

# TAKING CARE OF **BUSINESS**



The Ontario Teachers' Pension Plan is the largest single-profession pension plan in Canada with net assets of \$96.4 billion at December 31, 2009. Plan management and staff invest the plan's assets and administer pension services of 289,000 active and retired elementary and secondary school teachers and their survivors. Pensions are defined by a formula and are supported by contributions from teachers and the Ontario government, as well as investment income from the plan's diversified, global portfolio.

# FORTIFYING YOUR PENSION



## PLAN FUNDING

The plan is sponsored by the Ontario Teachers' Federation and the Ontario government. The sponsors determine contribution rates and pension benefit levels, and decide how pension surpluses are used and funding shortfalls are addressed.

[>> read more on pg 10](#)

## INVESTMENTS

Our investment program exists to earn returns to pay teachers' pensions. We manage risk carefully and invest according to the plan's risk tolerance. We invest with a long-term focus and consider all investment opportunities that are appropriate for the pension plan.

[>> read more on pg 24](#)

## MEMBER SERVICES

We are committed to providing Ontario's working and retired teachers with prompt, personalized and accurate pension information. We strive to provide outstanding service to members through our professional staff and convenient and secure member website, iAccess™ Web.

[>> read more on pg 44](#)

[Open for 2009 HIGHLIGHTS >>](#)

# 2009 HIGHLIGHTS

## STATE OF THE PLAN

### Funding challenges continue

#### Balanced pension plan

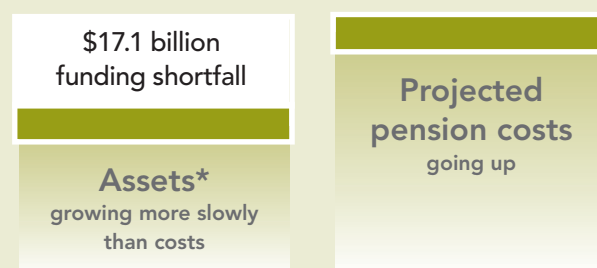
Filed valuation as at January 1, 2009



- > Ontario Teachers' Federation (OTF) and Ontario government – the plan sponsors – resolved a preliminary \$2.5 billion shortfall and filed a balanced funding valuation with the regulator in 2009
- > Pension plan is balanced when assets equal the cost of future pension benefits

#### Funding shortfall

Preliminary valuation as at January 1, 2010



- > A preliminary valuation shows a \$17.1 billion shortfall at January 1, 2010
- > The shortfall must be resolved by the time the next valuation is required by the regulator in 2012
- > No change in benefit or contribution levels is required before the next valuation is filed

#### Funding valuation<sup>1</sup>

(as at January 1, 2010) (\$ billions)

Net assets	\$ 96.4
Smoothing adjustment	12.7
Future contributions	26.7
Future special contributions <sup>2</sup>	5.4
Actuarially adjusted assets	141.2
Cost of future benefits	(158.3)
Shortfall	\$(17.1)

<sup>1</sup> Based on assumptions in the Funding Management Policy.

<sup>2</sup> Contribution increases by teachers and the Ontario government to address the 2005 funding shortfall.

\* Assets include future contributions.

#### More information:

- > State of the Plan, page 10
- > Funding valuation at January 1, 2010, page 23

# INVESTMENTS

Investment team beats market performance

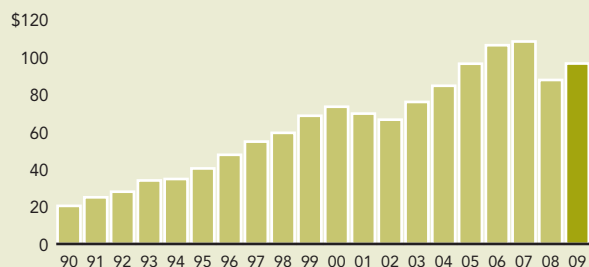
**13.0%** return

**8.8%** benchmark return

- > Fund performance exceeds benchmark by 4.2 percentage points
- > Net assets rise to \$96.4 billion
- > Markets unlikely to continue growing at this pace

## Net assets

(for the year ended December 31) (\$ billions)

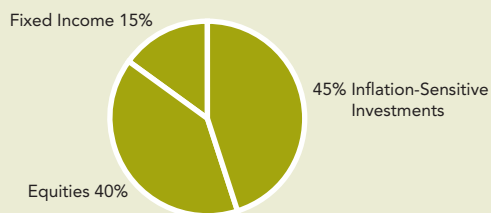


## Investment performance

(percent)	2009	2008	4-year	10-year	Since 1990
Return	13.0	(18.0)	2.3	6.2	9.7
Benchmark	8.8	(9.6)	2.4	4.0	7.6
Return above/ (below) benchmark (\$ billions)	\$3.4	(9.2)	(0.1)	15.8	19.2

## Asset-mix policy

(as at December 31, 2009)



## More information:

- > Investments, page 24
- > Investment performance, page 34

# MEMBER SERVICES

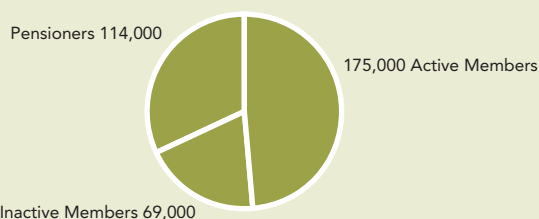
Delivering cost-effective, quality services

**9.1** out of 10 (QSI)

- > Members continue to rate our services at the top of the scale, based on the Quality Service Index (QSI)
- > Consistently rank among the world's pension leaders
- > Introduced daily key performance indicators to continuously monitor service quality and improvement (see page 52)
- > 89% of new retirees applied for their pensions online in 2009

### Member profile

(as at December 31, 2009)



### Fast facts

- > More than 50,000 teachers expected to retire by the end of 2020
- > 93 pensioners are age 100 or older
- > Average age of pensioners is 68
- > Average pension for teachers retiring in 2009 with the 85 factor is \$42,900
- > \$4.4 billion paid in pension benefits in 2009

### More information:

- > Member Services, page 44

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## Report from the Chair

*“Working together we continue to seek the best means for ensuring this pension plan remains strong and healthy for all plan members in the future.”*



**Eileen Mercier, MA, MBA, FICB, FICD**  
Chair

The board members and management spent much of 2009 overseeing management’s application of the lessons learned from 2008’s global financial crisis and positioning the fund for recovery. The fund’s 2009 performance was significantly ahead of the previous year’s, earning \$10.9 billion.

In addition to the immediate operational challenges posed by increased market volatility, the financial crisis has raised concerns about the viability of retirement systems around the world. Retirement financing is international, front-page news. In Canada, national newspaper editorials and television broadcasts on the subject are now commonplace.

There really are two pension debates underway. One concerns pension coverage and focuses on how fortunate public sector employees are to have a retirement plan in an environment in which the majority of workers have no workplace plan at all. Unfortunately, this debate often overlooks the fact that members of our plan pay 50% of the total contributions, sharing equally with the Ontario government, unlike some plans whose member contributions account for significantly less than half of the total. From our perspective, this half of the debate should focus instead on how to encourage those without pension plans to save for their retirement years. Although RRSPs were designed with such individuals in mind, statistics show that the majority of Canadians do not – or cannot – take full advantage of RRSPs.

The other pension debate centers around funding – sufficient, sustainable funding, to be exact. While no one can predict what is going to happen in the broader public debate, as a mature pension plan, we are well aware of the factors that are contributing to these viability questions. We have been addressing these issues with our sponsors for several years. Working together, we continue to seek the best means for ensuring this pension plan remains strong and healthy for all plan members in the future.

In fact, this is the mandate of a tripartite funding Sustainability Working Group comprising representatives of plan management, the Ontario government and the Ontario Teachers’ Federation (OTF). This group was established when the January 1, 2009 funding valuation was filed. With Dr. Harry Arthurs, who chaired the recent Ontario Expert Commission on Pensions, as its facilitator, this working group is considering all potential changes to safeguard our pension plan’s security and affordability. The Working Group has committed to report by this summer.

## **In the black, but not out of the woods**

The stock market recovery, which did not begin until March 2009, allowed the fund to post an investment return for the year of 13.0%. The market recovery largely reflected a degree of stabilization in world financial systems and economies but not true economic growth. All indications are that a return to sustained economic growth will be slow and somewhat fitful, with only modest investment returns in the immediate future.

One year of strong stock market performance has not altered the fact that North America and Europe still lack the job growth needed for sustainable economic expansion. Bank balance sheets are still under pressure, so expansion capital remains in tight supply. The financial industry's reluctance to resume lending is hurting the private equity, real estate and infrastructure markets, which historically have provided pension funds with strong returns.

All indexed pension plans are grappling with two de-stabilizing factors: first, low real interest rates that drive up the projected cost of future pensions, and second, an uncertain economic environment. In addition, our pension plan faces the ongoing challenge of maturing membership demographics.

This pension plan, unlike most others, is mature: it pays out substantially more in benefits than it collects. There will be approximately 1.2 working members for every pensioner in 10 years. Our investment risk tolerance is therefore lower than that of plans with a higher active-to-retired member ratio. Accordingly, we must set our investment plan with the expectation that, while we may not earn as much as others with a different demographic profile, we should not lose as much either when markets take a downturn. The board members are confident that our current investment plan will continue to produce solid returns for the amount of risk we can afford to take.

## **Stronger risk management**

Board members believe that risk consciousness must begin at the top. We adopted a Risk Appetite Statement that represents board member consensus on the various investment risks that are appropriate for this plan to assume. This is considered best practice and we are among the first institutional investors in the world to develop such a foundational risk appetite document.

Board members oversaw the strengthening of the plan's Enterprise Risk Management system in 2009, ensuring it is sufficiently robust. An external international expert in investment risk management reviewed all of our investment risk reporting processes and systems and confirmed that we are among the world's leaders in risk budgeting. However, opportunities for improvement were identified. Much of this now has been or is being implemented.



Attracting and retaining talent is among Teachers' top enterprise risks. Compensation is one of our most important risk mitigators; it can help us attract and retain employees, and it also can motivate individuals so the plan can achieve the long-term results it needs. With new operating strategies emerging, management and board members needed to review our approach to compensation to ensure employees' alignment to the new strategies. A review that began in 2007 was completed in 2009 and a new incentive compensation program that supports total fund management and Member Services' strategy was developed. The members of the board engaged compensation experts to advise them in their review and to test the program design under various scenarios to ensure alignment with the plan's requirements. The compensation changes will be completed and implemented in 2010; it is important to note that they will not diminish the effect of the fund's 2008 loss. Last year's negative results will continue to adversely affect compensation through to 2012.

## Pension funding

The plan and its sponsors continue to face serious funding challenges. Our members contribute a significant share of their salaries to the pension plan – approximately 11% in 2009. Even so, last year the plan collected \$2.7 billion in contributions, including the government's matching dollars, and paid out \$4.4 billion in benefits. This means the first \$1.7 billion of investment income each year just keeps us even. The introduction of conditional inflation protection for service earned in 2010 and onward will increase asset mix flexibility, but it will take many years to have a meaningful impact on the fund.

It is risky to assume that this fund can earn enough money fast enough to match the expected growth in the cost of future pensions, largely because markets and interest rates are unpredictable and sometimes volatile. Over the next three years, the plan's funding status will also be impacted by smoothing as we fully absorb 2008's losses. Even when the economy eventually recovers and real interest rates rise, these increases may not be enough to solve the funding problem.

Plan sponsors understand this problem and took major steps to address it in 2009. They filed the funding valuation earlier than necessary to extend the next mandatory filing date and gain time to deal with the expected continued shortfalls, which members of the Sustainability Working Group are studying.

Details of the 2009 filing are discussed on page 18. The key point for plan members is that contribution rates and benefits will remain unchanged until the next valuation is filed. This next statutory triennial filing is due in 2012, but can be filed sooner at the sponsors' discretion.

I cannot overstate the importance of the work underway by the Sustainability Working Group. Although it is too soon to say what measures it ultimately will choose to address the funding challenge, I can say that everyone fully appreciates the need to resolve this issue. An agreed-upon solution will permit everyone – plan sponsors, board members and management – to focus on the long-term task of ensuring, to the best of our ability, that the pension promise to Ontario's teachers will be met.



## New board members

On behalf of all board members, I would like to express our appreciation for their service to two members who stepped down this past year: Guy Matte, chair of the Governance Committee, retired after eight years as a board member, and Bill Swirsky, chair of the Audit & Actuarial Committee. Replacing them are Rod Albert, former president of the Ontario Teachers' Federation and the Ontario Secondary School Teachers' Federation, and David Smith, former chair and senior partner of PricewaterhouseCoopers. Rod knows Teachers' well; as OTF president, he played a key role in Teachers' creation as an independent organization in 1990. David brings 40 years of business experience to the board; his appointment reflects the ongoing importance to the board of audit and accounting expertise.

Finally, I would like to congratulate CEO Jim Leech on being honoured as a Champion of Public Education by The Learning Partnership, which brings together people from all sectors of society to strengthen public education in Canada. We commend him for spending some of his private time helping to improve educational opportunities for children.

## Looking ahead

We expect our investment returns to remain below the average of previous recoveries, reflecting slow economic growth and our plan's lower risk tolerance. Board members are confident that the organization is focused on the right priorities and that the plan is well-positioned for the eventual economic recovery.



Eileen Mercier  
Chair

## Report from the CEO

*“Tough decisions in 2008 allowed us to enter 2009 with good assets and a strengthened investment team.”*



**Jim Leech, MBA, ICD.D**  
President and Chief Executive Officer

2009 was spent taking care of day-to-day business and fortifying the pension plan for the future. It was a solid and productive year with investment returns positive and well ahead of our composite benchmark. Notwithstanding these gains, our assets remain below the pre-2008 level. Member Services retained its global standing for excellence and quality. Progress was also made in our multi-year program to update and upgrade critical investment risk and reporting systems and other corporate processes.

On the pension funding front, a balanced funding valuation was filed with the pension regulator in 2009 (see details on page 18). However, as anticipated, even with strong investment results, the plan is reporting a preliminary \$17.1 billion funding shortfall as at January 1, 2010. This is the result of the inclusion of previous investment losses and continued low interest rates. Over the past decade, we have experienced an ongoing series of such shortfalls, as plan demographics have matured.

As noted in the Chair’s message, a Sustainability Working Group, comprising Teachers’ executive management and representatives from the Ontario Teachers’ Federation (OTF) and the Ontario government, the plan’s sponsors, was struck following the 2009 filing to develop an action plan to address the challenges posed by these chronic funding deficits. Management is encouraged by the spirit of cooperation at the table as we all work together to deliver, by the middle of this year, an action plan to keep this plan both affordable and secure.

As a management team we are doing all we can in those areas we control: adapting our investment program so it has the best chance of reducing the gap between pension assets and liabilities; managing our costs; attracting and retaining the best talent; and providing the OTF and the provincial government with the best possible advice.

### Fund performance

The investment portfolio earned \$10.9 billion during the year, a significant improvement over the loss reported in 2008. At December 31, 2009, the plan’s net assets totalled \$96.4 billion.

The overall 13.0% return exceeded our composite fund benchmark by 4.2 percentage points, or \$3.4 billion. Our public equities and fixed income teams produced the highest level of value-added performance in their history. Since the private capital, real estate and infrastructure markets remained subdued, those teams focused most of their capital and energy on ensuring their existing holdings are adequately financed and strategically positioned for the future.

These returns are all the more noteworthy given they occurred only in the last three quarters of the year. Stock markets remained dismal through January and February, hitting bottom in early March. Neil Petroff, in his first year as Chief Investment Officer, and his investment team deserve a great deal of credit for the extent of the fund's recovery. They positioned us opportunistically throughout 2008 and 2009 in markets that they believed would rebound the quickest, and worked every day to manage the downside risk. They played a defensive game, as they committed to do, but as our rate of return shows, they took advantage of scoring opportunities.

We took decisive action in 2008 during the financial crisis – changing our fixed income strategy, reducing counterparty risk, increasing liquidity and examining every investment to ensure it continued to represent value in the new economic environment. We continue to account for our holdings at fair market value. At no time were we forced to sell assets at a discount to raise cash. Those tough decisions in 2008 allowed us to enter 2009 with good assets and a strengthened investment team.

## Enterprise Risk Management

As you will see through this report, if we had one focus in 2009 it was risk management. Although our proprietary approach to risk budgeting is one of the hallmarks of this fund, we now are taking an even more holistic approach to our various risk factors. The result is a truly risk-driven investment approach designed to protect and preserve the plan's assets as we invest for the future.

Our evolving investment approach helps us respond to market conditions while allowing for the demographic changes that continue to affect our plan's risk profile. With some of the best investment minds in the industry, the team is focused on managing the fund collaboratively and ensuring that the benefits offered by each asset class are realized by the fund.

## Industry leadership

Teachers' is continuing its heritage of pension industry leadership. We played an active role in 2009 in the development and launch of a new action plan for the Toronto Financial Services Working Group, which is committed to positioning Toronto as a world financial services hub in four key sectors, including retirement financing solutions and risk management. I was proud to accept a seat on the Financial Services Leadership Council, which was formed to set the direction and oversee this government/industry initiative among other things. Several others from our management team are involved in developing specific action plans.

Toronto is becoming a world centre of retirement financing excellence – where talent, expertise and motivation intersect. It is home to three of the country's – and indeed the world's – largest, most sophisticated and innovative pension funds (including ourselves) and to the Rotman School of Management's globally recognized International Centre for Pension Management. Some of our best mathematicians, actuaries, administrators and investment professionals are working in Toronto's pension industry today.

We support the Toronto Financial Services Working Group's *Call for Partnership and Action* report and share its vision of government and industry continuing to build on this momentum. Talent attracts talent and success attracts success. This will spur Toronto's critical mass of retirement financing expertise towards more growth and attract experts from around the world.

## Operational Excellence

From an operational perspective, in 2009 the executive team recognized the need to integrate our most complex and transformational systems projects. These multi-year programs, which affect the Investment division, IT and Investment Finance, have now been aligned under one umbrella called Operational Excellence.

We needed an executive-level sponsor of change to take this on, so I asked Rosemarie McClean, our Senior Vice-President of Member Services, to assume this responsibility in addition to her existing duties. She chairs an executive-level forum comprising the executive sponsors of each of our major projects currently underway or in the planning phase. The forum will anticipate – or resolve at the executive level – any issues that might inhibit a project's progress.

Rosemarie brings to this task the experience and learnings of having led change in our Member Services division over the past 15 years. This group is now among the best in the world. This is a result of a carefully planned transformation, which over several years established a series of integrated processes and systems that support our employees in achieving pre-established performance metrics. These systems incorporate a "continuous improvement" aspect that ensures the team stays at the top of its game. With Rosemarie's appointment as Executive Sponsor for Change, all parts of our organization will benefit from this Member Services experience.

## Our people

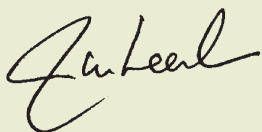
I give much credit to our employees across the organization for their composure and persistence during the economic mayhem and financial disruption of 2008/2009, and for continuing to provide the investment expertise and outstanding service our members deserve. They remained focused on the long term in spite of the din of the economic downturn.

Employees rallied together for others as well, increasing overall participation rates in our annual United Way campaign. Over the past three years our employees have contributed more than \$1 million to the United Way.

Employees also embraced the new Mission, Vision and Values, which were adopted in 2009. This was a true grassroots effort with the final statements developed by employees themselves across the organization. Known collectively as Teachers' Way, this update recognized that our former Vision, originally adopted nearly 20 years ago, had been achieved. Our Mission is *Outstanding service and retirement security for our members – today and tomorrow*. An aspirational new Vision was adopted: *To become the world's leading pension plan organization*. Our Values were also refreshed. Perhaps most significant among these is the addition of a new Value: *We champion accountability and risk consciousness*.

Finally, I would like to take this opportunity to thank the board members for their diligence and support throughout one of the most trying times in economic history. From the start of the economic meltdown in 2008, calm heads prevailed. They have been open to our strategies for improving investment returns and augmenting our risk management infrastructure. They asked the right questions when they needed to be asked and encouraged our teams to continue to focus on our plan's own circumstances and opportunities for success. And they backed several new investment ideas that have already started to pay off.

We remain mindful of the many economic and demographic factors facing the plan, and are committed to delivering on Teachers' Way. You will note that at the end of each of our divisional reports we outline our operational priorities for the coming year. I look forward to reporting next year on our progress.



Jim Leech  
President and Chief Executive Officer

# MANAGEMENT'S DISCUSSION & ANALYSIS

Our objective is to present readers with a view of the pension plan through the eyes of management by interpreting the material trends and uncertainties affecting the results and financial condition of the plan.

As well as historical information, this MD&A contains forward-looking statements regarding management's objectives, outlook and expectations. These statements involve risks and uncertainties and the plan's actual results will likely differ from those anticipated. Key elements of the plan's consolidated financial statements are explained and should be read in conjunction with these forward-looking statements.

## STATE OF THE PLAN

*"We report the financial and funding valuations annually that give us and the plan sponsors a valid snapshot of the plan's financial health at year end and over the long term."*



David McGraw, CA, MBA, ICD.D  
Senior Vice-President and Chief Financial Officer

### Plan funding status

#### Balanced pension plan

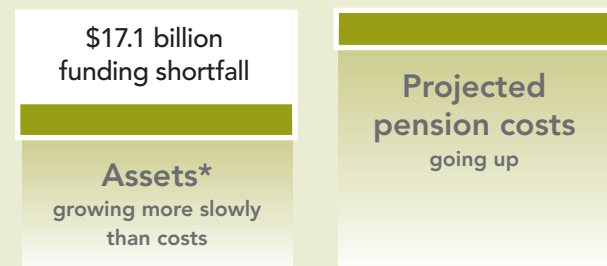
Filed valuation as at January 1, 2009



- > Ontario Teachers' Federation (OTF) and Ontario government filed a balanced funding valuation in 2009
- > Contribution rates and benefit levels unchanged
- > Filed valuation showed plan has sufficient assets to meet pension obligations
- > Pension plan is balanced when assets equal the cost of future pension benefits

#### Funding shortfall

Preliminary valuation as at January 1, 2010



- > Declining real interest rates and impact of 2008 loss chief causes of funding shortfall
- > Next filing deadline: 2012
- > No action required to address shortfall until next deadline

### Funding shortfalls expected to recur

Sustainability Working Group formed by OTF and government, together with pension plan management, to address recurring shortfalls.

Action plan expected by mid-2010.

\* Assets include future contributions.



**Barbara Zvan, M.Math, FSA, FCIA**  
Senior Vice-President, Asset Mix and Risk  
and Chief Investment Risk Officer

*“As the number of pensioners grows relative to working teachers, it becomes more difficult to address funding shortfalls with contribution increases alone. Demographic shifts are also affecting the amount of risk we can afford to take.”*

## Funding challenges

**Assets: the plan cannot earn money fast enough to match the growing cost of future pensions**

- > Low risk tolerance due to plan maturity (see page 15)
- > Modest investment returns projected, partly due to low risk tolerance

### Assets required for a typical \$40,000 pension

Real Interest Rate	Amount Required <sup>1</sup>
1.0%	\$995,000
2.0%	\$855,000
3.0%	\$745,000
4.0%	\$660,000
5.0%	\$585,000

<sup>1</sup>For retirement at age 58.

The real interest rate was 1.5% at the beginning of 2010.

**Liabilities: projected cost of future pensions continues to outpace growth of assets**

- > Low real (after inflation) interest rates make it more costly to fund pension benefits
- > 2008 investment loss affects assets as unamortized losses are absorbed over five years
- > Members living longer

**A 1% change in real interest rates has a more than \$25 billion impact on future pension costs**

## Addressing funding shortfalls

**The OTF and government can:**

- > increase contribution rates;
- > invoke conditional inflation protection for pension credit earned after 2009;
- > change other benefits members will earn in future; or
- > adopt a combination of these options.



# Overview

The Ontario Teachers' Pension Plan (Teachers') is Canada's largest single-profession pension plan. It was created in 1917 and until 1990 was administered by the Teachers' Superannuation Commission of Ontario. At that time the pension fund was nearly 100% invested in non-marketable Province of Ontario debentures.

The Ontario government established the Ontario Teachers' Pension Plan Board as an independent organization in 1990. Together, the board members and management have three key responsibilities: (1) investing the plan's assets in financial markets to fund the plan's liabilities; (2) administering the pension plan and paying benefits promised to members and their survivors; and (3) reporting on the plan's funding status.

At the end of 2009, we managed \$96.4 billion in net assets. We administer the pension benefits of Ontario's 175,000 elementary and secondary school teachers and 114,000 pensioners. Teachers' has one of the largest payrolls in Canada, paying out a total of \$4.4 billion in benefits in 2009. We employ 790 people at our office in Toronto, Ontario, seven in our London, England office and another 1,600 at our real estate subsidiary, The Cadillac Fairview Corporation Limited.

The organization's Mission statement is *Outstanding service and retirement security for our members – today and tomorrow.*

## Plan description

The Ontario Teachers' Pension Plan is a defined benefit arrangement. The plan pays pensions based on a formula and not according to the amount of money contributed or the returns earned by the plan's investment program. The plan pays 2% per year of service multiplied by the average salary of the member's best five years, partially integrated with the Canada Pension Plan (CPP). It includes full inflation protection for pension credit earned until the end of 2009. In 2008, a change was made to the plan's cost-of-living provisions with inflation protection for pension credit earned after December 31, 2009, guaranteed at 50%, with up to 100% indexation possible, depending on the plan's funding status.

The plan is sponsored by the Ontario government and the Ontario Teachers' Federation (OTF). They jointly decide:

- the benefits the plan will provide;
- the contribution rate paid by working teachers and matched by the government and designated employers; and
- how any funding shortfall is addressed and any surplus is used.

These decisions are largely governed by two Ontario statutes, the Teachers' Pension Act and the Pension Benefits Act, and by the federal Income Tax Act.

Pensions are financed with investment income generated by the pension fund plus contributions from working teachers, the government and designated employers. Contributions in 2009 consisted of approximately \$1.3 billion from working teachers, \$1.4 billion from the Ontario government and \$37 million from designated employers and transfers from other pension plans. (Contributions are detailed in Note 12 to the consolidated financial statements.)

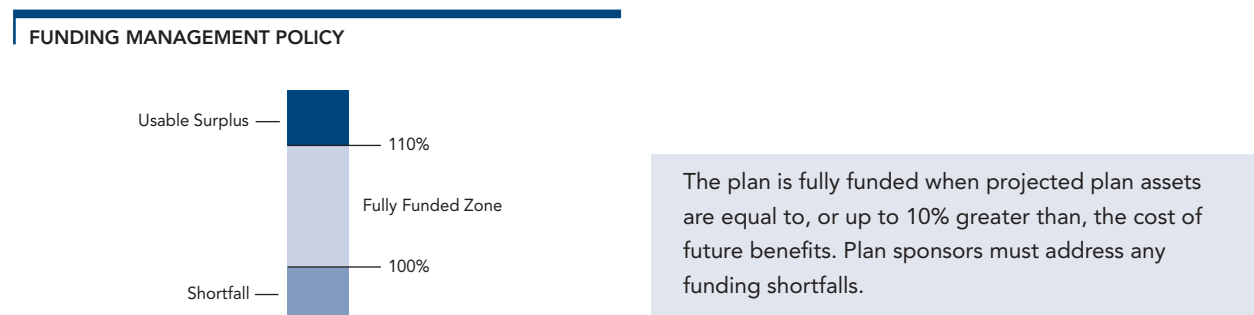
## Funding approach

The plan's funding approach is aimed at providing pension security for all generations of plan members. The goal is to pay benefits as they come due while keeping contribution rates affordable. This requires ongoing effort and a spirit of cooperation and consensus among the two plan sponsors, who are responsible for all funding decisions, and the plan's board members.

The plan sponsors have adopted a Funding Management Policy that sets out guidelines indicating when funding surpluses may be used and how shortfalls may be addressed. The policy also includes a range in the real-rate-of-return assumption used for funding valuations – the assumption is based on the real interest rate plus a premium of either 0.5% or 1.4%, depending on the plan's financial strength. The policy calls for the lower basis (0.5%) when the plan is in a strong financial position, enabling the plan to build up an asset cushion. The policy calls for the higher basis (1.4%) when the plan's finances are weaker, and helps the plan to absorb short-term changes in market returns and so keep contributions and benefits stable in less favourable times.

Under the Funding Management Policy, the plan is considered fully funded when plan assets are equal to, or up to 10% greater than, the cost of future benefits. When assets exceed future benefits by more than 10%, the surplus can be used to lower contribution rates, improve benefits, or a combination of both.

When assets fall below the plan's fully funded zone, the plan sponsors must address funding shortfalls to rebalance the plan.



The plan sponsors have four options for resolving shortfalls:

1. increase contribution rates;
2. invoke conditional inflation protection;
3. reduce other future benefits; or
4. a combination of these measures.

If plan sponsors were to decide to increase contribution rates, the current maximum rate in the Funding Management Policy is 15% of members' base earnings above the Canada Pension Plan (CPP) limit, matched by the government and designated employers.

Conditional inflation protection offers a safety valve to help manage funding shortfalls. If the sponsors were to invoke conditional inflation protection in a valuation filing, annual cost-of-living increases for anyone who retired before January 1, 2010, would not be affected; however, annual cost-of-living increases for future retirees would be determined as follows:

- The portion of a member's pension credit earned until the end of 2009 would still be 100% protected against changes in the cost of living.
- Inflation protection for pension credit earned after December 31, 2009, is guaranteed at 50%, with up to 100% indexation possible, with sponsors making the decision on the percentage payable based on the plan's funding status.

Any reduction in the indexation factor will remain in effect until a subsequent funding valuation for filing shows there are sufficient funds to provide full inflation protection again. If there is enough surplus, inflation protection up to the 100% level could be restored on a go-forward basis to reflect previously unrecognized inflation. On the other hand, if a funding shortfall still exists following the implementation of conditional inflation protection, further contribution increases or future benefit reductions would be required.

If the sponsors were to invoke conditional inflation protection, the Ontario government and designated employers participating in the plan would continue to share pension costs by making extra contributions equal to any cost-of-living increases members do not receive. Until then, the actuary projects pension costs, including the cost of 100% inflation protection, because it is assumed the plan will provide full inflation protection if there is sufficient funding to allow it.

The plan sponsors, together with pension plan management, created a tripartite Sustainability Working Group to consider all possible ways to deal with the plan's persistent funding challenges. Under existing Ontario law, pension benefits already earned by working and retired members cannot be reduced. The Working Group's recommendations are due by mid-2010. No change to contribution rates or benefits will occur before the plan files a funding valuation with the pension regulator. The next valuation must be filed by September 30, 2012, although the sponsors may decide to file sooner.

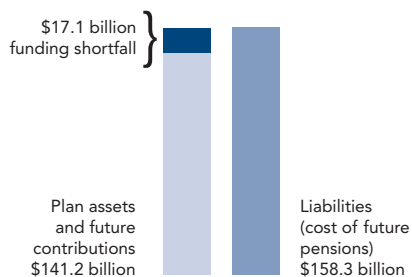
## Summary of funding status

In 2009, the plan filed a balanced valuation with the provincial pension regulator, showing there were enough assets to cover the cost of future benefits as at January 1, 2009. Please see page 18 for more details.

As detailed on page 20, the plan began the new year with a preliminary shortfall of \$17.1 billion when assets (including future contributions) as at January 1, 2010, were compared to the projected cost of benefits already earned plus those expected to be earned by current members in the future. With this shortfall, the plan was 89.2% funded at the beginning of 2010.

### PRELIMINARY FUNDING VALUATION

(as at January 1, 2010)



A history of funding valuations and related decisions is on page 109.

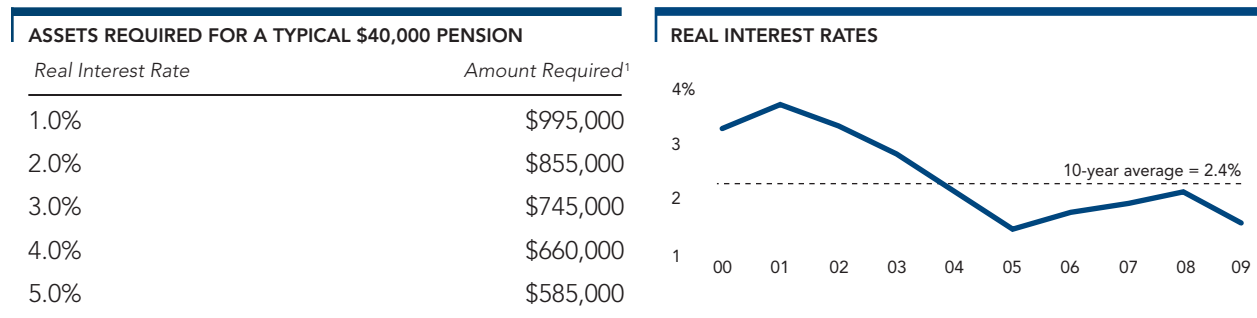
## Funding challenges

Management projects ongoing shortfalls due to a combination of factors, which are discussed below. Many defined benefit pension plans worldwide face similar funding challenges and are having to make the tough decisions needed to balance assets and pension liabilities. This plan is among the first large Canadian pension plans to face this reality because it is a mature pension plan; that is, the cost of future benefits is growing faster than plan assets.

### Interest rate environment

Low real interest rates – the rate above inflation – drive pension costs up because they substantially affect projections of the amount of money required now to fund pensions in the future. Securing a typical \$40,000 pension requires 23% more money when real interest rates are at 1.5% than at 3%. The 1.5% real interest rate for long-term bonds at 2009 year end is historically low.

The present value of pension liabilities goes up when interest rates decline, and goes down when interest rates rise. We use the yield on long-term Government of Canada 30-year Real-Return Bonds (RRB) to determine the present value of the plan's liabilities. This rate declined during 2009 from 2.1% at the start of the year to 1.5% at the end.



<sup>1</sup>For retirement at age 58.

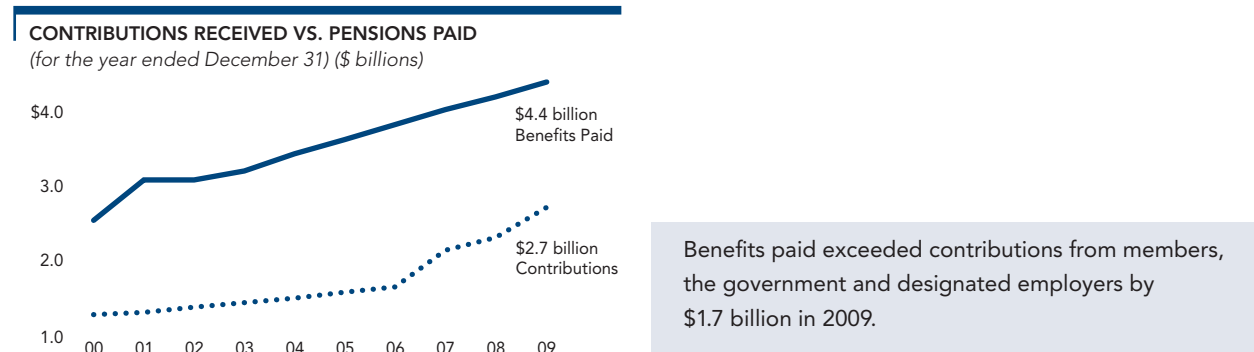
While declining interest rates provide some benefit by increasing the value of portfolio assets such as bonds, real estate, infrastructure and timberland, this is outweighed by an upward impact on the present value of liabilities.

### Plan maturity

The Teachers' pension plan is mature. There are currently 1.5 working teachers for each retiree. This ratio is projected to fall to approximately 1.2:1 in 10 years. As a result, a declining proportion of the membership carries increased responsibility for meeting the plan's funding requirements. Meanwhile, pensions now are being paid for longer periods, given member life expectancies. The funding valuation uses the most up-to-date life expectancy assumptions.

A typical teacher retiring in 2009 has 26 years of pension credit and is expected to receive a pension for 30 years, plus a survivor may be paid after that. Working teachers can expect to collect their pensions for longer than they contributed to the plan.

The plan pays out more in total benefits each year than it receives in total contributions. In 2009, benefits paid exceeded contributions received by \$1.7 billion. This has been the trend for many years and is projected to continue in the future. The mature nature of the plan means our investment managers must carefully weigh the amount of risk taken to generate returns.



The ability of contributions to absorb funding shortfalls and keep the plan fully funded has changed dramatically since 1990. This is due to two reasons: growth in the size of the fund relative to the value of future contributions and the declining ratio of working-to-retired teachers. Working teachers are the only members who make contributions. These are matched by the provincial government and designated employers, such as private schools that participate in the plan.

In 1990, future contributions represented 42% of the plan's net assets. If the plan had experienced a shortfall, contributions could have been increased to close the gap. Future contributions now represent only 26% of net assets. Consequently, this low ratio of working teachers to pensioners and the small percentage of contributions to total assets make it increasingly difficult to overcome funding deficiencies using contribution rate increases alone. Teachers' investment managers operate within an asset mix with a moderate equity allocation, while exploiting opportunities and using diversification and innovation to maximize returns within that mix. Conditional inflation protection will, over time, provide some flexibility. But, because of the maturity of this plan, we will still be more constrained than other large pension plans that are less mature.

#### DECLINING RATIO OF WORKING-TO-RETIRED MEMBERS

	1970	1990	2009
Active members per retiree	10:1	4:1	1.5:1
Expected years on pension	20	25	30
Present value of contributions as a percentage of net assets <sup>1</sup>	93%	42%	26%
Increase in contribution rate for 10% decline in asset values	0.56%	1.9%	4.3%

<sup>1</sup> Assuming the plan is fully funded and current contribution rates.

The low ratio of working-to-retired teachers makes it difficult to overcome funding shortfalls with contribution increases alone. Consequently, our investment managers must be as concerned with potential losses as they are with potential investment gains.

#### Smoothing losses and gains

Because pension plans invest and pay benefits over decades, they "smooth" certain investment gains and losses over five-year periods. Smoothing applies to returns above or below the rate of inflation plus 6% generated by holdings other than fixed income securities. Returns below 6% plus inflation are considered losses for smoothing purposes.

Smoothing insulates contribution rates and benefits against the extremes of portfolio return volatility. The smoothing adjustment (also called the "actuarial asset value adjustment") is further discussed in Note 4 to the consolidated financial statements.

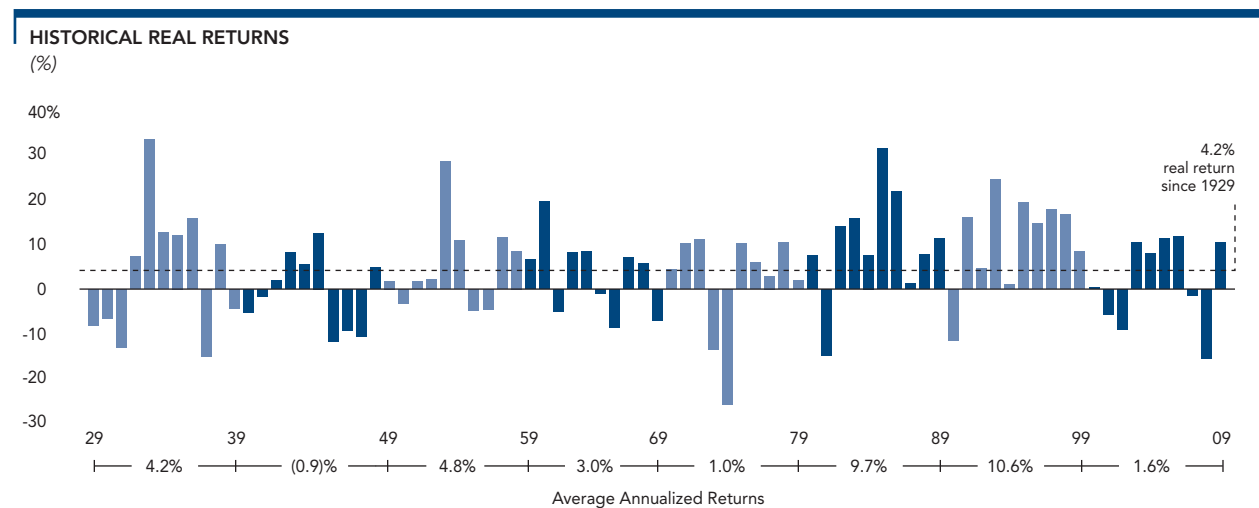
Recognizing the remainder of the unamortized investment loss from 2008 over the next three years ending in 2012 will have a significant impact on the plan's funding status.

As gains also are smoothed, \$3.3 billion of 2009's gains have been deferred and will be recognized over the next four years. Unamortized gains and losses totalled \$12.7 billion at the end of 2009. This loss will be recognized over the next four years.

The smoothing adjustment may show "losses" in years when we experienced positive returns if non-fixed income returns are below our 6% plus inflation expectation for these assets.

**Modest investment returns**

History's most powerful bull market began in 1982 and ended in 2000. Since then, market returns have reverted to lower historical levels. Investment returns, together with contributions at current rates, are projected to be insufficient to cover future pension costs. We expect returns over the next decade to be modest. Teachers' investment program has a long and strong record of generating value-added performance, but the mature demographics of the plan's membership has increased the challenge we face.



This graph shows how a hypothetical global portfolio (60% equities,<sup>1</sup> 40% fixed income) would have performed over the last 80 years. This portfolio earned an average real return of 4.2% over the 80-year period.

<sup>1</sup> 21% Canadian, 17% U.S., 22% EAFE.

Sources:

Canadian equities (S&P/TSX Composite) – Global Financial Database until 1976, Global Insight thereafter.  
 US equities (S&P 500 Composite) – Global Financial Database until 1976, Global Insight thereafter, translated to Canadian dollars.  
 Non-Canadian equities (MSCI EAFE) – Global Financial Database until 1981, Datastream thereafter, translated to Canadian dollars.  
 Fixed income – Total Return index estimated from long-term government bond yield data from Global Financial database, Global Insight thereafter.  
 Exchange rate data comes from Global Financial database until 1992 and WM Reuters thereafter.  
 All returns converted into real dollars using Canadian CPI.

## Addressing the funding challenge

The plan relies heavily on the investment program to generate the returns required to pay pensions. We continually look for the best new opportunities and techniques to earn the required investment returns without adding to the fund's risk exposure.

Based on current projections, it would not be prudent to assume that the plan can earn enough to cover the projected cost of future pensions at current funding levels. Our demographics dictate that we must have a lower risk investment strategy, and this is further aggravated by the projected low return environment.

## Funding valuation filed in 2009

A balanced funding valuation must be filed with the pension regulator at least every three years, but plan sponsors have the option of filing earlier.

In 2009, the plan filed a funding valuation as at January 1, 2009. This submission was made only one year after the previous filing in 2008. Due to the smoothing adjustment through which large gains and losses are recognized over five years, this filing reflected one-fifth of the loss incurred in 2008. Essentially, the early filing provides the plan sponsors with an additional year to develop and discuss any contribution rate and/or benefit changes considered necessary to balance plan assets and pension costs over the long term.

To prepare for the filing, the plan sponsors resolved a \$2.5 billion preliminary funding shortfall that had been projected as at January 1, 2009, and reported in last year's annual report. Most of the projected shortfall was eliminated by assuming a slightly higher long-term real investment return than was used in the preliminary valuation: the real interest rate plus a 1.5% premium was used, instead of a 1.4% premium. The real interest rate is the yield from long-term Government of Canada Real-Return Bonds. Using this slightly higher investment return assumption allowed the plan to file a balanced valuation and give the sponsors more time to evaluate options to address funding shortfalls. The rest of the shortfall was eliminated by a minor change in a non-economic actuarial assumption.

The following tables reconcile the 2009 preliminary and filed funding valuations and the assumptions used for each.

<b>FUNDING VALUATION<sup>1</sup></b> <i>(as at January 1)(\$ billions)</i>	<i>2009 Filed</i>	<i>2009 Preliminary</i>
Net assets	\$ 87.4	\$ 87.4
Smoothing adjustment	19.5	19.5
Future contributions	25.9	25.1
Future special contributions	5.5	5.5
Actuarial assets	138.3	137.5
Future benefits	(137.5)	(140.0)
Surplus/(deficit)	\$ 0.8	\$ (2.5)

<sup>1</sup> Valuation dates determined by co-sponsors.



<b>FUNDING VALUATION ASSUMPTIONS<sup>1</sup></b> (percent)	<i>2009 Filed</i>	<i>2009 Preliminary</i>
Rate of return	5.00	4.90
Inflation rate	1.35	1.35
Real rate of return	3.65	3.55

<sup>1</sup>The final valuation used a slightly higher assumption (real interest rate plus 1.5%) than the assumption in the current Funding Management Policy (real interest rate plus 1.4%), explained on page 13.

## Measuring the state of the plan annually

### Use of estimates

Canadian Generally Accepted Accounting Principles (GAAP) require us to make estimates when we account for and report assets, liabilities, investment income and expenses, and to disclose contingent assets and liabilities in the plan's financial statements. We are also required to continually re-evaluate the estimates that we use. We have reviewed the development and selection of critical accounting estimates with the Audit and Actuarial Committee of the board.

Actuarial assumptions used in determining accrued pension benefits reflect best estimates of future economic and non-economic factors proposed by management and approved by board members. The primary economic assumptions include the discount rate, salary escalation rate and inflation rate. The non-economic assumptions include plan member mortality, withdrawal and retirement rates. The plan's actual experience will differ from these estimates and the differences are recognized as gains or losses in future years.

The fair value of each investment and investment-related liability is an estimate of the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Management's and third-party appraisers' best estimates are used in selecting the assumptions to determine the fair value of investments that are not publicly traded.

### Comparing the financial and funding valuations

Achieving balance between plan assets and the cost of future benefits is an ongoing job for the plan sponsors. Teachers' management assesses the funding position of the plan each January, and offers the sponsors advice and analytical support on plan funding issues.

We report two valuations of the plan:

- Financial statement valuation: This valuation is prepared by an independent actuary based on best estimates provided by management and approved by board members. It takes into account pension credit accrued to date by current retirees, inactive and active members, and contributions already received by the plan. This method is prescribed by the Canadian Institute of Chartered Accountants (CICA) and is designed to facilitate comparisons between different organizations' plans.

- Actuarial valuation for funding purposes: Also called the funding valuation, this too is prepared by an independent actuary using assumptions approved by the plan's board members. It determines the long-term financial health of the plan at current contribution rates by calculating benefits earned to date, plus projected future benefit costs and contributions. The actuary projects the plan's benefit costs (including the cost of between 50% and 100% of the annual change in the consumer price index for post-2009 service, depending on the plan's funding status) and compares them to plan assets. The actuary then adds in future contributions from current teachers, the government and other designated employers (plus future special contributions from the government and designated employers as well as current and future teachers until 2021). The projection includes the future cost of pensions for current members, but does not include the cost of benefits for teachers who are expected to be hired in the future. This valuation is required by law to be balanced and filed with the pension regulator at least every three years. It is used by the sponsors to establish benefit and contribution rates.

The report of the Ontario Expert Commission on Pensions (The Arthurs Report) recommended that jointly sponsored pension plans such as Teachers' should be exempt from the additional funding required by a third valuation, which is commonly referred to as a "solvency valuation." We are calling on the Ontario government to enact this Arthurs Report recommendation.

#### COMPARING THE FINANCIAL AND FUNDING VALUATIONS<sup>1</sup>

<i>(\$ billions)</i>	<i>Preliminary Funding at Jan. 1, 2010</i>	<i>Financial at Dec. 31, 2009</i>
Net assets	\$ 96.4	\$ 96.4
Smoothing adjustment	12.7	12.7
Future contributions	26.7	–
Future special contributions	5.4	–
Actuarial assets	141.2	109.1
Future benefits	(158.3)	(131.9)
Deficit	\$ (17.1)	\$ (22.8)

<sup>1</sup> Based on assumptions in the Funding Management Policy.

### Financial statement valuation at December 31, 2009

The plan ended 2009 with a financial statement deficit of \$22.8 billion. This compares to a deficit of \$11.2 billion for 2008. The discount rate used in the financial statement valuation was 4.6%, which is equal to the yield of long-term Government of Canada Real-Return Bonds, plus 0.5%, plus the assumed inflation rate (see Note 5 (a) to the consolidated financial statements on page 94). The financial position of the plan is summarized in three accompanying tables on pages 21 and 22.

As **Table 1** shows, net assets available for benefits totalled \$96.4 billion, up \$9.0 billion from 2008. After allowing for the smoothing adjustment discussed on page 16, actuarially adjusted net assets totalled \$109.1 billion, up \$2.2 billion from 2008. The cost of future pensions on a financial statement basis was \$131.9 billion (\$118.1 billion in 2008). The actuarial assumptions used to determine the cost of future benefits payable in the future in respect of past service include management's best estimates of teachers' future salaries and demographic factors.

The \$22.8 billion deficit represents the difference between the cost of pensions earned to date and actuarially adjusted net assets.

<b>TABLE 1: YEAR-END FINANCIAL POSITION</b> <i>(as at December 31) (\$ billions)</i>	2009	2008
<b>Net assets available for benefits</b>		
Net investments	\$ 93.5	\$ 85.1
Contributions receivable from Province of Ontario	2.5	2.2
Other net assets	0.4	0.1
<b>Net assets</b>	<b>96.4</b>	<b>87.4</b>
<b>Financial status</b>		
Net assets	96.4	87.4
Smoothing adjustment	12.7	19.5
<b>Actuarially adjusted net assets</b>	<b>109.1</b>	<b>106.9</b>
Cost of future pensions <sup>1</sup>	(131.9)	(118.1)
<b>Deficit</b>	<b>\$ (22.8)</b>	<b>\$ (11.2)</b>

<sup>1</sup> See Table 3.

**Table 2** notes that investment returns in 2009 amounted to \$10.9 billion compared with a \$19.0 billion loss in 2008. Contributions received totalled \$2.7 billion, while \$4.4 billion was paid out in benefits. This compares with contributions of \$2.3 billion and benefit payments of \$4.2 billion in 2008.

The member contribution rate was increased on January 1, 2009, as the final increase required to balance the January 1, 2005 actuarial funding valuation. The contribution rate for teachers in 2009 was 10.4% of earnings up to the Canada Pension Plan (CPP) limit of \$46,300 and 12.0% of earnings above that. This rate is unchanged for 2010, but the 10.4% increment will apply to the first \$47,200, reflecting an increase in the CPP limit. These contributions are matched by the government and other designated employers.

<b>TABLE 2: CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS</b>		
<i>(for the year ended December 31) (\$ billions)</i>	2009	2008
<b>Income</b>		
Investment income/(loss)	\$10.9	\$(19.0)
Contributions	2.7	2.3
	13.6	(16.7)
<b>Expenditures</b>		
Benefits	4.4	4.2
Operating expenses	0.2	0.2
	4.6	4.4
Increase/(decrease) in net assets available for benefits	\$ 9.0	\$(21.1)

The benefits paid shown in **Table 3** include the addition of 4,100 retirement and disability pensions and 700 survivor pensions during 2009, as well as a 2.5% cost-of-living increase effective January 1, 2009. The annual cost-of-living adjustment effective January 1, 2010, was 0.5%, the lowest percentage increase since 1976 when automatic indexing was introduced.

<b>TABLE 3: ACCRUED PENSION BENEFITS</b>		
<i>(for the year ended December 31) (\$ billions)</i>	2009	2008
Accrued pension benefits, beginning of year	\$118.1	\$115.4
Interest on accrued pension benefits	4.7	5.3
Benefits earned	3.6	3.5
Benefits paid	(4.4)	(4.2)
	122.0	120.0
Changes in actuarial assumptions <sup>1</sup>	10.0	(2.3)
Experience (gains)/losses	(0.1)	0.4
Accrued pension benefits, end of year	\$131.9	\$118.1

<sup>1</sup> See Note 5(a) to the consolidated financial statements on page 94.

**Funding valuation as at January 1, 2010**

The plan began 2010 reporting a preliminary funding shortfall of \$17.1 billion to cover benefits already earned plus those projected to be earned in the future by current members (as shown on page 20). The cost of future benefits at January 1, 2010, is estimated at \$158.3 billion, while assets (actuarial) are estimated at \$141.2 billion.

In accordance with the sponsors' Funding Management Policy, the rate-of-return used in the funding valuation is 5.5%, which is equal to the yield on long-term Government of Canada Real-Return Bonds, the board's choice of interest rate, plus 1.4%, plus the assumed inflation rate. This rate of return is higher than the discount rate used in the financial statement valuation, as it takes into account the expected rates of return for this fund's asset mix, as well as the required risk balance needed to manage the growing maturity of the plan.

Valuation assumptions change over time. While actual experience mirrors some assumptions closely, annual market returns (excluding fixed income and real-return bonds) typically fluctuate much more significantly compared to the assumption and so are smoothed over five years. The following table shows the assumptions used in this valuation. (Assumptions used for valuations filed previously with the pension regulator are found on page 109.)

<b>FUNDING VALUATION ASSUMPTIONS</b>	
<i>(percent)</i>	<i>2010</i>
Rate of return	5.50
Inflation rate	2.55
Real rate of return	2.95

# INVESTMENTS

*“During the 2008 market sell-off, we maintained a strong liquidity position and avoided selling high-quality assets at a loss. Those assets remained in the fund to grow again for plan members in 2009.”*



**Neil Petroff, MBA**  
Executive Vice-President, Investments  
and Chief Investment Officer

## Performance highlights

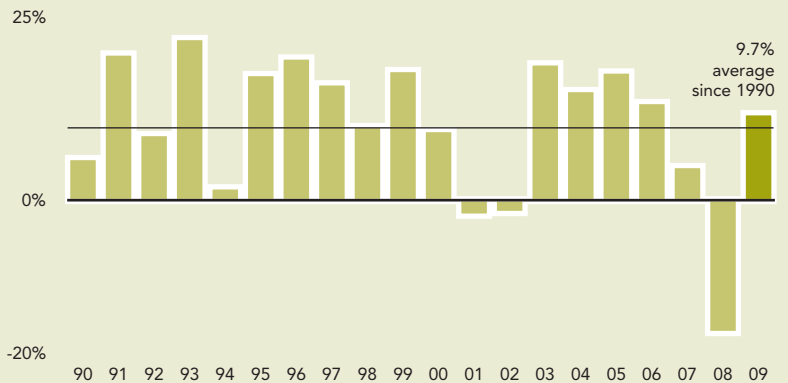
**13.0%** return

**8.8%** benchmark return

- > Exceeded the fund benchmark by 4.2 percentage points, adding \$3.4 billion in value above the benchmark
- > Investment income of \$10.9 billion fuelled net asset growth to \$96.4 billion

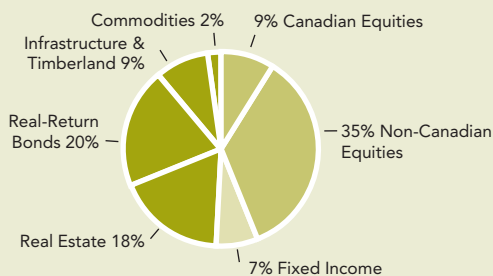
### Rates of return

(for the year ended December 31)



### Actual asset mix

(as at December 31, 2009)



■ 49% Inflation-Sensitive Investments
 ■ 44% Equities
 ■ 7% Fixed Income

▲ **4.0%** return     
 ▲ **21.4%** return     
 ▲ **23.6%** return

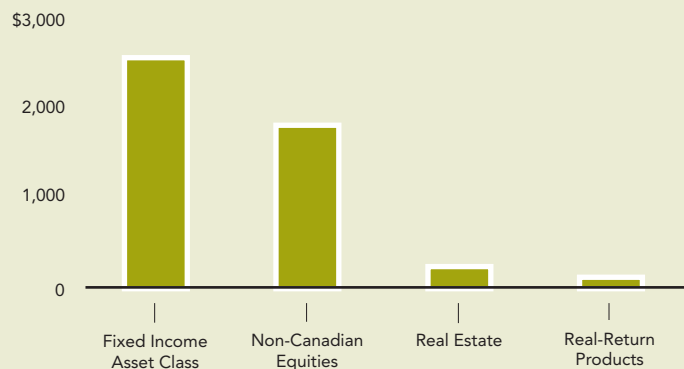
*Equities includes public and private equity.*

# What we're doing to help meet pension obligations

## Actively managing assets to boost returns

### Major sources of above-benchmark performance

(for the year ended December 31) (\$ millions)

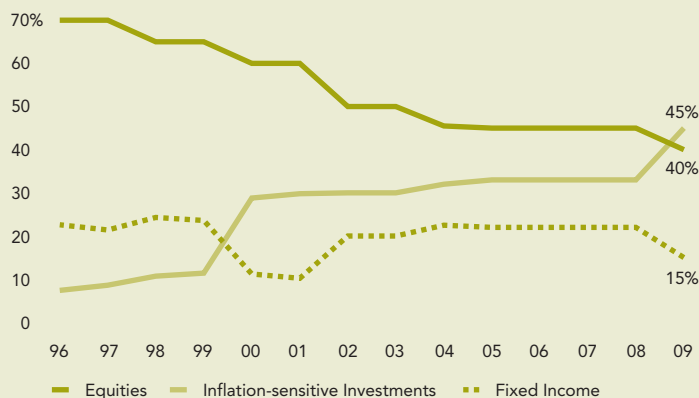


**\$3.4** billion in value-added performance

- > Decisions several years ago to make major investments in Brazil – one of the world's hottest markets last year – are paying off (see page 38).
- > Credit products and hedge funds, which performed poorly in 2008, as well as active currency management pushed performance well ahead of the fixed income benchmark (see page 39).

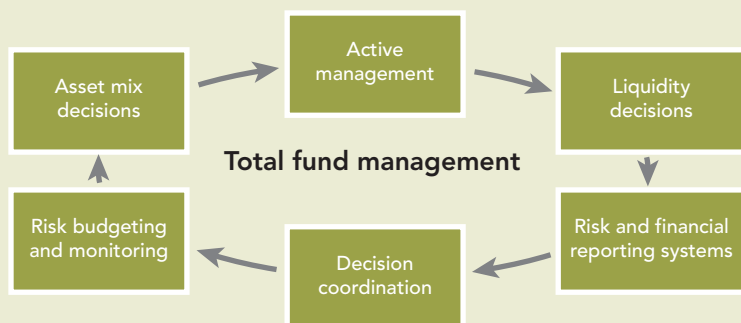
## Protecting assets from undue losses as we invest for the future

### Asset-mix policy



- > Our asset-mix policy at the end of 2009 reflects the plan's lower risk tolerance due to plan maturity.

## Collaborative investment and risk management



- > We use a total fund management style that encourages the sharing of information and movement of capital among asset classes and portfolios to optimize risk-adjusted returns.



## Goals

The investment program exists to earn the returns required to help meet the plan's funding needs. The goal is to generate strong enough performance so that together, plan assets and contributions at stable, affordable rates equal the cost of future benefits over the long term.

Contribution rate stability can best be achieved by minimizing the difference between asset values and pension obligations. Contribution affordability is a function of the benefit design set by the plan's sponsors and the extent to which investment income plus contributions can reasonably be expected to cover pension costs.

We seek to meet the plan's needs by maximizing returns at an appropriate level of risk, taking into account pension liabilities and the challenges presented by the plan's mature membership profile. The membership profile has matured as the ratio of working teachers to pensioners has declined (see page 16).

We expect the trend will continue. The mature status of the plan means our investment managers are limited in how much risk they can take to generate returns. Conditional inflation protection, approved by the plan's sponsors in 2008 for benefits earned after 2009, will increase the plan's tolerance for risk but only over time.

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### OUR STRATEGY HAS THREE COMPONENTS:

Determine a level of investment risk that is appropriate for the plan's membership profile and implement strong risk management practices

Select the most appropriate asset mix for providing investment income and protecting the fund from undue losses

Use active management and innovative thinking to add value above the returns available from passive investing

Supporting our investment strategy are corporate governance activities, a duty to consider all appropriate investments, and efforts to attract, develop and retain the best talent in the industry.

# Managing the pension balance

Pension plan assets and liabilities (the cost of future pensions) must balance over the long term.

We have a responsibility to manage the investment fund in the best interest of present and future plan members and their survivors.

We invest with a long-term focus because the pension plan will be paying benefits to today's young teachers 70 years or more from now. We look at the plan's liabilities, how long they will be paid and how they will behave in the future. Then we seek investments within appropriate risk limits that have the best possibility of meeting the plan's long-term needs.

## Risk-conscious culture

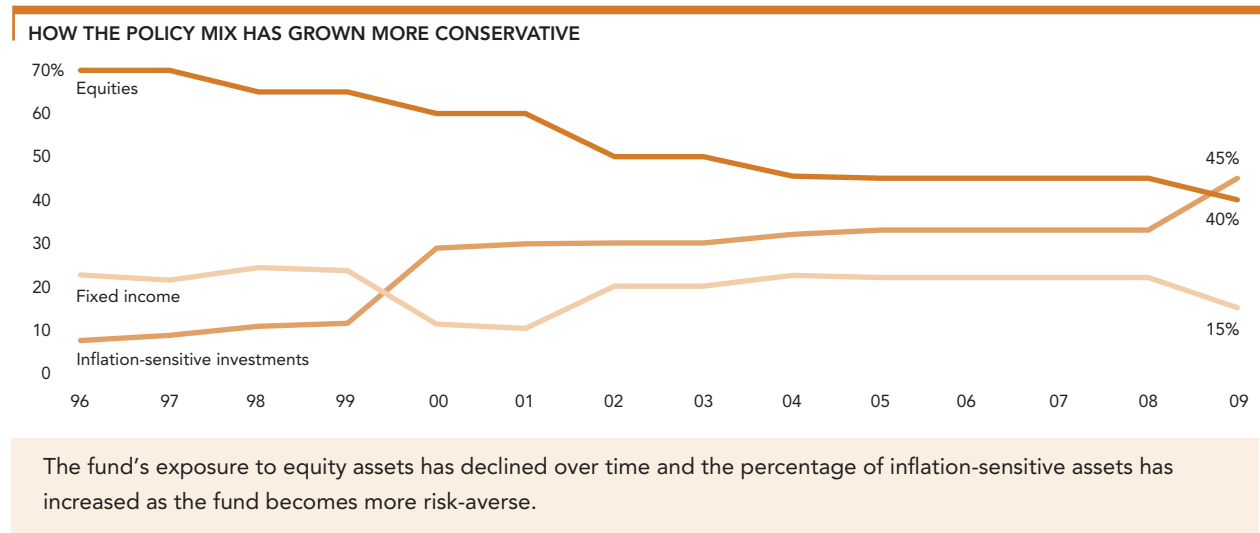
Risk plays a critical role in our investment activities and we manage funding and investment risks carefully. As the plan has matured and the plan's risk tolerance has decreased, our approach has become increasingly risk driven and we operate within a risk-conscious culture.

We spend considerable resources determining the optimal level of risk and ensuring the types of risk we take are appropriate. Our investment managers must be as concerned about the potential for loss from an investment as they are about how much could be earned.

Risk can come from both sides of the balance sheet. The asset side risk is obvious; investments can, and do, decline in value periodically. The liabilities contribute to risk in a less obvious but major way. As described on page 15, falling real interest rates dramatically increase our best estimate of the plan's liabilities. Increased life expectancy also augments pension costs.

These factors can cause assets and projected liabilities to move independently. That is why there are years such as 2009 when our investments performed well but the plan still had a funding shortfall. Falling real interest rates drove up the present value of liabilities in 2009.

Managing these various risks requires collaboration across portfolios aided by risk and accounting systems that provide consolidated, coordinated views of the entire fund and its components.



## Managing risk

One of the lessons of the global financial crisis was that risk cannot be managed in isolation. Many investors were forced to sell high-quality public equities, incurring large realized losses, during the 2008 financial crisis because they needed money and there was no market for illiquid assets. Those illiquid asset holdings fit within these investors' risk parameters during normal market conditions but obviously did not during abnormal market conditions and ultimately undermined their entire asset-mix strategy.

While our investment discipline ensured that we did not have to sell good assets at a loss in 2008, we are refining the execution of our investment strategy to more closely integrate risk, capital and liquidity management. This is all the more appropriate given the maturity of this pension plan.

The shaded area following is a discussion of risk management policies and procedures relating to credit, market and liquidity risks as required under the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3862, Financial Instruments – Disclosures, which permits these specific disclosures to be included in the MD&A. It forms an integral part of the audited consolidated financial statements for the year ended December 31, 2009.

Our goal always is to maintain market and credit risks at both the overall fund and department levels within the allowable ranges set by members of our board for the total fund and by senior management for individual portfolios.

We manage investment risk on a daily basis in accordance with our investment objectives and policies.

The Investment Committee of the board, which comprises all board members and meets a minimum of 10 times a year, monitors overall investment risk exposure. The board members review and approve risk management policies that affect the total portfolio and new investment programs that introduce incremental risk to the plan.

Our risk management activities concentrate on the ultimate risk facing the plan – the risk that the plan's assets will fall short of its liabilities (the benefits owed to members). We recognize that funding risk can come from assets or liabilities. The biggest risk to projected liabilities is real interest rates: a 1% decline in real interest rates increases projected liabilities by 21% on a funding basis and by 18% on a financial statement basis. The biggest risk to plan assets is a decline in equity markets.

Over the past 15 years, we have developed a robust risk system that provides the investment managers with the flexibility to examine and compare a wide range of strategies and different asset classes and to calculate the benefits of diversification across strategies, asset classes, departments and portfolios. To understand the long-term dynamics of the total risk in the plan, we also review conditions for the different asset classes and maintain a comprehensive asset-liability model.

Through our risk system, we measure the potential loss within each portfolio, series of portfolios, across departments, across asset classes and finally at the total fund level. Risk calculations are also computed relative to the plan's liabilities and benchmarks. We monitor and report the observed risk values against those budgeted.

Last year's annual report stated that this system would be enhanced to keep pace with investment product complexities and loss probabilities. In 2009, we launched a multi-year project to further expand and improve risk systems and reporting accuracy and develop a more holistic approach to data governance. This is a considerable undertaking and requires a team of 30 dedicated staff. The intent is to better manage data, integrate systems, more accurately report on risk, strengthen risk modelling and provide investment managers with more useful reports to aid their decision-making. Among other things, this system will broaden the capture of the terms and conditions related to the complex financial products in which we invest and make this information readily accessible to analysts and portfolio managers.

Related to this project was the creation of a Data and Process Council. This permanent body, comprising senior investment, finance and information technology managers, oversees efforts to continually improve and maintain the integrity of our data and processing systems. This forum strives to address issues related to the timeliness, accuracy and completeness of reporting of risk and financial data. In addition, the Data and Process Council establishes and monitors metrics, determines process performance goals, and sets and defines tasks and processes that achieve these goals across all departments and systems involved in the investment lifecycle.

We use risk budgeting to allocate risk across the fund's asset classes. The risk budget is presented to board members annually for review and approval. The data in our risk system is updated continuously and now includes the 2008–2009 market experience. As a result, the market events that the system is designed to reflect are now more extreme than they were two years ago.

The fund's current liquidity position is governed by the plan's liquidity policy and reported regularly to the board's Investment Committee. Sufficient liquidity is necessary to meet short-term mark-to-market payments resulting from the plan's derivative exposure and to allow the plan to adjust the asset mix in response to market movements. The fund's liquidity position is analyzed daily and periodically tested by simulations of major events such as significant movements in the markets.

Counterparty risk management has also been enhanced and is monitored across the entire fund by a new Investment Division Credit Counterparty Committee. It reports to the Investment Planning and Risk Committee, which also reports to board members on a regular basis.

More information on our investment risk management activities is provided on our website and in Note 2 to the consolidated financial statements. Please see page 59 for more information on Enterprise Risk Management (ERM).

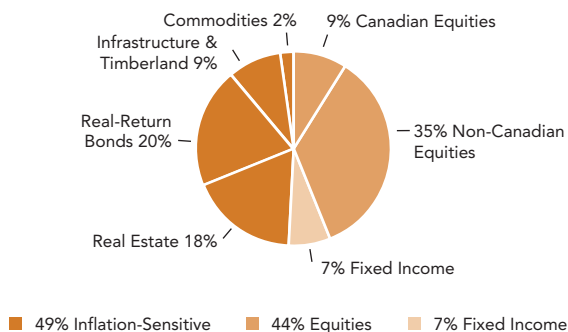
### Setting asset-mix targets

The board members approve the asset-mix policy at least annually, making modifications as required and giving management discretion to adjust the weighting, within board-approved limits, in either direction to take advantage of investment opportunities as they arise.

In 2009, the asset-mix policy was 45% inflation-sensitive investments, 40% equities and 15% fixed income. Allocations will likely be adjusted throughout 2010 to reflect a changing macro-economic outlook and other factors.

#### ACTUAL ASSET MIX

(as at December 31, 2009)



<b>NET INVESTMENTS BY ASSET CLASS</b>		
<i>(for the year ended December 31) (\$ billions)</i>	2009	2008
<b>Equities</b>	<b>\$41.2</b>	<b>\$34.9</b>
Canadian	8.4	6.2
Non-Canadian	32.8	28.7
<b>Fixed income<sup>1</sup></b>	<b>6.4</b>	<b>5.3</b>
Bonds	13.5	11.5
Absolute return strategies and hedge funds	8.4	14.8
Money market and related liabilities	(15.5)	(21.0)
<b>Inflation-sensitive investments</b>	<b>45.9</b>	<b>44.9</b>
Real estate	17.2	16.2
Real-return bonds	18.9	17.4
Infrastructure and timberland	7.9	10.0
Commodities	1.9	1.3
<b>Net investments<sup>2</sup></b>	<b>\$93.5</b>	<b>\$85.1</b>

<sup>1</sup> See page 39 for a definition of the fixed income asset class.

<sup>2</sup> Net investments plus contributions and other net assets (liabilities) equal net assets available for benefits of \$96.4 billion at year-end 2009. Net investments are defined as investments (\$123.9 billion) minus investment-related liabilities (\$30.4 billion) as noted on the Consolidated statement of net assets available for benefits and accrued pension benefits and deficit (page 72).

## Approach to long-term value creation

Several strategies are used to maximize returns by adding value greater than the performance of the markets in which we invest.

We use a total-fund management style that encourages the sharing of information and movement of capital among managers of asset classes and portfolios to optimize risk-adjusted returns. We reward portfolio managers for maximizing value-added returns within the risk limit on total assets, not just their own portfolios. During the past year we took steps to reinforce and enhance the total-fund management approach. Among those steps:

- Leaders of various asset teams now meet regularly to share ideas and consider whether capital should be redeployed from one area to another. They are aided by improvements to the risk and financial reporting systems discussed above. Particularly important is coordinating value-added decisions at the level of the total fund, monitoring the level of investment risk across the total fund, ongoing management of fund-wide liquidity and assessing asset-mix decisions to enhance our long-term investment strategy.
- Broader committees have been established to maintain a fund-wide view of exposure categories. For example, one committee monitors credit exposures and counterparty risks across all asset classes while another committee monitors all emerging markets exposures.

Active management is instrumental to the ongoing success of the plan. Active management means selecting securities we believe are undervalued, as well as under- or overweighting various asset classes relative to the asset-mix policy approved by the board members. The objective is to exceed the returns available from passively investing in benchmark indexes at policy weights. Management does not believe that passive investing through conventional public equity and fixed income market indexes can, with confidence, generate the risk-adjusted returns the plan requires. Based on fundamental and quantitative analysis, we also over- or underweight individual index components, asset classes, sectors and foreign currency positions. This strategy, known as overlays, aims to exploit medium-term investment opportunities.

Risk is allocated to investment strategies to construct a well-diversified portfolio capable of generating superior returns on a risk-adjusted basis. The largest active risk budgets currently are in private equity, public equities and real estate. These assets have earned significant returns above their benchmarks over time. We are able to allocate risk to illiquid assets (such as real estate and private equity) because of our long-term investment horizon.

As discussed below, we also seek to create long-term value by championing sound corporate governance with market regulators and with the companies in which we invest.

### **Corporate governance**

Teachers' has been a leader in this field because we believe there is a direct correlation between adherence to proper governance standards and the creation of long-term value for shareholders. This view is discussed in our guidelines, *Good Governance Is Good Business*, available on our website.

To encourage improved standards and practices, we review and publish our recommended corporate governance policies and proxy voting guidelines each year. As well, proxy voting decisions are posted in advance on our website and we communicate regularly with boards of directors to advance the interests of our plan members.

[www.otpp.com](http://www.otpp.com) > [Governance](#) > [Proxy votes](#)

During 2009, Teachers' voted on 5,249 proposals presented at shareholder meetings of 584 companies – 82 in Canada, 354 in the United States and 148 elsewhere. A list of votes by company is available on our website, as are our proxy voting guidelines.

Teachers' is active in the Canadian Coalition for Good Governance, the Global Institutional Governance Network, the International Corporate Governance Network, the U.S. Council of Institutional Investors, the Asia Corporate Governance Association, the Institute of Corporate Directors and the corporate governance subcommittee of the Pension Investment Association of Canada. In 2009, we were one of only two non-American participants on an American Bar Association task force that produced a report for U.S. corporations titled *Delineation of Governance Roles and Responsibility*.

Notable developments in 2009:

- The Ontario Securities Commission approved a TSX rule change to require that public issuers obtain shareholder approval for public company acquisitions that result in the issuance of 25% or more of their outstanding shares. This change, which we first advocated in 2006, not only protects shareholders from excessive dilution but makes Canada's capital market more attractive to foreign investors by aligning the TSX rule with those of other major international exchanges.
- We added a guideline for Advisory Votes on Compensation (Say on Pay) to our proxy voting guidelines. It notes that we will generally not support a shareholder proposal seeking to implement an advisory vote on compensation. Where we are required to vote management compensation proposals, we will review compensation to ensure it meets our criteria set out in section 2.3 (Management Compensation) of the guidelines. This voting guideline is unchanged for 2010.
- In January, we issued a letter to the boards of approximately 500 companies around the world whose shares we hold, making it clear to directors that we oppose the re-pricing of stock options and other forms of equity-based compensation for executives. We were pleased to see only a small number of repricing proposals put forward at companies in which we hold shares, all of which we voted against.
- We also supported shareholder proposals that we believed would improve board structure. We voted for 27 shareholder proposals that would require all company directors to be elected annually by majority voting, and we voted for 19 shareholder proposals requiring companies to separate the positions of Chair and CEO where the same person fulfilled both roles.

#### **Members' financial interests take priority**

Teachers' investment program exists to earn returns required to help meet the plan's funding needs.

With 289,000 teachers and retirees in the plan, it is inevitable that certain investments we hold will raise concerns among the plan's members. Like other Canadian pension plans, we are required by law to invest prudently with members' best financial interests in mind, and cannot select or exclude investments solely on the basis of political, social, environmental or any other non-financial criteria.

We do, however, believe companies that are responsible, well governed, and compliant with social and industry standards and regulations make good long-term investments based on considerations of performance and long-term value. Our analysis and due diligence process takes environmental, social and governance considerations into account as risk factors. To ensure we are aware of emerging issues and how corporations are responding, we subscribe to three social investment monitoring services that cover Canadian, U.S. and international companies. We are signatories to the U.K.-based Carbon Disclosure Project and the Extractive Industries Transparency Initiative. We support these initiatives because of their focus on enhanced disclosure for investors. Enhanced disclosure assists us in understanding all the risks that could impact the value of the fund's investments, enabling us to make the best possible investment decisions.

We list the plan's significant investments (greater than \$100 million) and public equities holdings greater than \$50 million in this report. We also publish this information on our website to ensure stakeholders are informed about the plan's major investments.

[www.otpp.com](http://www.otpp.com) > [Investments](#) > [Major investments](#)



**Investment talent and innovation**

Managing the pension fund is a complicated task. The most important factor in our success is our ability to attract, develop and retain innovative and disciplined investment professionals.

Teachers' has been a leader in developing in-house pension investment management, which costs substantially less than external management. Over the years, in-house management has enabled Teachers' to develop the intellectual capital that has established us as a global pioneer in pension investment management. We plan to continue repatriating capital to increase fund returns by reducing external investment management, as over time, our internally generated returns match or exceed those of external advisors.

Nevertheless, there are markets in which it is more advantageous for us to invest through externally managed funds. In 2009, we decided that external management will be limited to targeted funds in areas where we lack people or expertise.

As one of Canada's largest pension funds, we provide the resources, expanded training and advancement opportunities for our people to seek, and meet, the highest professional standards. These are important factors in our ability to attract and retain leading investment professionals. Our commitment to cultivating talent internally was again demonstrated in 2009. Michael Wissell was promoted to Senior Vice-President, Tactical Asset Allocation, from Vice-President. Five other Investment division staff were promoted to vice-president positions. Their experience at Teachers' dates back as far as 1997. In other significant developments, Barbara Zvan – Senior Vice-President, Asset Mix and Risk – was also named Chief Investment Risk Officer with direct access to both the CEO and the board's Investment Committee. Dan Houle, Vice-President, Investment Operations, moved from the information technology department to the Investment division where he reports directly to the Executive Vice-President.

Management is mindful that Teachers' competes for talent with other investment organizations. Accordingly, during the past year we devoted considerable effort to leadership consistency aimed at keeping Teachers' an employer of choice.

Also important to our success are the business leaders and professionals who serve as Teachers' board members. They offer a wealth of experience in finance, business management, accounting, economics and actuarial science.

## Investment Performance

### GOAL

Produce value-added returns above the policy asset-mix benchmark within our total fund risk limits

### HOW WE MANAGE

Define asset-mix policy and investment plan for the year and manage within market conditions

### HOW WE PERFORMED

Significantly outperformed the fund's composite benchmark on a one-year basis

### Market overview

The second quarter of 2009 marked the onset of a robust recovery in world capital markets, which preceded a cyclical economic upturn in the latter half of the year. Economic growth was driven primarily by the manufacturing sector, which benefited from a sharp rebound in global trade volume and inventory re-stocking. Fiscal and monetary stimulus helped to underpin the fledgling economic recovery. At year end, the labour market showed marked improvement relative to a year earlier, although job growth remained slightly negative causing the near-term outlook for private sector spending to remain cloudy.

Stock and commodities markets generally moved in lockstep during 2009. As the year began, both continued steep declines from 2008. Markets then bottomed in March and rebounded over the rest of the year. Many stock markets around the world gained more than 50% from their March lows. This includes the U.S., the epicentre of the global financial crisis. The S&P 500 Index (total return) rose 68% from its March bottom and gained 26.5% for the full year (measured in U.S. currency). Canada's S&P/TSX Composite Index had its best year since 1979, gaining more than 59% from March and ending 2009 up 35.1%.

Emerging markets equities did particularly well, with the MSCI Emerging Markets Index up 62.3% in local currencies. This index more than doubled after the March rebound began. Brazil was the world's top stock market performer – its Bovespa Index gained 82.7% in local currency terms.

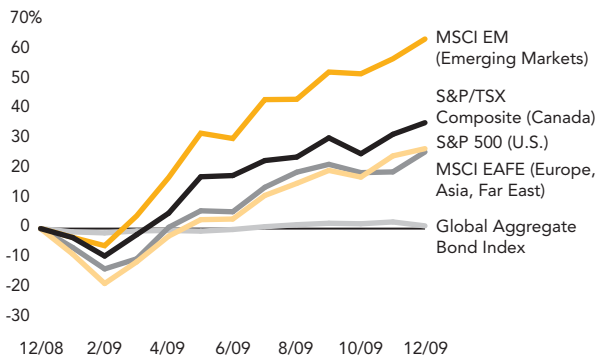
Commodities also did well, largely due to demand from China, where heavy stimulus spending maintained already strong growth momentum. Commodity prices – especially oil and gold – also rose as the U.S. dollar continued its decline against most major currencies, and as fears of inflation increased investor interest in "hard" assets.

With a 33.8% gain, the Brazilian real was 2009's best performer in trading against the U.S. dollar. The real, which posted its strongest appreciation since its creation in 1994, gained 13.6% against the Canadian dollar.

The Canadian dollar also was a strong performer, gaining 15.1% against the U.S. dollar, buoyed by rising commodity prices, a stronger banking system and the lowest debt-to-GDP ratio in the G20 group of industrialized countries.

Bond markets produced gains in 2009 with a sharp difference between government bonds and corporate issues. This reflected a shift from risk-aversion in 2008, when investors had sought safety in government bonds, to risk-taking. Canada's DEX Universe Bond Index gained 5.4% for the year. But drilling deeper, the All Government Bond Index was up just 1.6% while the All Corporate Bond Index – which plunged in 2008 – soared 16.3%. Corporate yields declined sharply and steadily. The government bond universe excluding agencies was down 1.5% and long maturity bonds in this category declined 4.3%.

**GLOBAL MARKET PERFORMANCE**



The rebound in equities markets last year was almost as extraordinary as the decline in 2008. We do not expect markets to continue growing at this pace.

**Consolidated returns**

We are a long-term investor. We measure our investment performance against one- and four-year benchmarks for each asset class and the total fund. Performance is measured in Canadian dollars. The rising Canadian dollar against most foreign currencies dampened returns on foreign assets when expressed in our home currency. For example, the U.S. S&P 500 gained 26.5% for 2009, but only 7.4% when expressed in Canadian dollars.

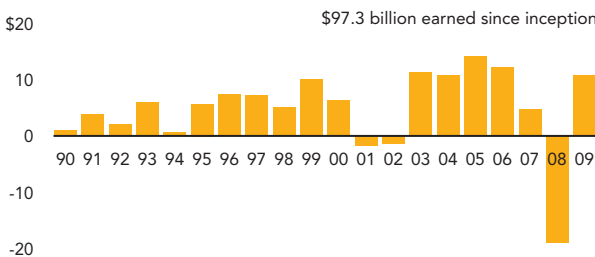
**INVESTMENT PERFORMANCE**

(percent)	2009	2008	4-Year	10-Year	Since 1990
Rate of return	13.0	(18.0)	2.3	6.2	9.7
Benchmark	8.8	(9.6)	2.4	4.0	7.6
Return above/(below) benchmark (\$ billions)	\$3.4	\$(9.2)	\$(0.1)	\$15.8	\$19.2

The fund posted a 13.0% return, generating \$10.9 billion in investment income in 2009. Net assets rose to \$96.4 billion from \$87.4 billion at the end of 2008. As detailed in the table above, the total fund return exceeded the composite fund benchmark by 4.2 percentage points, adding \$3.4 billion in value above market benchmarks. The total fund has averaged annual growth of 2.3% over the past four years, underperforming the composite benchmark by 0.1 percentage points.

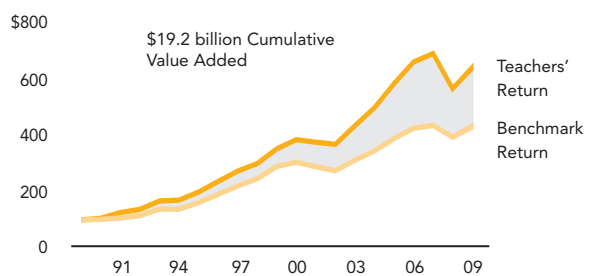
**INVESTMENT INCOME EARNED**

(as at December 31) (\$ billions)



**INVESTMENT GROWTH**

(\$100 invested in 1990)



Our diversified investment program has earned a total of \$97.3 billion since inception in 1990. The value added above the benchmark return is \$19.2 billion of the total investment income.

**RATES OF RETURN COMPARED TO BENCHMARKS**

<i>(percent)</i>	<i>1-Year Return</i>	<i>1-Year Benchmark</i>	<i>4-Year Return</i>	<i>4-Year Benchmark</i>
<b>Equities</b>	<b>21.4</b>	<b>17.2</b>	<b>1.7</b>	<b>0.1</b>
Canadian equities	23.5	31.9	1.7	4.0
Non-Canadian equities	21.2	13.6	1.7	(1.1)
<b>Fixed income<sup>1</sup></b>	<b>23.6</b>	<b>(4.8)</b>	<b>(5.0)</b>	<b>3.1</b>
<b>Inflation-sensitive investments</b>	<b>4.0</b>	<b>5.4</b>	<b>4.6</b>	<b>3.4</b>
Real estate	7.0	6.0	8.3	6.7
Real-return bonds	6.7	6.3	2.2	2.5
Infrastructure and timberland	(5.5)	(1.0)	4.3	3.2
Commodities	(3.9)	(3.6)	(11.4)	(11.4)
<b>Total fund<sup>2</sup></b>	<b>13.0</b>	<b>8.8</b>	<b>2.3</b>	<b>2.4</b>

<sup>1</sup> See page 39 for a definition of the fixed income asset class.

<sup>2</sup> Asset returns generated by the Investment Planning and Risk Committee (IPRC) are attributed to the respective asset classes and aggregated in the total fund return based on the fund's asset-mix weightings. In previous annual reports, the IPRC return was included in the total fund return only. This change was made to improve reporting clarity for annual performance results.

**BENCHMARKS USED TO MEASURE FUND PERFORMANCE**

Canadian equities	S&P/TSX 60 Total Return Index
Non-Canadian equities	S&P 500 Total Return Index MSCI EAFE+EM Total Return Index MSCI All Country World ex Canada Total Return Index MSCI Emerging Markets Total Return Index Custom Non-Canadian National Total Return Index Custom Global Private Capital Benchmark Total Return Index
Fixed income	Custom Canada Bond Universe Total Return Index Custom Canada Long Bond Universe Total Return Index Custom Long Duration Index Custom Ontario Debentures Total Return Index
Inflation-sensitive investments	Custom Canada Real Return Bond Total Return Index Custom U.S. Treasury Inflation Protected Securities Index Goldman Sachs Commodities Total Return Index CPI plus 5% (Real Estate) Local CPI plus 4% plus country risk premium (Infrastructure and Timberland)

## Performance by asset class

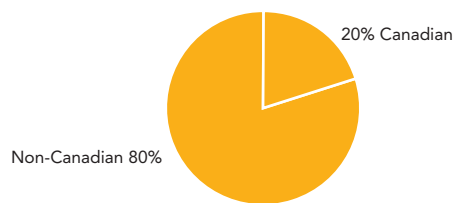
### Equities

Equities (both public and private) totalled \$41.2 billion at year end compared to \$34.9 billion at December 31, 2008. They returned 21.4% compared to a benchmark return of 17.2%, or \$1.2 billion above the benchmark. On a four-year basis, equities generated a 1.7% compound annual return, outperforming this category's four-year benchmark by 1.6 percentage points. In addition to public equities, this asset class includes private equity investments made by Teachers' Private Capital, discussed below.

Much of our exposure to global public equities markets is achieved through derivatives. This is a cost-effective way to achieve broad market exposure and allows us to focus on a smaller universe of stocks for our more concentrated active and Relationship Investing portfolios.

#### EQUITIES

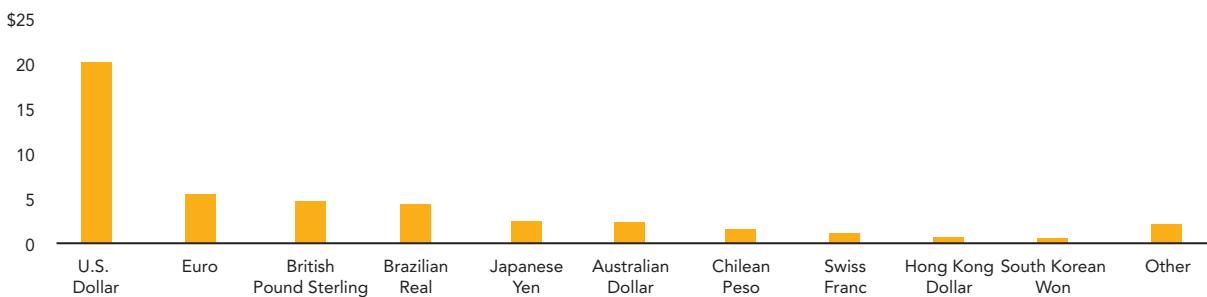
(as at December 31, 2009) (percent)



Canada is a relatively small segment of the global economy. We invest outside Canada to properly diversify our equity holdings.

#### NET CURRENCY EXPOSURE

(for the year ended December 31, 2009) (\$ billions)



Our most significant currency exposures are to the world's largest economies plus the countries of Brazil, Japan, Chile and Australia where we also have sizeable investments. We discontinued our currency hedge policy in 2007 and currency hedging is now actively managed.

### Canadian equities

Canadian equities (both public and private) totalled \$8.4 billion at year end compared to \$6.2 billion at December 31, 2008. They returned 23.5% compared to a benchmark return of 31.9%, or \$0.6 billion below the benchmark. Underperformance to the benchmark was primarily attributed to private equity, as explained on page 38. On a four-year basis, these equities generated a 1.7% compound annual return, underperforming this category's four-year benchmark by 2.3 percentage points.

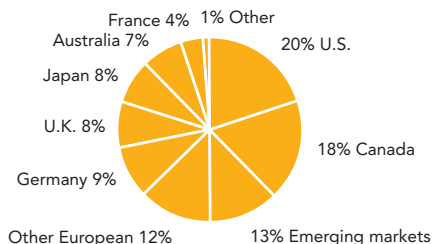
**Non-Canadian equities**

Non-Canadian equities (both public and private) totalled \$32.8 billion at year end compared to \$28.7 billion at December 31, 2008. They returned 21.2% compared to a benchmark return of 13.6%, or \$1.8 billion above the benchmark. The main drivers of outperformance were active management decisions to invest in two Brazilian companies – OGX Petróleo and LLX Logística. These companies, which performed very strongly against market benchmarks, are held in the Relationship Investing portfolio. Externally managed portfolios also contributed to above-benchmark performance. We measure performance in Canadian dollars, which dampened non-Canadian equities returns as the Canadian dollar rose against most foreign currencies. On a four-year basis, these investments generated a 1.7% compound annual return, outperforming this category's four-year benchmark by 2.8 percentage points.

Non-Canadian equities are overseen by both internal and external managers using a combination of active strategies and index funds. Our largest emerging markets exposure is to Brazil whose stock market was the world's best performer in 2009. After extensive due diligence, we began acquiring Brazilian resource equities, real estate and bonds in 2005. A boom that began in 2005 has propelled millions of Brazilians into the middle class and the country is now the world's 10<sup>th</sup> largest economy.

**STOCKS BY GEOGRAPHIC REGION**

(as at December 31, 2009)



Global diversification provides us with more opportunities to manage risk and add value. This chart includes the shares we own directly in companies and excludes the impact of derivatives.

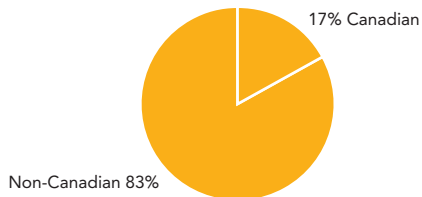
**Teachers' Private Capital**

Private equity investments (included in the above totals for Canadian and non-Canadian equities) totalled \$10.0 billion at year end compared to \$9.9 billion at December 31, 2008. Teachers' Private Capital returned -2.8% compared to a benchmark return of 11.3%, or \$1.4 billion below the benchmark. On a four-year basis, these assets generated a 3.9% compound annual return, outperforming this category's four-year benchmark of 1.3%.

Private equity performance reflected stagnant private equity markets as they adjusted to the financial crisis and the impact of the rising Canadian dollar on foreign investments. Performance is benchmarked against a combination of global equity markets, many of which performed extremely well last year. Equity market performance was led by the financial and commodity sectors, which are under-represented in the private equity portfolio.

**PRIVATE EQUITY**

(as at December 31, 2009)



Our \$10.0 billion private equity portfolio includes direct private equity investments, as well as investments in leading private equity funds around the world.

## Fixed income

Our fixed income asset class includes more than government bonds and treasury bills. There are also corporate bonds, absolute return strategies, external hedge funds and money-market securities. In addition, this asset class provides funding for investments in other asset classes, equivalent to a treasury department in a corporation.

Assets in this category (net of related liabilities) totalled \$6.4 billion at year end compared to \$5.3 billion at December 31, 2008. They returned 23.6% compared to a benchmark return of -4.8%, or \$2.6 billion above the benchmark. Absolute return strategies (credit products and hedge funds), mezzanine debt and active foreign exchange management led the benchmark outperformance. On a four-year basis, these assets generated a -5.0% compound annual return, underperforming this category's four-year benchmark by 8.1 percentage points.

As reported last year, we continued our strategy of returning to more traditional fixed income investments and reduced the use of externally managed hedge funds. We manage our fixed income assets in core portfolios of Government of Canada nominal bonds and Ontario debentures, and value-added portfolios of money market, corporate bonds and credit products.

<b>FIXED INCOME ASSET CLASS</b> (\$ billions)	2009	2008
Bonds	\$ 13.5	\$ 11.5
Hedge funds	5.3	7.8
Absolute return strategies	3.1	7.0
Money market and related liabilities	(15.5)	(21.0)
<b>Total</b>	<b>\$ 6.4</b>	<b>\$ 5.3</b>

This asset class holds our traditional fixed income investments that provide safety and liquidity, as well as investments in hedge funds and absolute return strategies that aim to add value above the benchmark and increase the fund's overall returns.

### *Bonds*

These assets totalled \$13.5 billion at year end compared to \$11.5 billion at the end of 2008. The debt on the plan's real estate assets, valued at \$3.0 billion at year end compared to \$2.7 billion in 2008, is deducted from the bond portfolio. Bonds include Government of Canada bonds, Province of Ontario debentures and mezzanine debt. We increased our government bond holdings last year.

### *Absolute return strategies and hedge fund assets*

Absolute return strategies, which are managed internally, and external hedge funds totalled \$8.4 billion at year end compared to \$14.8 billion at the end of 2008. The goal of these strategies is to generate positive returns regardless of movements in the broad markets. We include absolute return strategies in the fixed income asset class because they normally provide steady income, similar to bonds, but with an additional risk allocation aimed at adding value above the benchmark.

External hedge fund assets were valued at \$5.3 billion at year end compared to \$7.8 billion at the end of 2008. These assets are designed to earn consistent market-neutral returns while diversifying risk across multiple managers, strategies and styles. The change in the value of our hedge fund investments at year end resulted from reducing our exposure to these investments during 2009, as well as the impact of the rising Canadian dollar that affected valuations for U.S.-denominated hedge funds.

#### **Money market and related liabilities**

We held \$1.2 billion in treasury bills at year end to meet the plan's short-term liquidity needs. The plan's liquidity position is governed by a policy and reported regularly to the board.

Repurchase agreements and swaps that are used for funding other asset classes are reported in the fixed income asset class and rate of return, totalled \$16.7 billion at year end compared to \$24.2 billion at the end of 2008.

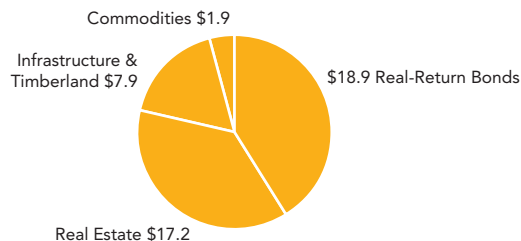
Both derivative contracts and bond repurchase agreements have played a large part in our investment program since the early 1990s. For efficiency reasons, we use derivatives to gain passive exposure to global equity and commodity indexes in lieu of buying the actual securities. We also use bond repurchase agreements to fund investments in other asset classes because it is cost-effective and allows us to retain our economic exposure to government bonds.

#### **Inflation-sensitive investments**

The inflation-sensitive portfolio includes real estate, real-return bonds, infrastructure and timberland, and commodities. Inflation-sensitive investments totalled \$45.9 billion at year end compared to \$44.9 billion at December 31, 2008. They returned 4.0% compared to the benchmark return of 5.4%, or \$0.4 billion below the benchmark. On a four-year basis, inflation-sensitive investments generated a 4.6% compound annual return, outperforming this category's four-year benchmark by 1.2 percentage points.

#### **INFLATION-SENSITIVE INVESTMENTS**

(as at December 31, 2009) (\$ billions)



Inflation-sensitive investments, at \$45.9 billion, is our largest asset class. These investments play an important role in decreasing risk and meeting our long-term pension obligations.

Investments that tend to correlate closely with changes in inflation act as a hedge against increases in the cost of future pension benefits. Over the past few years, inflation-sensitive investments have played an increasingly important role in meeting our performance objectives and decreasing risk. In 2008, this asset class surpassed equities as the largest in our asset mix.



**Real estate**

The real estate portfolio totalled \$17.2 billion at year end compared to \$16.2 billion at December 31, 2008. The portfolio returned 7.0% compared to a benchmark return of 6.0%, or \$0.2 billion above the benchmark. On a four-year basis, these assets generated an 8.3% compound annual return, outperforming this category's four-year benchmark by 1.6 percentage points.

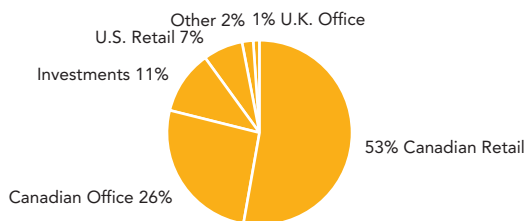
Rising equity markets increased the value of our publicly listed real estate holdings in 2009, primarily Multiplan Empreendimentos Imobiliários in Brazil and Hammerson plc in the U.K., which contributed significantly to above-benchmark performance for real estate. This performance was partially offset by valuation losses in our North American property portfolio, reflecting the recessionary impact in certain North American property markets.

Real estate is considered a good fit for the pension plan because it provides strong, predictable income. These assets are managed by our wholly owned subsidiary, Cadillac Fairview. It aims to maintain a well-balanced portfolio of retail and office properties that provides dependable cash flows.

The real estate portfolio earned income of \$1.0 billion in 2009 primarily from lease arrangements for retail and office space. At year end, the occupancy rate of the retail space was 93%, while the office occupancy rate was 89%.

**REAL ESTATE PORTFOLIO**

(as at December 31, 2009)



Our real estate portfolio was valued at \$17.2 billion at year end. It is managed by our subsidiary company, Cadillac Fairview, one of North America's largest managers of commercial property.

**Real-return bonds**

Real-return bonds totalled \$18.9 billion at year end compared to \$17.4 billion at December 31, 2008. They returned 6.7% compared to a benchmark return of 6.3%, or \$0.1 billion above the benchmark. On a four-year basis, these assets generated a 2.2% compound annual return, underperforming this category's four-year benchmark by 0.3 percentage points.

These securities provide returns that are indexed to inflation, as measured by the consumer price index (CPI). Our holdings include real-return bonds issued by the Ontario, Quebec, Canadian and U.S. governments, and the manager of Highway 407 in Ontario. We also hold inflation-linked mortgages guaranteed by Canada Mortgage and Housing Corporation.

**Infrastructure and timberland**

Infrastructure and timberland investments totalled \$7.9 billion at year end compared to \$10.0 billion at December 31, 2008. The portfolio returned -5.5% compared to a benchmark return of -1.0%, or \$0.4 billion below the benchmark. On a four-year basis, these assets generated a 4.3% compound annual return, outperforming the four-year benchmark by 1.1 percentage points.

The change in portfolio value occurred largely because shares in Macquarie Infrastructure Group were sold, as disclosed last October, and publicly traded infrastructure investments are reported in the equities asset class; however, investment decisions for these infrastructure-related holdings are overseen by investment managers in the infrastructure and timberland portfolio.

The portfolio's one-year return and benchmark were negative, due to low inflation rates (which affect tariffs for regulated assets) and difficult economic conditions that impacted volumes and traffic in some sectors.

Most of the investments in this portfolio are located outside Canada and their performance is measured against the local-country CPI plus a premium; however, because we report performance in Canadian dollars, both the return and benchmark were also negatively affected by the dollar's appreciation against most foreign currencies. We are a long-term investor in infrastructure companies and expect that returns will vary from year to year according to economic conditions, inflation rates and other factors.

Infrastructure and timberland generally offer stable long-term cash flows. We began building this portfolio in 2001 and it now includes investments in airports, pipelines, electrical power generation, water and natural gas distribution systems. Teachers' is regarded as a "first mover" into this sector among pension funds worldwide.

### *Commodities*

Investments in commodities totalled \$1.9 billion at year end compared to \$1.3 billion at December 31, 2008. The portfolio returned -3.9% compared to a benchmark return of -3.6%, or \$3 million below the benchmark. On a four-year basis, these assets generated a -11.4% compound annual return, matching the four-year benchmark return.

We invest in commodities through swap agreements linked to the S&P GSCI, a composite index of commodities sector returns. Though diversified across industrial metals, precious metals, agricultural crops and livestock, this index has a weighting of approximately 70% in energy.

### **Investment costs**

Total investment costs were \$214 million, compared to \$155 million in 2008 and \$229 million in 2007. This is equivalent to 24 cents per \$100 of average net assets, compared with 15 cents in 2008 and 22 cents in 2007, and reflects increased investment in risk and accounting systems and accruals to incentive plans based on the strong 2009 performance.

These costs exclude the commissions paid when trading securities, and management and performance fees for private equity and certain other externally managed funds. However, all such costs are deducted in determining net investment returns.

## Priorities for 2010

The Investment division has established the following priorities for 2010:

- Select the most appropriate asset mix, with an appropriate level of risk, for meeting the plan's long-term funding objectives.
- Earn value-added returns above our portfolio and total fund benchmarks.
- Continue to maximize coordination and collaboration between our investment departments in order to optimize total fund performance.
- Complete the conversion of our FMC Portfolio Management System to SimCorp Dimension, which will provide access to more robust data and better decision-support tools.
- Improve information technology capabilities in a cost-effective manner.

## MEMBER SERVICES

*“Our commitment to do our best for plan members is reflected in our service rating from plan members and consistent ranking among the world’s pension leaders.”*



**Rosemarie McClean, MBA, ICD.D, CMA**  
Senior Vice-President, Member Services

## Service quality and cost effectiveness

**9.1** out of 10 (QSI)

- > Members continued to rate our services and communications at the top of the scale, based on the Quality Service Index (QSI)
- > QSI measures members’ satisfaction based on surveys conducted by a third party
- > Achieved 9.0 or higher out of 10 in every quarter last year

### Quality Service Index

(on a scale of 0 to 10)

	2009	2008
Total QSI	9.1	9.0
Service QSI (85%)	9.2	9.1
Communications QSI (15%)	8.8	8.8

### Members’ needs come first:

- > Invested in technology and the people needed to evolve our personalized service model
- > Led simplification of plan’s buyback rules and processes
- > Introduced daily key performance indicators to continuously monitor service quality and improvement (see page 52)
- > We participate in surveys by CEM Benchmarking Inc., which conducts independent evaluations of the costs and services of 66 major pension plans. We consistently place among the industry leaders

### How we scored in service level comparisons

	2008 <sup>1</sup>	2007
Ontario Teachers’ Pension Plan	85	86
CEM world average	73	71
Peer group average	77	75
Canadian participants – average	71	70

<sup>1</sup> 2009 results will be released in mid-2010.

Sources: CEM Benchmarking Reports, CEM Benchmarking Inc.

*We pursue excellence through our long-term service delivery strategy, which seeks to provide personalized, customized and proactive service to members.*

## Long-term service delivery strategy

### Customization:

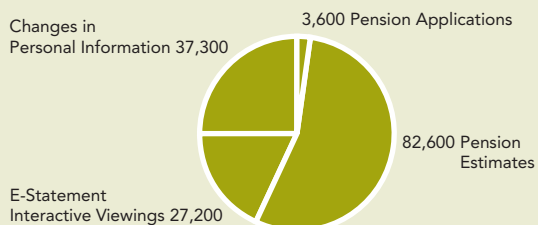
- > Implemented system enhancement that enables us to provide proactive service to members who decline offer of a pension guarantee period in their online retirement applications

### Choice:

- > 89% of new retirees chose to retire online, using our secure website *iAccess™* Web

### Self-service activities on *iAccess™* Web

(for the year ended December 31, 2009)

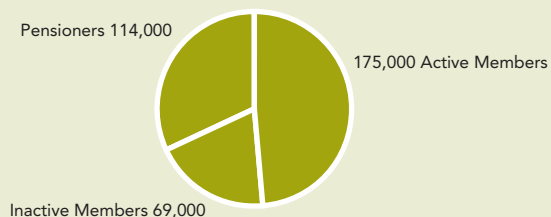


### Counselling:

- > Created 24-hour feedback mechanism for frontline staff and began counselling on the 10-year pension guarantee and buybacks

### Member profile

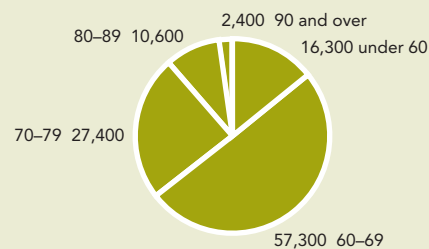
(as at December 31, 2009)



- > The number of pensioners grew by 3,000 to 114,000 in 2009

### Pensioners by age

(as at December 31, 2009)



- > We are serving more pensioners over longer retirement periods

## Overview

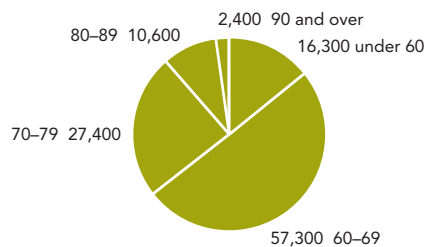
The Member Services division interacts with pensioners, working and inactive members, school boards and designated employers – our customers. To them, this team is the face of the Ontario Teachers' Pension Plan.

This team is also an information powerhouse, taking in and processing billions of dollars of contributions and millions of pieces of personal information every year while administering the timely payment of pensions to 114,000 retirees and survivors – one of Canada's largest payrolls.

With pensioners living longer, pensions are being paid over a longer period than before. The average age at retirement was 58 for new retirees in 2009, with an expected 30 years on pension, and a survivor pension may be paid after that. Currently there are approximately 10,600 pensioners in their eighties, 2,300 pensioners in their nineties, and 93 are age 100 or older.

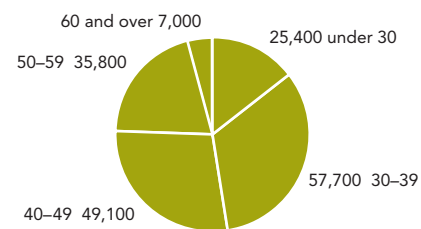
### PENSIONERS BY AGE

(as at December 31, 2009)



### TEACHERS BY AGE

(as at December 31, 2009)

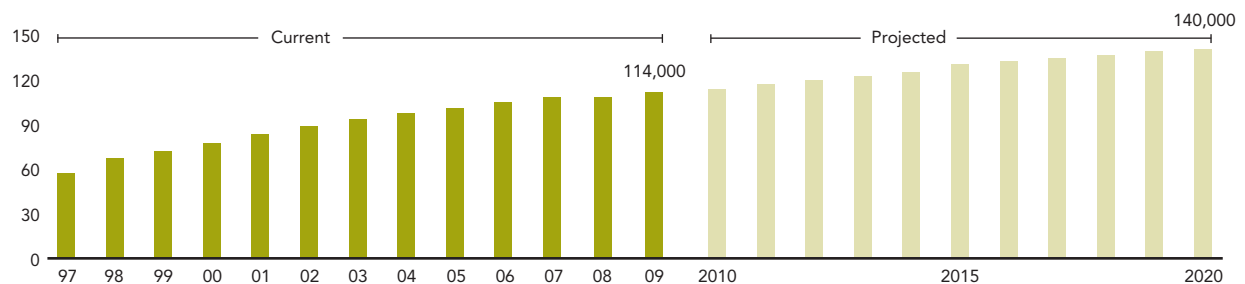


The average age for pensioners is 68 and for teachers is 42.

We expect more than 50,000 teachers to retire over the next 11 years. Accordingly, the number of pensioners will continue to grow, both in absolute terms and as a percentage of total plan membership. The ratio of active members to retirees will be approximately 1.2:1 in a decade.

### NUMBER OF PENSIONERS

(for the year ended December 31) (thousands)

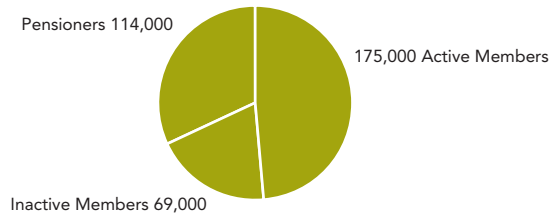


Plan membership totalled 358,000 at year end, including 175,000 working teachers, 114,000 retirees and survivors, and 69,000 inactive members. This past year 7,700 teachers entered or returned to the profession.

The number of pensioners has grown every year since 1917 when a pension plan for Ontario teachers was created. In 2009, 4,100 new retirees began collecting retirement or disability pensions. That was 600 fewer than expected. Anecdotal evidence suggests this might reflect concern about the weak economy and the 2008 market collapse. The average pension for a teacher retiring in 2009 at the 85 factor – age plus years of eligible service – was \$42,900.

**MEMBER PROFILE**

(as at December 31, 2009)



The total number of pensioners grew by 3,000 in 2009. Active members increased by 2,000.

The smallest group in our membership is 69,000 inactive members who taught for a brief period between 1950 and 2005. Many do not know they have entitlements. There is no legal requirement to track down these people, and most pension plans don't. We make every possible effort to locate them because we feel our service standards and integrity should be consistent for all members. We found 4,200 in 2009 and paid out a total of \$26 million in refunds or commuted values.

We deal with 193 school boards and designated employers, whose administrative systems vary widely in practice and sophistication. Our primary focus has been to improve the quality of the data used to calculate the benefits we pay to members. In 2004, we began asking school board finance officers to certify that contributions and information delivered to us were correct in terms of timely remittance and application of the plan's rules – just as a public company's CEO and CFO would certify its financial statements. This has proven invaluable in getting administrators to focus on what, to them, is simply one payroll deduction.

Recognizing that employers are typically understaffed and face funding constraints, we have made a point of offering them hands-on assistance. This focuses their workload and improves our efficiency as increased online use reduces the time and effort required to obtain accurate, up-to-date data. Each employer now has a designated contact on our Employer Information Services team. This person gains detailed understanding of the employer's payroll system and practices, and serves as a conduit for feedback. Our employees also conduct workshops and employer visits throughout Ontario, helping employer personnel master the pension reporting requirements and online technology we provide.

## Goals

Our overall objective is to provide outstanding personalized service to pension plan members at a reasonable cost. Each year we set specific goals designed to move us further along the continuum of service. The overarching philosophy is continuous improvement and cost-effective delivery of services. We gauge our success in terms of the service satisfaction ratings received from plan members and a third-party evaluation of our international peer group. Details are available on page 51. Internally, as discussed on page 52, this year we introduced daily tracking of seven key performance indicators to help us better manage service quality in real time.

We are committed to improving our key performance indicators each year with specific initiatives and measurable objectives. For example, we developed streamlined processes for pension buybacks and the success of this initiative will be partially evaluated against the improvements made to that process's same-day service measurement.

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### IN 2009, WE MEASURED OUR PERFORMANCE AGAINST FOUR MAJOR GOALS:

Enhance member service through personalization

Optimize business processes to reduce complexity and improve immediate service

Improve internal controls and processes

Enhance staff development

## Managing service delivery

Our long-term service delivery strategy was revised in 2007 to reflect growing member use of online pension services and information. The refined strategy is summarized as a formula –  $e=mc^3$  – in which our pursuit of excellence comprises:

- more customization: providing more proactive and tailored services;
- more choice: giving members options about how they receive information; and
- more counselling: helping members navigate complex pension rules and decisions that have lifetime ramifications.

**Customization** seeks to provide services that are tailored to the individual needs of our clients. We know from listening to plan members that the service needs of new teachers differ vastly from those approaching retirement. To better meet these varied needs, we use database technology to segment our membership in terms of service requirements. This has enabled us to target communications, providing each member with directly relevant information while saving money for the plan. Systemization also enables us to increasingly become more proactive. For example, in 2009 we implemented a system enhancement that automatically flags any online retirement application which declines the offer of a pension guarantee period. A pension benefit specialist then telephones the teacher to explain the guarantee and proactively ensures the applicant understands his or her selection.

**Choice** pertains to the medium through which a member communicates with us. We are committed to ensuring that every member can be served properly through the medium he or she prefers. The secure *iAccess*™ Web section of our website enables members to update personal information any time of the day or night and do “what-if” calculations using their personal data. While many members prefer the convenience of online services, other members prefer to be served by telephone or mail. Our contact centre standard is that calls should be taken within 30 seconds and in 2009, we answered, on average, within 29 seconds.



**Counselling** combines the expertise of our frontline pension benefit specialists with our evolving technology capabilities to help members make informed decisions. The decision to provide guidance, rather than just information, represents a considerable leap forward in meeting a demand that members have long expressed. The benefits and rules of the Ontario Teachers' Pension Plan are complex and the decisions made by an individual can have lifetime ramifications.

Our approach over the years has been described as full disclosure. We cited and explained the applicable options under the plan, leaving it entirely to the member to weigh the alternatives and make his or her choice. In 2009, under a multi-year initiative, we equipped pension benefit specialists with tools and training that enable them to delve into a member's circumstances, discuss certain benefit options in more detail and help the member make informed choices. To promote service quality, an independent survey company interviews the member that night and the frontline agent gets feedback the next day, in addition to a review by our internal experts. The scope of counselling will expand incrementally over time.

Next year we plan to enhance our systems to provide more counselling services, and we intend to develop customized client checklists to ensure that all relevant information is thoroughly identified and communicated to the member.

### Key performance drivers

To execute our service delivery strategy, our key performance drivers are technology, expertise, the desire to provide outstanding service, and efficient and effective processes.

The 2008 annual report noted the creation of a permanent process improvement team. In 2009, this team focused on pension service buybacks, a complex and time-consuming process that has ranked last in our member satisfaction surveys. The team figured out how to simplify the buyback rules and developed a streamlined processing system. Implementation will begin in 2010.

We devoted considerable effort this year to developing the systems required to administer the conditional inflation protection provision that applies to pension service earned after December 31, 2009. Having the systems to administer this before they are needed should ensure smooth processing if indexing is reduced. While the goal is to pay full inflation protection, the portion of a pension earned after 2009 can be inflated by between 50% and 100% of the annual change in the CPI, depending on the plan's funding status at the time. Therefore, it is possible that annual adjustments will be less than 100% at various times in the future.

In 2008, we obtained access to Ontario's death registry to verify our pension payroll. Access to the death registry addresses the risk that, through direct deposit, benefits might continue to be paid to deceased pensioners. This year we created a computerized cross-reference and identified 41 cases involving total overpayments of \$745,000. Recovery of overpayments was higher than expected in 2009 and substantially exceeded the one-time cost of creating the cross-reference. There will be ongoing savings in benefit payments, along with a reduction in plan liabilities as deceased pensioners are removed from projections.

We invest in people. According to our research, we invest more in training, coaching and staff development than our peer organizations do.

# Performance

GOAL	MANAGING SERVICE DELIVERY	PERFORMANCE
<p>Enhance member service through personalization</p>	<p>Expand the pension benefits specialist role to provide in-depth counselling on certain subjects</p>	<p>Began counselling on the 10-year pension guarantee and buybacks. Created 24-hour member feedback mechanism for frontline agents. Married technology and human outreach to ensure online pension applicants understand impact of various retirement dates and buybacks</p>
<p>Optimize business processes to reduce complexity and improve immediate service</p>	<p>Working from the members' viewpoint, examine all processes in a linear fashion to reduce time and effort, and eliminate real or potential gaps</p> <p>Increase employer use of online facility to reduce processing time and effort, and improve accuracy</p> <p>Enable members to update personal information and analyze their retirement situation online. Free up staff to improve/expand service elsewhere</p>	<p>Led simplification of plan's buyback rules, the least satisfactory service area. Developed streamlined processing for 2010</p> <p>89% of retirement applications were made online</p>
<p>Improve internal controls and processes</p>	<p>Ensure a pension does not continue to be paid by direct deposit if the retiree dies and family or executors do not notify the plan</p>	<p>Established computerized cross-reference with Ontario death registry. Identified 41 cases and total overpayments of \$745,000. Recovered substantially more than system implementation cost</p>
<p>Enhance staff development</p>	<p>Help staff qualify for career advancement opportunities at Teachers'</p>	<p>Expanded coaching program for frontline staff to leverage same-day feedback from members. Averaged four days of staff development and training per full-time employee</p>

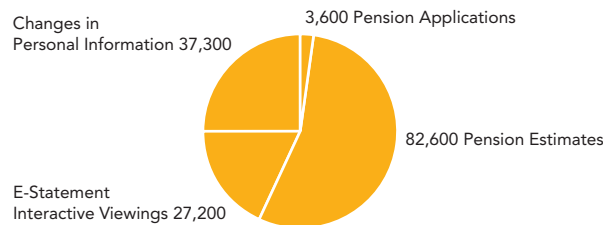
We completed 171,000 member requests, compared to 180,000 in 2008. We completed 63% of member requests on the same day, a performance standard adopted this year. The previous standard was two days.

The proportion of total services provided to members through our secure *iAccess*™ Web facility continues to grow. There were 174,000 web sessions while telephone inquiries fell by 4%.

Eighty-nine percent of retirement applications were submitted online, an 11% increase from 2008 and continuation of a strong trend. Member acceptance of online applications is important because approximately 80% of retiring teachers retire in June. This used to create an enormous workload surge as plan staff had to transfer and validate the data from paper applications. In addition to saving time and effort, applying online increases accuracy and spares the plan the cost of producing and mailing application kits. There were virtually no paper applications this year. Retiring teachers who did not apply online telephoned our frontline specialists, who entered their data into the online system. Application by telephone was introduced as an option in 2009.

**SELF-SERVICE ACTIVITIES ON *iAccess*™ Web**

(for the year ended December 31, 2009)



Our secure member website *iAccess*™ Web allows members to answer their own questions and update personal information at their convenience.

**Composite Quality Service Index (QSI)**

We regularly ask members to rate our services through a third-party survey. We engage an independent company to survey a statistically valid membership sample to gauge the quality of our service and communications several times each year. The survey protocol was developed by Teachers' in the early 1990s and is continually reviewed and refined to reflect the current services and communications.

All Member Services employees – from new recruits to executives – receive a variable component of compensation based on the levels of satisfaction expressed in these Quality Service Index (QSI) measurements. Compensation also reflects the success achieved in meeting organizational goals that are set annually to drive continuous improvement.

Members again gave us an "A" in 2009. The overall QSI score was 9.1 on a 10-point scale, and 55% of respondents awarded us 10 out of 10. This is our highest standing since 2005. As shown in the accompanying table, members rate us in terms of direct service and communications, with direct service representing 85% of the overall score. 2009 was the first year since the QSI was revised to incorporate web service feedback that we received a score of 9.0 or higher in all four quarters of the year.

<b>QUALITY SERVICE INDEX</b>		
<i>(on a scale of 0 to 10)</i>	<b>2009</b>	<b>2008</b>
Total QSI	<b>9.1</b>	9.0
Service QSI (85%)	<b>9.2</b>	9.1
Communications QSI (15%)	<b>8.8</b>	8.8

The Quality Service Index is a measurement of service satisfaction. Our 9.1 rating is based on surveys with members conducted by a third party using a scale of zero to 10.

In 2008, we launched a project to identify and examine the specific factors that influence the QSI score, a project noted in last year's report. In 2009, this study produced a list of seven key performance indicators and we began tracking them daily to monitor performance to ensure service quality and improvement.

<b>KEY PERFORMANCE INDICATORS</b>	<b>SCORE</b>
<b>Same-Day Service</b> The percentage of requests that are completed within one day.	63%
<b>Right the First Time</b> How often we accurately process "high risk" service requests the first time. These are complex matters that often involve other departments and manual calculations.	84%
<b>Backlog Service Lead Time</b> The estimated time required to complete outstanding service requests at December 31, 2009. It is an important factor in influencing customer satisfaction and also helps us identify spikes in service demand.	16 days
<b>Staff Development and Training Days</b> The average number of development and training days for each full-time employee.	4 days
<b>Straight Up Service</b> How often we can provide service to members without assistance from the Employer Information Services department, which interacts with school boards and designated employers.	88%
<b>Key System Availability</b> The percentage of time that key systems are fully available to handle service requests.	99%
<b>Employer Workload</b> The effort we require from employers in resolving matters such as data issues.	5% increase

### Cost Effectiveness Measurement (CEM)

We measure our services against the leading pension plans worldwide by participating in surveys by CEM Benchmarking Inc., which conducts independent evaluations of the costs and services of 66 major pension plans.

We have consistently placed among the industry leaders in recent years. With members spread throughout Ontario's vast geographic expanse, we emphasize more cost- and time-efficient use of online and telephone communications for members.

**CEM BENCHMARKING RESULTS – SERVICE LEVEL SCORE COMPARISON**

	2005	2006	2007	2008 <sup>1</sup>
Ontario Teachers' Pension Plan	84	85	86	85
CEM world average	71	71	71	73
Peer group average	74	73	75	77
Canadian participants – average	70	70	70	71

<sup>1</sup> 2009 results will be released in mid-2010.

Sources: CEM Benchmarking Reports, CEM Benchmarking Inc.

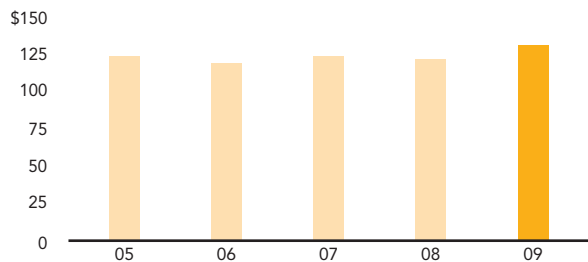
Our service level ranks well ahead of the CEM world average, as well as our peer group of 14 similar plans.

**Expense management**

The cost per member served in 2009 was \$130 versus \$122 in 2008.

**COST PER MEMBER SERVED**

(for the year ended December 31)



We provide full services directly to our members, unlike many other plans.

Our annual service cost is above the median of the pension plans in the CEM survey mentioned above. This is primarily because we provide full services directly to members. Services provided by many other plans in the study are wholly or partially administered by employers, thus reducing the cost of those plans.

This year we decided to change our longstanding policy of budgeting Member Services at the prior year's level plus inflation. In 2009, we invested in the technology and people needed to build and maintain an increasingly automated environment, which is helping us to evolve our service model.

## Priorities for 2010

We expect this year's agenda to be dominated by system changes required to comply with proposed legislation and potential plan amendments:

- The Family Statute Law Amendment Act, 2009, will significantly change the valuation and division of pensions upon the termination of a marriage or common law relationship. Plan administrators will be responsible for calculating the spouse's share and for implementing the division methods, which will be prescribed by regulation. This will be a significant undertaking.
- The plan sponsors approved changes to the buyback rules, in order to simplify administration and improve service. In 2010 we will be making the required system changes to implement the new rules.
- Bill 236 was introduced in the Ontario legislature in December. This bill makes changes to the Pension Benefits Act to implement many of the recommendations of the Ontario Expert Commission on Pensions. The bill proposes to increase communication requirements (annual statements to retired members and notice of plan amendments), introduces immediate vesting of benefits, increases the small pension payout threshold and prescribes RRSP transfers.

# GOVERNANCE

As an investor, we believe good governance is good business because it helps companies deliver long-term shareholder value.

As a plan administrator, we measure ourselves by the same governance, internal control and enterprise risk management standards that reflect corporate best practices and high standards of stewardship.

The plan's governance structure assigns clear roles to the plan sponsors and to the independent board members who are appointed to oversee management's decisions and actions.

## Overview

Governance is a system of checks and balances aimed at ensuring an organization pursues its mission in a legal, responsible and effective manner. It assigns decision-making authority with accountability, ensures that those managing the organization are capable and fairly compensated, and that the interests of management are properly aligned with the interests of those they serve. Governance also ensures that the organization has identified and addressed the myriad risks it might face.

### Plan governance approach

We seek to employ the best practices of stewardship in every area of Teachers' plan governance. Teachers' is governed by nine board members. Four members are appointed by each of the plan's sponsors, the Ontario government and the Ontario Teachers' Federation (OTF). The two sponsors jointly appoint the board's chair.

The plan's governance approach is discussed in more detail on our website. The board members and plan sponsors also have an ongoing mechanism through which the two sponsors provide input and feedback to the board concerning the plan's funding status and the factors that may affect it.

#### Plan sponsors



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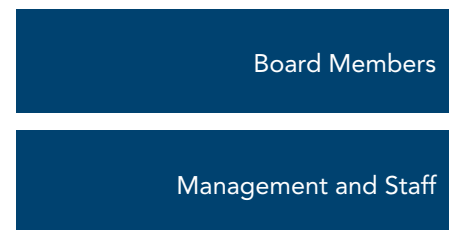
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#### Ontario Teachers' Pension Plan



- The plan sponsors are responsible for ensuring the plan remains fully funded over the long term, sharing responsibility for surplus and shortfalls.
- They determine contribution rates and benefit levels.
- Each sponsor appoints four members to the plan's board for staggered two-year terms and they mutually select the board chair.

- Teachers' is an independent organization, established by Ontario law.
- Board members are required to act independently of both the plan sponsors and the plan's managers to make decisions in the best interests of plan members and their beneficiaries.
- Management and staff administer the pension plan, invest the pension fund and pay members and their survivors the benefits promised to them.



## Board members

All board members serve on the Investment Committee. Board and committee attendance was 98% for 2009. Individual attendance is reported below. For more information on board members and board committees, please see our website.



**Eileen Mercier**

Former Senior Vice-President and CFO of Abitibi-Price Inc.; Fellow of the Institute of Canadian Bankers and the Institute of Corporate Directors  
*Chair of the Board*

Appointed 2005; Chair since 2007  
Attendance 100%



**Louis Martel**

Managing Director and Chief Client Strategist, Greystone Managed Investments, Inc.  
*Member of the Audit & Actuarial and Human Resources & Compensation Committees*

Appointed 2007  
Attendance 95%



**Rod Albert**

Former President of the Ontario Teachers' Federation  
*Member of the Human Resources & Compensation and Governance Committees*

Appointed 2010  
Attendance n/a



**Sharon Sallows**

Partner, Ryegate Capital Corp.; Former executive, Bank of Montreal  
*Member of the Human Resources & Compensation and Governance\* Committees*

Appointed 2007  
Attendance 100%



**Jill Denham**

Former Vice Chair, Retail Markets, Canadian Imperial Bank of Commerce  
*Member of the Governance and Human Resources & Compensation\* Committees*

Appointed 2006  
Attendance 100%



**David Smith**

Former Chair and Senior Partner of PriceWaterhouseCoopers; Former President & CEO of the Canadian Institute of Chartered Accountants  
*Member of Audit & Actuarial\* and Human Resources & Compensation Committees*

Appointed 2009  
Attendance 100%



**Helen Kearns**

President, Bell Kearns and Associates; Former President, Nasdaq Canada; Former director, Toronto Stock Exchange  
*Member of the Benefits Adjudication,\*\* Audit & Actuarial and Governance Committees*

Appointed 2005  
Attendance 100%



**Jean Turmel**

President, Perseus Capital Inc.; Board member, TMX Group Inc.  
*Member of the Investment,\* Audit & Actuarial, and Human Resources & Compensation Committees*

Appointed 2007  
Attendance 100%



**Hugh Mackenzie**

Principal, Hugh Mackenzie and Associates  
*Member of the Audit & Actuarial, Governance and Benefits Adjudication\* Committees*

Appointed 2007  
Attendance 100%

\*Committee Chair \*\*Committee Vice-Chair

**Board members**

Much of Teachers' success can be attributed to its governance structure, which is built on the premise of an independent board of professionals committed to governance best practices, leading edge investment principles and innovative corporate strategy.

Together, the board members have the wide range of professional experience required to oversee a plan as vast and complex as Teachers'. They have been drawn from the fields of business management, finance and investment management, actuarial science, economics, education and accounting. No member of management serves as a board member or on any of the board's committees.

Board Chair Eileen Mercier is among the leaders in Canada's corporate governance community and was honoured in 2009 with the Institute of Corporate Directors' Fellowship Award. The ICD confers Fellowship Awards annually on a prominent group of individuals who continually distinguish themselves by bringing exceptional corporate governance leadership to boardrooms throughout the country.

The board members' mandate, committee structure and terms of reference, and Teachers' three Codes of Business Conduct are posted on the Teachers' website. Board member remuneration is discussed on page 67.

[www.otpp.com](http://www.otpp.com) > [Corporate info](#) > [Plan governance](#)

**Board responsibilities**

The board members are responsible for overseeing the management of the pension plan. They delegate day-to-day investment of the plan's assets to the Chief Executive Officer with the power to sub-delegate appropriately. Nevertheless, the board members are ultimately responsible for overseeing and reviewing investment policies, risk appetite and asset mix, benchmarks, performance and compensation. As well, they approve annual performance objectives for the investment portfolio and review transactions that exceed discretionary limits set for management. Their collective wisdom adds value as investment managers must crystallize and justify their thinking when seeking approval for strategic recommendations and significant investments from a group that is expert in financial matters, yet removed from the day-to-day clamour of the markets.

The board members and plan management are fully responsible for investment decision-making. The plan's sponsors are not involved in investment decisions.

**Board activities**

Board members met 11 times in 2009 for board and Investment Committee meetings, each of which included sessions without management present. In addition, the Governance Committee met three times, the Human Resources and Compensation Committee met 10 times, the Audit and Actuarial Committee met eight times, and the Benefits Adjudication Committee heard five member appeals and held two general meetings. There also were numerous educational meetings.

Board member and committee attendance was 98% in 2009. Individual board member attendance is reported on the previous page.

## Effective oversight and controls

Management is responsible for establishing corporate strategy, objectives and an annual financial plan. Board members review progress against management's stated objectives. Board members confirm that management's strategies and decisions are in the best interests of all pension beneficiaries. They also help ensure that management can attract and retain the best available staff – the more senior the position, the more directly involved the board members are. It is also up to the board members to ensure that the organization's standards are respected, that its policies and procedures are appropriate and are complied with. Supporting these responsibilities is an internal audit function that reports directly to the Audit and Actuarial Committee. The Enterprise Risk Management framework and internal controls are also important elements of governance.

### Enterprise Risk Management (ERM)

The pension plan is exposed to a number of risks. Risk is defined as a state of uncertainty beyond expectations where some of the possibilities involve a loss, catastrophe or other undesirable outcome. The intent of ERM is to ensure risks are managed as effectively as possible. It involves identifying and assessing the risks facing the organization and the risk mitigation strategies in place to address them. This encompasses investment and non-investment risks as both are critical.

As Teachers' has grown, so has the need for a more structured ERM process. We formalized the ERM governance structure in 2008 by establishing an ERM Committee comprising the heads of all divisions and corporate support departments. This committee is chaired by the CEO.

The ERM Committee aggregates the risks identified throughout Teachers' to provide a comprehensive understanding of the overall risks the organization faces. It provides the infrastructure that ensures all risks can be brought to the attention of the executive team promptly, and that they will be reviewed in the context of the whole organization. It is also a forum from which key risks are reported to board members.

Annually, the ERM Committee performs a thorough risk evaluation and reports top-ranked risks to the board members along with an explanation of how management mitigates these concerns. Board members are also updated on top and emerging risks at least semi-annually.

In 2009, Teachers' created a new Enterprise Risk Management Policy. The policy states that we are committed to ensuring that risk management is a core capability and plays an integral role in all activities. The policy also:

- establishes a process within which employees identify, manage, measure and report risks inherent in the execution of Teachers' business;
- serves as the decisive governance document for all at-risk activities;
- requires an appropriate risk culture, which must be cultivated across the organization with the tone set at the top; and
- supports Teachers' corporate objectives.

The ERM governance structure was enhanced in 2009. A working committee was established to support the executive-level ERM Committee in gathering information to identify risks and in implementing future initiatives. The importance of risk awareness was highlighted in the organization's revised Mission, Vision and Values statement, which was introduced mid-year. This statement incorporates "accountability and risk consciousness" as one of six core values for all employees.

Teachers' will continue to strengthen the ERM process in 2010 to ensure compliance with evolving best practices.

**Disclosure controls and procedures and internal control over financial reporting**

Teachers' has conducted a comprehensive internal control evaluation to document, assess and enhance the design of its internal controls. It did so using the Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We are not required by law to comply with National Instrument 52-109 of the Canadian Securities Administrators but have chosen to meet the standards required by the Instrument as part of our emphasis on good governance.

The President and Chief Executive Officer (CEO) and the Senior Vice-President and Chief Financial Officer (CFO) are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for Teachers'. We have designed disclosure controls and procedures to provide reasonable assurance that material information relating to the plan, including Teachers' consolidated subsidiaries, is made known to us.

We evaluated the effectiveness of Teachers' disclosure controls and procedures as of the end of the period covered by annual certification, and the CEO and CFO have concluded, based on the evaluation, that the disclosure controls and procedures are effective.

We have also designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles (GAAP).

We have evaluated the effectiveness of Teachers' internal control and procedures over financial reporting as of the end of the period covered by the annual certification, and the CEO and CFO have concluded, based on the evaluation, that the internal controls and procedures are effective. No changes were made in Teachers' internal control over financial reporting during the year ended December 31, 2009, that materially affected, or are reasonably likely to materially affect, Teachers' internal control over financial reporting.

**Protecting audit integrity**

Teachers' and others who stress the value of effective corporate governance have expressed concern over the years about relationships in which the accounting firms that audit public companies also receive substantial payments from those companies for non-audit management consulting services. Such consulting fees can compromise the integrity of the audit function. Teachers' strives to minimize our own use of such consulting services from the plan's auditors and discloses the total amount paid. In 2009, fees paid to Deloitte & Touche LLP, the plan's auditors, totalled \$4.3 million (\$4.1 million in 2008), of which \$4.1 million was for audit activities and \$0.2 million for other, non-audit services.

**Transparent reporting**

Teachers' board members receive from management in-depth monthly reports and quarterly summaries of the financial and funding positions of the plan, performance results, risk levels, client satisfaction ratings, key Member Services statistics and compliance. They also receive annual reviews of each department and internal controls, semi-annual reports on enterprise risk, and reports on all other significant events.

We also strive to keep stakeholders fully informed of the state of the plan:

- In addition to publishing this annual report, Teachers' provides regular newsletters to 289,000 members, updating them on key financial and other important information. Our website details plan governance practices and facts about our investment strategy and major portfolios, as well as service initiatives and news updates.

- Each April, Teachers' holds an annual meeting at which executives report on the state of the plan and invite questions. This meeting is open to all members of the plan and the sponsors. In 2010, it will take place in Toronto on Friday, April 9, at 5 p.m. The meeting is webcast for those who cannot attend in person and is archived for later viewing. In 2009, we began posting member questions and replies on our website so all members could, at their convenience, see the range of concerns and management's response.
- Each August, the Chair addresses the OTF Board of Governors. Teachers' executives have regular meetings with representatives of both plan sponsors regarding the Sustainability Working Group, the Partners' Committee, the Partners' Consultative Committee, as well as discussions with the plan's actuary.

### **Future adoption of revised Canadian Institute of Chartered Accountants (CICA) Section 4100 and certain International Financial Reporting Standards (IFRS)**

The Accounting Standards Board of Canada (AcSB) issued an exposure draft revising CICA Section 4100, Pension Plans, in July 2009 and provided further clarification in a Decision Summary in December 2009. The revised CICA Section 4100 is expected to be finalized in April 2010, subsequent to the printing of this annual report. The revised CICA Section 4100 is effective for fiscal years beginning January 1, 2011. Early adoption is permitted.

The exposure draft makes reference to certain IFRS, which include guidance on fair value measurement and disclosure for investment assets and investment liabilities. The AcSB also clarified that investments will be presented on a non-consolidated basis. Accounting policies not relating to investments and pension obligations must be in compliance with either Canadian accounting standards for private enterprises or IFRS.

The AcSB also clarified the definition of financial statement surplus or deficit. The revised definition would eliminate the actuarial asset value adjustment when calculating the financial statement surplus or deficit for accounting purposes. The revised accounting guidance does not affect the funding valuation. Discussion of the funding valuation and funding position is on page 18.

A preliminary analysis has been completed on the specified IFRS reference in the exposure draft and we do not expect a significant impact on the financial statements.

### **Compensation discussion and analysis**

The goals of our compensation programs are to attract and retain high-calibre employees, motivate and reward top performance, encourage team work, align personal and organizational objectives and reward successful performance over the long term.

Each year, the Human Resources & Compensation Committee of the board reviews compensation policies, including incentive components linked to investment department and total fund performance. In 2009, the board retained the services of an independent compensation consultant to review management's recommendations on planned changes to the compensation system for 2010.

Given the varied employment opportunities at Teachers', each position is compared against relevant job groups and incentive programs in like markets. Our overall objective is to be competitive with those organizations against which we compete directly for talent. Such organizations include other major Canadian pension funds, banks, insurance companies and investment managers; for some positions, we look at the general financial industry.

Teachers' compensation program has been developed on a foundation of "pay for performance." Our compensation structure comprises base pay, short-term incentive and long-term incentive. Base pay and incentive levels in each area of the business are based on the competitive labour market practices for specific jobs. Teachers' targets base salaries at the median of the market, with an opportunity, conditional on performance, to earn above-average total compensation (i.e., base pay plus short-term and long-term incentive payments). All full-time employees participate in one or more incentive programs. Incentive plan structures are designed to motivate and reward performance delivery against pre-set objectives, benchmarks, or both.

Investment incentive compensation programs are measured on a four-year basis; accordingly, the impact of the 2008 under-benchmark performance is moderated by the 2006, 2007, and 2009 positive performance. The underperformance in 2008 will continue to carry forward and impact compensation through 2011.

## 2009 performance results

### Corporate performance

Each year, the executive team collaborates to establish corporate and divisional objectives for the fiscal year. All employees are aligned with individual objectives to support the corporate and/or divisional objectives. The corporate objectives always include a measure of the rate of return, dollars of value added (i.e., dollars earned versus benchmark dollars earned), and service quality in relation to expenses.

Additional corporate objectives include significant strategic initiatives supported by management. Corporate and divisional objectives are assessed and a report card is prepared to determine the overall level of performance achieved.

CORPORATE OBJECTIVES			
	Actual	Goal	Status
<b>Rate of return</b>			
One-year vs benchmark	12.96%	8.78%	✓
<b>Dollars of value added above benchmarks (net of costs)</b>			
One-year (\$ millions)	\$3,183 <sup>1</sup>	Exceed benchmark	✓
<b>Service expenses and quality</b>			
Ongoing Member Services costs (\$ millions)	\$37.42 <sup>2</sup>	\$38.69	✓
Cost per member	\$128.1 <sup>2</sup>	\$132.0	✓
Quality Service Index	9.06/10.0	>9.0/10.0	✓
<b>Other corporate objectives in 2009 include:</b>			
Define and plan for implementation of Strategy 2020			✓
Improve investment risk reporting accuracy and completeness			✓
Achieve milestones towards conversion of our FMC Portfolio Management System to SimCorp Dimension			✓
Implement plan changes			✓

<sup>1</sup> Net of expenses.

<sup>2</sup> Net of adjustments for processing inactive members and long-term incentive payments.

### *Investment performance*

At the beginning of each year, the board members approve the active risk allocation for the total fund and each investment department, which in turn establishes expected annual dollar value-added performance goals (i.e., dollars earned versus benchmark dollars earned) for the year. The greater the risk allocation for a department, the greater the value added target to be achieved. Actual investment performance at the total fund and departmental levels (measured in dollars of value added after expenses) is compared against the target for adding value above the benchmark. This value-added performance is measured over four annual performance periods and incentive payments are based on an average of the previous four years' performance factors.

In 2009, the total fund value-added performance after expenses was \$3,183 billion, resulting in a performance factor of 9.97. The significant overperformance from 2006, 2007 and 2009 smoothes the underperformance from 2008. The result is a positive payout factor for the four-year total fund performance. The negative performance in 2008 will continue to be carried forward for the following two years. Departmental payout factors for the Short-term Incentive Plan ranged from zero to five, reflecting the performance of each asset group.

### **Compensation programs**

#### *Unionized employees (327 employees)*

Compensation structures have been negotiated into the Collective Agreement. The new four-year agreement runs through December 31, 2013. All bargaining unit employees are eligible for short-term incentives based on the following three elements:

1. corporate performance;
2. individual performance; and
3. cost control and quality service targets for those bargaining unit employees in the Member Services departments and total fund performance above the composite benchmark for those employees working in investment-support departments.

#### *Management and professional employees*

##### *Base salary (443 employees excluding students)*

Base salaries for staff are intended to be market competitive, are reviewed annually after the end of each fiscal year, and salaries for vice-presidents and above are approved by the board members. In setting salaries, consideration is given to individual performance and salary range adjustments against our market comparators.

#### *Short-term Incentive Plan*

##### ■ *Member Services and Corporate (110 participants)*

Rewards are based on the corporate performance score and achievement of individual objectives over the course of the year. Target incentive payments are set as a percentage of salary for delivering fully satisfactory performance against objectives and competencies. Based on performance, actual payments can range from zero to two times the target incentive amount.

##### ■ *Investment support (135 participants)*

Rewards are based on the corporate performance score, achievement of individual objectives and four-year total fund performance above a composite benchmark. Target incentive payments are set as a percentage of salary for delivering fully satisfactory performance against objectives and competencies. Based on performance, actual payments can range from zero to two-and-a-half-times the target incentive amount.

- *Investments (198 participants)*

Rewards are based on the achievement of total fund and investment department performance, measured in dollars of value added above established benchmarks over four annual performance periods. Senior executives have an individual performance component that reflects achievement of annual objectives and leadership competencies.

Target incentive payments are set as a percentage of salary for delivering benchmark performance. Based on actual total fund and departmental performance, actual incentive payments can range from zero to five times the target incentive amount.

#### *Long-term Incentive Plan*

- *Member Services (17 participants)*

This program is available to employees at the director level and above. Rewards are based on delivery of cost control relative to inflation and quality service results, both over three years. Target incentives are set as a percentage of salary at the start of the three-year cycle to which a multiplier, determined by actual performance, is applied. The actual incentive payment can range from zero to two times the target incentive amount.

- *Investments (141 participants)*

This program is available to investment employees at the assistant portfolio manager level, and higher, and corporate vice-presidents. A small number of select employees in investment support areas may receive discretionary grants each year. The program is based on four-year performance results to reward investment managers in a manner that matches our long-term goals and strategies.

At the start of the four-year cycle, employees receive an initial dollar grant. These dollar grants are determined based on a percentage of the employee's salary plus prior year's annual incentive. The initial dollar grant will increase or decrease in value over the four-year period based on two factors:

1. a combination of total fund and investment department performance, measured in dollars of value added after expenses above established benchmarks over four annual performance periods; and
2. the compound absolute rate of return for the total fund over the four-year period.

#### *Benefits*

Teachers' provides a competitive benefit program which includes life insurance, disability, health and dental benefits, time-off policies, and an Employee Assistance Program. Teachers' retirement benefit for employees is a defined benefit pension.

#### *Looking forward*

During 2009, Teachers' conducted a review of its compensation programs to ensure they are aligned with Investment and Member Services business strategies, are market competitive, and drive the desired behavioural outcomes for our continued success. The compensation system will be amended in 2010, consistent with the following principles:

- alignment with corporate and divisional strategies;
- alignment of compensation with relevant short-term and long-term goals; and
- alignment of pay for performance with appropriate risk governance measures.



### Executive compensation

The compensation table represents disclosure of base salary, annual bonus, long-term incentives and other compensation earned in 2009, 2008 and 2007 by the Chief Executive Officer, Chief Financial Officer and the three other most highly compensated executives, excluding subsidiary companies.

<i>Name and Principal Position</i>	<i>Year</i>	<i>Base Salary<sup>1</sup></i>	<i>Annual Bonus<sup>2</sup></i>	<i>Long-term Incentive Plan</i>	<i>Other Compensation<sup>3</sup></i>	<i>Change in Pension Value</i>	<i>Total Compensation<sup>4</sup></i>
<b>Jim Leech<sup>5</sup></b> President and CEO	2009	\$500,000	\$706,300	\$1,098,200	\$10,455	\$746,500	\$2,314,955
	2008	441,923	435,600	1,148,900	10,365		2,036,788
	2007	274,123	850,000	2,241,900	1,212		3,367,235
<b>David McGraw</b> SVP and CFO	2009	285,000	144,600	169,700	7,612	133,400	606,912
	2008	293,269	109,700	174,500	6,855		584,324
	2007	256,827	149,200	393,000	3,828		802,855
<b>Neil Petroff<sup>6</sup></b> EVP, Investments	2009	350,000	581,000	751,200	592	1,585,200	1,682,792
	2008	310,906	568,100	848,600	538		1,728,144
	2007	263,731	580,000	2,241,900	476		3,086,107
<b>Wayne Kozun</b> SVP, Public Equities	2009	243,800	487,600	581,100	417	211,500	1,312,917
	2008	247,769	487,600	533,200	430		1,268,999
	2007	202,132	371,700	993,800	365		1,567,997
<b>Ron Mock</b> SVP, Fixed Income and Alternative Investments	2009	230,000	460,000	537,300	9,239	158,400	1,236,539
	2008	226,865	376,900	391,400	9,239		1,004,404
	2007	199,715	354,000	1,397,600	4,250		1,955,566

<sup>1</sup> Bi-weekly payroll resulted in 27 payments for 2008 versus 26 bi-weekly payments.

<sup>2</sup> 2008 annual incentive payments for Mr. Leech and Mr. Petroff have been deferred until 2011.

<sup>3</sup> Other compensation includes one or more of the following: group term life insurance, automobile allowance, unused vacation cashout.

<sup>4</sup> Change in pension value is not included in Total Compensation.

<sup>5</sup> Mr. Leech was appointed President and CEO on December 1, 2007.

<sup>6</sup> Mr. Petroff was appointed Executive Vice-President, Investments, on January 1, 2009.

There are no severance guarantees in place.

### Retirement benefits

Executive employees of the Ontario Teachers' Pension Plan participate in the Public Service Pension Plan (PSPP) and the Public Service Supplementary Benefits Account (SBA). These plans combined provide indexed pension benefits equal to 2% of the executive's best five-year average annual base salary for each year of service, less a CPP integration formula. Benefits under these combined plans are capped by the base salary reached at the maximum pension contribution permitted under ITA regulations.

Executives earning 2009 annual salaries in excess of \$209,380 also participate in a non-registered, unfunded Supplemental Employee Retirement Plan (SERP). This plan provides non-indexed retirement benefits equal to 2% of the executive's best three-year average annual salary for each year of service, less the initial annual pension to which the executive is entitled under the PSPP and SBA, combined.

- For executives at the Executive Vice-President level and above, average annual salary includes a percentage of annual incentive, building at 20% per year to 100%.
- For executives at the Senior Vice-President level, having attained the age of 55, average annual salary includes a percentage of annual incentive, building at 10% per year to 50%.
- For executives at the Vice-President level, having attained the age of 55, average annual salary includes a percentage of annual incentive, building at 5% per year to 25%.

The total liability for the SERP increased by a net amount of \$2.2 million in 2009 for a total accrued SERP liability of \$18.2 million as at December 31, 2009.

The table below outlines the estimated present value of the total pension from all sources (PSPP, SBA and SERP) and estimated annual pension benefits at age 65 for the Chief Executive Officer, Chief Financial Officer and the three other most highly compensated executives, excluding subsidiary companies.

<i>Name and Principal Position</i>	<i>Projected Years of Service at Age 65</i>	<i>Estimated Total Annual Pension Benefit at Age 65</i>	<i>Present Value of Total Pension at January 1, 2009</i>	<i>2009 Compensatory Annual Change in Pension Value</i>	<i>2009 Non-Compensatory Annual Change in Pension Value</i>	<i>Present Value of Total Pension at December 31, 2009</i>
<b>Jim Leech</b> President and CEO	11	\$293,500	\$2,515,000	\$801,300	-\$54,800	\$3,261,500
<b>David McGraw</b> SVP and CFO	17	165,000	406,000	126,200	7,200	539,400
<b>Neil Petroff</b> EVP, Investments	32	766,000	1,786,800	1,888,700	-303,500	3,372,000
<b>Wayne Kozun</b> SVP, Public Equities	36	462,200	1,177,000	296,200	-84,700	1,388,500
<b>Ron Mock</b> SVP, Fixed Income and Alternative Investments	17	140,800	720,200	137,700	20,700	878,600

The values shown are estimated based on assumptions and represent entitlements that may change over time.

### Board and committee member remuneration

Each year, the Human Resources & Compensation Committee of the board reviews compensation policies, including incentive components linked to investment department and total fund performance. In 2009, the board retained the services of an independent compensation consultant to review management's recommendations on planned changes to the compensation system for 2010.

Each board member receives an annual retainer of \$12,000, plus \$12,000 as a member of the Investment Committee. The board Chair receives an additional retainer of \$100,000 and the Chairs of the Investment, Governance, Human Resources & Compensation and Audit & Actuarial Committees receive additional retainers of \$5,000 each.

Fees for committee and other eligible meetings are \$1,200. Board meeting fees are combined with Investment Committee fees at \$1,500 per day. The Chair of the Benefits Adjudication Committee receives an additional fee of \$1,000 for each Benefits Adjudication meeting or hearing attended to a maximum of five per annum.

Board members are reimbursed for normal expenses for travel, meals and accommodation, as required. For 2009, these expenses totalled \$82,000.

<i>Board Member</i>	<i>Retainer and Chair Fee</i>	<i>Board Meetings</i>	<i>Committee Meetings</i>	<i>Meeting Fees</i>	<i>2009 Total Remuneration</i>
<b>Eileen Mercier</b> , Chair of the board	\$124,000	11	26	\$47,700	\$171,700
<b>Jill Denham</b> , Chair, Human Resources & Compensation Committee	\$ 29,000	11	30	\$52,500	\$ 81,500
<b>Helen Kearns</b> , Vice-Chair, Benefits Adjudication Committee	\$ 27,000	11	37	\$60,900	\$ 87,900
<b>Hugh Mackenzie</b> , Chair, Benefits Adjudication Committee	\$ 29,000	11	39	\$63,300	\$ 92,300
<b>Louis Martel</b>	\$ 24,000	10	24	\$43,800	\$ 67,800
<b>Guy Matte</b> , Chair, Governance Committee <sup>1</sup>	\$ 29,000	10	23	\$42,600	\$ 71,600
<b>Sharon Sallows</b>	\$ 24,000	11	28	\$50,100	\$ 74,100
<b>David Smith</b> , Chair, Audit & Actuarial Committee <sup>2</sup>	\$ 10,602	5	15	\$25,500	\$ 36,102
<b>William Swirsky</b> , Chair, Audit & Actuarial Committee <sup>2</sup>	\$ 21,750	7	16	\$29,700	\$ 51,450
<b>Jean Turmel</b> , Chair, Investment Committee	\$ 29,000	11	26	\$47,700	\$ 76,700

<sup>1</sup> Guy Matte retired on December 31, 2009.

<sup>2</sup> William Swirsky was Chair of the Audit & Actuarial Committee from January 2009 to August 2009. David Smith assumed this position in September 2009.

## Legislation update

As a result of the filing of the 2008 funding valuation, Schedule 1 and the Partners' Agreement, including the Funding Management Policy, were amended by the partners on June 3, 2009 (effective January 1, 2009) as follows:

- Schedule 1 was amended to clarify application of the 1% increase in the basic contribution rate;
- the Partners' Agreement was amended to expressly incorporate the Funding Management Policy; and
- the Funding Management Policy was revised to reflect the operational mechanics of implementing and tracking conditional inflation protection.

Schedule 1 was also amended by the partners on June 3, 2009 (effective January 1, 2010) to require the government and designated employers to pay extra contributions in the event that conditional inflation protection is invoked. Enabling amendments to the Teachers' Pension Act (TPA) to allow this to happen have been passed into law by the Ontario government (effective January 1, 2010).

Further changes to the TPA to allow for third-party management of other pension plans and/or funds by the Ontario Teachers' Pension Plan (subject to the Partners' Agreement) were passed into law in June by the Ontario government.

The Partners also agreed to changes to Schedule 1 that simplify and streamline the buyback process for members. These changes, effective September 1, 2010, have now been signed off.

We responded to the Canadian government's request for comments on its March 2009 consultation paper regarding private pension plans regulated under the federal Pension Benefits Standards Act, 1985 (since we invest in federally regulated companies whose pension plans are subject to this legislation, and also because our investments are affected by the investment rules under this statute since they have been adopted under the Ontario Pension Benefits Act). Our response focused on pension funding and investment rules, similar to our earlier response to the report of the Ontario Expert Commission on Pensions (the Arthurs Report), as well as pension coverage and current limits under the Income Tax Act (Canada).

The Ontario government enacted new rules in 2009 that will simplify and streamline the valuation and division of pension benefits upon marriage breakdown. This will replace the previous regime that was unnecessarily complex for plan members.

The Ontario government has also announced a number of proposed reforms to the Pension Benefits Act (PBA) arising from the Ontario Expert Commission on Pensions Report (2008). We are in the process of reviewing these proposals and their potential impact on the Plan.