrieve your account number and obtain a new password online. Visit the *i*Access Web login page by clicking on *Member Sign-in* from any page of our www.otpp.com website. Then select *Forgot your account number?* or *Forgot your password?* Once you have answered a few security questions, we will send you your login information to the e-mail address we have on file. ■

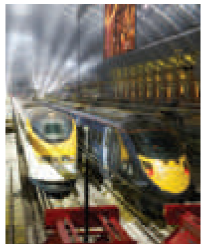
New banking options announced

Effective May 28, 2011, members can add CIBC and President's Choice Financial to the list of participating financial institutions that allow secure online payments to Teachers'.

Teacher wins demographic contest

Congratulations to Mrs. S. Gupta of Brampton who won a $100 Cadillac Fairview shop! gift card. Mrs. Gupta went online to *i*Access Web and made a change to her demographic information. If you make a change to your *i*Access Web demographic profile by June 30, 2011, you will be entered into our summer draw. One entry per person. Random draw. Winner will be notified by telephone.

HS1 deal wins infrastructure award



In January, Teachers' investment in Britain's High Speed 1 (HS1) rail link with Borealis was recognized as the European Infrastructure Deal of the Year by Project Finance International (PFI). The HS1 contract, awarded late last year, gives Teachers' and Borealis a 30-year concession to operate the HS1 rail network connecting London's St. Pancras station to the Channel Tunnel.

"We appreciate PFI's acknowledgement of our successful bid for HS1," said Stephen Dowd, Teachers' senior vice-president, Infrastructure. "HS1 is an excellent fit with our investment criteria and leverages our strong experience operating major assets in the UK."

Teachers' invests in alternative energy

Last year, Teachers' announced an equity investment in BluEarth Renewables Inc., a Calgary-based company focused on acquiring, developing, constructing and operating hydro, wind and solar power projects. Teachers' Private Capital, the pension plan's private investment arm, has committed to provide up to $75 million in equity capital to BluEarth to fund renewable power opportunities.

"BluEarth's principals have a strong track record of success and we look forward to supporting their efforts to create another leader in the growing market for renewable power," said Jane Rowe, Senior Vice-President, Teachers' Private Capital.

Teachers' buys stake in Brazilian investment bank

In December, Teachers' announced an investment in one of Brazil's premier investment banks, BTG Pactual. A consortium including Teachers', the Government of Singapore Investment Corporation, China Investment Corporation and Abu Dhabi Investment Council, among others, bought an 18.65 per cent interest in the bank for US $1.8 billion.

The investment gives Teachers' access to other opportunities in Brazil, one of the world's largest emerging markets. In addition, it provides added global exposure and experience working together with some of the world's largest sovereign wealth funds. ■

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We appreciate your comments about anything you read in *Pensionwise*. Please e-mail member_communications@otpp.com

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TEACHERS' PENSION PLAN ONTARIO

Printed on recycled stock
ISSN 1706-0214

Return undeliverable Canadian addresses to:

PM# 40062973

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