ONTARIO TEACHERS'
PENSION PLAN – RÉGIME DE RETRAITE DES ENSEIGNANTES ET DES ENSEIGNANTS

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April 3, 2017

Cindy Veinot, Assistant Deputy Minister & Provincial Controller
Office of the Provincial Controller Division
Treasury Board Secretariat
2nd Floor, Frost Building South
7 Queen's Park Crescent
Toronto, ON M7A 1Y7

Dear Ms. Veinot:

Enclosed is a copy of the Ontario Teachers' Pension Plan's 2016 Annual Report including the consolidated financial statements for the year ended December 31, 2016 and the auditor's report.

In addition, you will also find enclosed a copy of the financial statements for the Ontario Teachers' Retirement Compensation Arrangement as at December 31, 2016 which were approved by the Ontario Teachers' Pension Plan Board as trustee on March 2, 2017. The statements are not distributed generally; however, you can share them with others in your department in the Ministry of Finance. We would appreciate it if you could direct any other requests for copies you may receive from either inside the Ontario government or externally, directly to me.

If you require any further information, please feel free to contact the undersigned at (416) 730-7813.

Sincerely,

David McGraw
Chief Financial Officer

encl.

Copy: Marco Trasolini
Mary Cover
Jeff Davis

ONTARIO TEACHERS'
PENSION PLAN – RÉGIME DE RETRAITE DES ENSEIGNANTES ET DES ENSEIGNANTS

Ontario Teachers'
Retirement Compensation Arrangement

Financial Statements
December 31, 2016

Deloitte.

Deloitte LLP
Bay Adelaide East
22 Adelaide Street West
Suite 200
Toronto ON M5H 0A9
Canada

Tel: 416-601-6150
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To the Administrator:

We have audited the accompanying consolidated financial statements of Ontario Teachers' Pension Plan Board Retirement Compensation Arrangement (the "RCA") which comprises the statement of financial position as at December 31, 2016, and the statement of changes in net assets available for benefits, statement of changes in accrued pension benefits and statement of changes in deficit for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian accounting standards for pension plans and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Ontario Teachers' Pension Plan Board's RCA as at December 31, 2016, and the changes in its net assets available for benefits, changes in accrued pension benefits and changes in deficit for the year then ended in accordance with Canadian accounting standards for pension plans.

Deloitte LLP

Chartered Professional Accountants
Licensed Public Accountants
March 2, 2017

ONTARIO TEACHERS' RETIREMENT COMPENSATION ARRANGEMENT
STATEMENTS OF FINANCIAL POSITION

As at December 31 (Canadian $ thousands)		2016		2015
Net assets available for benefits				
Assets				
Cash	$	10,359	$	4,402
Receivable from Canada Revenue Agency		18,468		19,238
Receivable from the Province of Ontario		—		50
Investments (note 3)		12,792		3,496
		41,619		27,186
Liabilities				
Tax payable		4,757		1,860
Accounts payable and accrued liabilities		199		200
Payable to the Province of Ontario		426		—
		5,382		2,060
Net assets available for benefits		$36,237		$25,126
Accrued pension benefits and deficit				
Accrued pension benefits (note 4)		335,040		309,172
Deficit		(298,803)		(284,046)
Accrued pension benefits and deficit	$	36,237	$	25,126

On behalf of the RCA Trustee

Chair of the Board

Chair of the Audit & Actuarial Committee

ONTARIO TEACHERS' RETIREMENT COMPENSATION ARRANGEMENT
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

For the year ended December 31 (Canadian $ thousands)		2016		2015
Net assets available for benefits, beginning of year	$	25,126	$	26,102
Contributions				
Members		10,325		5,590
Province of Ontario		7,951		3,309
Designated employers		2,386		2,352
Total contributions		20,662		11,251
Investment income		138		150
Increase in net assets available for benefits		20,800		11,401
Benefits paid				
Retirement pensions		8,090		7,401
Death benefits		1,434		4,871
Total benefits paid		9,524		12,272
Administrative expenses				
Management fee and other (note 5)		51		29
Actuarial fee		103		63
Audit fee		11		13
Total administrative expenses		165		105
Decrease in net assets available for benefits		9,689		12,377
Increase / (Decrease) in net assets available for benefits		11,111		(976)
Net assets available for benefits, end of year	$	36,237	$	25,126

ONTARIO TEACHERS' RETIREMENT COMPENSATION ARRANGEMENT
STATEMENTS OF CHANGES IN ACCRUED PENSION BENEFITS

For the year ended December 31 (Canadian $ thousands)		2016		2015
Accrued pension benefits, beginning of year	$	**309,172**	$	329,994
Increase in accrued pension benefits				
Benefits accrued		**6,479**		8,224
Experience losses (note 4c)		**57**		—
Interest on accrued pension benefits		**5,040**		5,514
Changes in level of conditional indexing (4b)		**2,480**		1,208
Changes in actuarial assumptions and methods (note 4a)		**21,336**		—
		35,392		14,946
Decrease in accrued pension benefits				
Benefits paid		**9,524**		12,272
Experience gains (note 4c)		—		2,294
Changes in actuarial assumptions and methods (note 4a)		—		21,202
		9,524		35,768
Net increase / (decrease) in accrued pension benefits		**25,868**		(20,822)
Accrued pension benefits, end of year	$	**335,040**	$	309,172

STATEMENTS OF CHANGES IN DEFICIT

For the year ended December 31 (Canadian $ thousands)		2016		2015
Deficit, beginning of year	$	**(284,046)**	$	(303,892)
Increase / (Decrease) in net assets available for benefits		**11,111**		(976)
Net (increase) / decrease in accrued pension benefits		**(25,868)**		20,822
Deficit, end of year	$	**(298,803)**	$	(284,046)

1. DESCRIPTION OF ARRANGEMENT

The following description of the Ontario Teachers' Retirement Compensation Arrangement (RCA) is a summary only. For more complete information, reference should be made to the Retirement Compensation Arrangement Agreement between the Province of Ontario (the Province) and Ontario Teachers' Federation (the Agreement).

a) General

The Ontario Teachers' Pension Plan (the Plan) consists of a registered component, the registered pension plan (the RPP), and an unregistered component, the RCA. Restrictions in the *Income Tax Act* (Canada) (the ITA) on the payment of certain benefits from a registered plan for periods of service after 1991 may impact some Plan members. To address affected members, the RCA was established by agreement between the co-sponsors (the Province of Ontario and Ontario Teachers' Federation) as a supplementary plan to provide these benefits.

The registered office of the Plan is located at 5650 Yonge Street, Toronto, Ontario M2M 4H5, Canada.

b) Trust and Trustees

The RCA is administered under a trust separate from the assets of the RPP. The Ontario Teachers' Pension Plan Board (the Board), administering the RPP, has been appointed by the co-sponsors to act as the trustee of the RCA.

c) Funding

The RCA is funded on a pay-as-you-go basis from a portion of the contributions made to the Plan by members, the Province and designated employers. The portion is based on a limit on contributions to the Plan with contributions above the limit being remitted to the RCA. The limit is determined annually by the Plan's independent actuary such that the RCA contributions are expected to be more than sufficient to pay the benefits over the next 12 months. At the beginning of 2017, the actuary determined that the limit should remain at $14,500. Due to the funding policy adopted by the co-sponsors, the net assets available for benefits of the RCA will continue to be substantially less than the accrued pension benefits.

d) Retirement Pensions

A retirement pension is available when the benefits payable under the Plan exceed the benefits that can be paid under the RPP due to limitations imposed by the ITA. The benefit payable under the RCA will equal the difference between the maximum benefit permitted under the ITA and the amount payable under the Plan.

Pension benefits are adjusted in January each year for inflation, subject to an upper limit of 8% and a lower limit of 0% in any one year with any excess above or below those limits carried forward. For credited service earned up to December 31, 2009, inflation protection is 100% of the change in the Consumer Price Index. Credited service earned after December 31, 2009 is subject to conditional inflation protection. For credited service earned between January 1, 2010 and December 31, 2013, the minimum indexation level is set at 50% of the change in the Consumer Price Index. There is no minimum level of inflation protection for credited service earned after 2013. The indexation level stated in the most recent funding valuation filed for the RPP applies to the RCA and remains in effect until a subsequent filing for the RPP updates the amount. Inflation protection of up to 100% for credited service earned after 2009 can be restored on a go-forward basis, depending on the funded status of the RPP.

e) Refundable Tax

Contributions received and investment income earned is subject to a refundable withholding tax at a rate of 50%. Benefit payments made reduce the amount that is taxed by a rate of 50% and the amount to be received is determined upon filing the annual RCA return.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of Presentation

These financial statements are prepared in Canadian dollars, the RCA's functional currency, in accordance with the accounting standards for pension plans in Part IV of the Chartered Professional Accountants (CPA) Canada Handbook (Section 4600). Section 4600 provides specific accounting guidance on investments and pension obligations. For accounting policies that do not relate to either investments or pension obligations, the RCA must consistently comply with either International Financial Reporting Standards (IFRS) in Part I or accounting standards for private enterprises in Part II of the CPA Canada Handbook. The RCA has elected to comply with IFRS in Part I of the CPA Canada Handbook. To the extent that IFRS in Part I is inconsistent with Section 4600, Section 4600 takes precedence.

The financial statements for the year ended December 31, 2016 were authorized for issue through a resolution of the Board on March 2, 2017.

b) Future Changes in Accounting Policies

The relevant new guidance issued by the International Accounting Standards Board not yet adopted by the RCA includes:

- IFRS 9, Financial Instruments. The new standard will replace IAS 39, Financial Instruments: Recognition and Measurement and includes guidance on recognition and derecognition of financial assets and financial liabilities, impairment and hedge accounting. The new standard will come into effect January 1, 2018 with early application permitted.

Management does not expect any significant impact on either the RCA's financial position or its investment income when adopting the new standard.

c) Cash

Cash is comprised of bank deposits.

d) Receivable from Canada Revenue Agency

The receivable from the Canada Revenue Agency is related to refundable tax described in Note 1e. The amount is estimated based on benefits paid during the year and refunds not yet received.

e) Tax payable

Tax payable includes refundable tax payable and income tax on benefit payments to be remitted to the Canada Revenue Agency. Refundable tax payable is estimated based on contributions received and investment income earned during the year. Refundable tax is described in Note 1e.

f) Investments

Investments are stated at fair value. Fair value is the price that would either be received to sell an asset or be paid to transfer a liability in an orderly transaction (i.e. an exit price) between market participants at the measurement date. The RCA invests in short-term money market securities. These are valued using either quoted closing mid-market prices or discounted cash flows based on current market yields, when quoted closing mid-market prices are unavailable.

Investments are classified and disclosed in one of the following categories reflecting the significance of inputs used in making the fair value measurement:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the assets or liabilities, either directly or indirectly; and
- Level 3 – unobservable inputs.

If different levels of inputs are used to measure the fair value of an investment, the classification within the hierarchy is based on the lowest level input that is significant to the fair value measurement.

Investment income is recognized on an accrual basis.

g) Accrued Pension Benefits

The value of accrued pension benefits and changes therein during the year are based on an actuarial valuation prepared by Mercer (Canada) Limited, an independent firm of actuaries. The valuation is made annually as at August 31 and then extrapolated to year end. It uses the projected benefit method pro-rated on service and management's best estimate, as at the valuation date, of various economic and non-economic assumptions (note 4).

As described in note 1d, the inflation protection benefits for credited service earned after December 31, 2009 is conditional, depending on the funded status of the RPP. For the financial statement valuation, consistent with the RPP, the RCA estimates the conditional inflation protection benefits based on the indexation levels stated in the most recent RPP funding valuation filing.

h) Contributions

Contributions from the members, the Province and designated employers are recorded on an accrual basis. When the contributions received from the Province exceed the required amount, a payable will be recorded.

i) Benefits

Benefit payments to members and others, commuted value payments and refunds to former members, and transfer payments to other plans are recorded in the period in which they are paid. Any benefit payment accruals not paid are reflected in accrued pension benefits.

j) Use of Estimates

In preparing these financial statements, management uses estimates and assumptions that primarily affect the reported values of assets and liabilities, and related income and expenses. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable and relevant under the circumstances. The effect of a change in an estimate or assumption is recognized in the period in which the estimate or assumption is revised. Significant estimates and assumptions are used primarily in the determination of accrued pension benefits and the amounts of contributions. Note 4 explains how estimates and assumptions are used in determining accrued pension benefits. The amount of contributions is based on a limit determined annually by Mercer (Canada) Limited in a manner that is expected to be more than sufficient to pay the benefits over the next 12 months.

3. INVESTMENTS AND RISK MANAGEMENT

a) Investments

The RCA invests solely in Treasury Bills issued by the Canadian government. As at December 31, 2016 and December 31, 2015, the Treasury Bills held by the RCA mature within one year. All investments are classified as level 1 in the fair value hierarchy since prices are quoted in active markets.

b) Objective, Policies and Processes of Risk Management

The RCA's primary risk is that the contributions raised are not sufficient to pay the benefits over the next 12 months. The objective of investment risk management is to preserve the asset value to pay the benefits. This objective is achieved through investing primarily in short-term money market securities.

c) Market Risk

Market risk is the risk of loss that results from fluctuations in market price. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk. Currency risk is the risk that fluctuations in exchange rates will result in losses to the RCA on monetary assets and liabilities denominated in foreign currencies. The RCA has no currency risk as it does not have any assets or liabilities denominated in foreign currency. Interest rate risk is the risk that changes in interest rates will adversely affect the future fair value or cash flows of a financial instrument. The RCA does not have significant interest rate risk.

d) Credit Risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The RCA is subject to minimal credit risk because its investments are primarily short-term Treasury Bills issued by the Canadian government and the receivable is due from the Canada Revenue Agency.

e) Liquidity Risk

Liquidity risk refers to the risk that the RCA does not have sufficient cash to meet its current payment liabilities. The RCA is funded on a pay-as-you-go basis. When the assets are insufficient to pay the benefits, the payment of benefits will be temporarily suspended until sufficient contributions are raised to fund the payments that are due under the RCA.

4. ACCRUED PENSION BENEFITS

a) Actuarial Assumptions

The actuarial assumptions used in determining the value of accrued pension benefits of $335 million (2015 – $309.2 million) reflect management's best estimate of future economic events and involve both economic and non-economic assumptions. The non-economic assumptions include considerations such as mortality as well as withdrawal and retirement rates. The primary economic assumptions include the discount rate, the salary escalation rate and the inflation rate. The discount rate for the RCA is set equal to 50% of the discount rate for the RPP, in order to reflect the impact of the 50% refundable tax under the RCA. The discount rate for the RPP is based on market rates, as at the valuation date, of bonds issued by the Province of Ontario, which have characteristics similar to the Plan's liabilities. The discount rate is determined by applying a weighted average discount rate that reflects the estimated timing and amount of benefit payments. The inflation rate is the difference between the yield on Government of Canada long-term nominal bonds and Government of Canada real-return bonds. The salary escalation rate incorporates the inflation rate assumption and long-term expectation of growth in real wages.

A summary of the primary economic assumptions, as at December 31, is as follows:

	2016	2015
Discount rate	**1.63%**	1.63%
Salary escalation rate	**2.80%**	2.50%
Inflation rate	**1.80%**	1.50%

The primary economic assumptions were changed as a result of changes in capital markets during 2016. The change in economic assumptions resulted in a net increase in the value of accrued pension benefits of $10.7 million (2015 net decrease - $26.2 million inclusive of the impact of the salary agreements reached with the Affiliates of Ontario Teachers' Federation in 2015 as noted below).

The primary economic assumptions for 2015 incorporated the agreement between the Province of Ontario and the Affiliates of the Ontario Teachers' Federation providing for a 1% increase in salaries on September 1, 2016 plus an additional increase of 0.5% on the 98th day of the 2016 school year. The agreement also provides for a lump sum payment on September 1, 2015 of 1% of earned wages to all members covered by the collective agreement. This lump sum payment is included in members' pensionable earnings.

The estimate of the value of accrued pension benefits is highly sensitive to salary increases, both actual and assumed, and to the assumed maximum pension limit per the ITA. Any changes to the salary assumptions will have a significant impact on the liabilities for future benefits. In addition, significant uncertainty exists in projecting the liabilities of the RCA due to changes in the number of future participants as well as changes to the ITA relating to pensions.

The RCA valuation approach calculates benefits both with and without the application of the ITA limit for post 1991 service using the same assumed salary escalation rates as those used for the RPP valuation. The RCA benefits are then determined as the difference between the two calculations.

In 2016, the non-economic assumptions were changed to include a new provision of $10.5 million for future retirees. The new provision has been added for active members expected to retire early with an age reduced pension due to restrictions under the ITA. There was also a small refinement made to the assumed retirement age for inactive members. In 2015, the non-economic assumptions were updated to reflect recent experience of Plan members related to retirement, termination of Plan membership and increases in salaries related to experience. Changes in non-economic assumptions, inclusive of the provision for future retirees subject to ITA reductions, increased the accrued pension benefits by $10.6 million (2015 - $5.0 million increase). The changes in economic and non-economic assumptions resulted in a net increase in the value of accrued pension benefits of $21.3 million in 2016 (2015 - $21.2 million decrease).

It is also difficult to predict the benefits expected to be paid over the next 12 months and therefore, it is possible that the assets may be insufficient to pay the benefits. In such a case, the payment of benefits may be temporarily suspended and the contributions raised in order to fund the payments that are due under the RCA.

b) Plan Provisions

Effective January 1, 2017, the maximum contribution limit in the RPP remained at $14,500 per annum. Upon review of the funding situation of the RCA by Mercer (Canada) Limited, it was determined that estimated contributions to the RCA, together with the existing RCA assets and estimated investment returns, should be sufficient to pay the benefits required in the short term.

Credited service earned after December 31, 2009 is subject to conditional inflation protection as described in note 1(d). The inflation protection benefits vary between 50% and 100% of the change in the Consumer Price Index (CPI) for credited service earned between January 1, 2010, and December 31, 2013, and vary between 0% and 100% of the change in the CPI for credited service earned after 2013. The conditional inflation protection provision can only be invoked or updated when a funding valuation for the RPP is filed. The Ontario government and designated employers participating in the Plan will make extra contributions to the Plan to match the inflation protection benefits members forego up to a maximum foregone inflation of 50% of CPI.

For the financial statement valuation, future pension payments for the credited service earned are indexed at the levels stated in the most recent RPP funding valuation filing. The indexation levels from the most recent RPP filing as at January 1, 2016 are as follows:

Credited service	Inflation protection level
Earned before 2010	100% of CPI
Earned during 2010 - 2013	90% of CPI
Earned after 2013	90% of CPI

In the most recent filing for the RPP, inflation protection was partially restored for recent retirees. Effective January 1, 2017, pensioners who retired after 2009 received a one-time increase to their pensions to prospectively restore benefits to the level they would have been had 100% inflation protection been provided each year since retirement commenced. Future cost of living increases will be equal to 90% of the annual increase in the CPI on credited service earned after 2009 (up from the previous level of 70%). This level will remain in effect until the next actuarial valuation for the RPP is filed with the regulatory authorities at which time the level may be reduced or increased depending on the funded status of the RPP.

c) Experience gains and losses

Experience losses on the accrued pension benefits of $0.1 million (2015 - $2.3 million gains) arose from differences between the actuarial assumptions and actual results.

5. RELATED PARTY TRANSACTIONS

The Board provides administrative services to the RCA and charged a management fee of $44,351 (2015 - $29,444). There are no other related party transactions between the RCA and either the Board or the RPP.

6. CAPITAL

The net assets available for benefits are described as the RCA's capital in the financial statements. The objective of managing the RCA's capital is to ensure the RCA has sufficient assets to pay the benefits over the next 12 months. The RCA is funded from a portion of the contributions made to the Plan by members, the Province and designated employers. The portion is based on a limit on contributions to the Plan with contributions above the limit being remitted to the RCA. The limit is determined annually by Mercer (Canada) Limited such that the RCA contributions are expected to be more than sufficient to pay the benefits over the next 12 months.