Speech to the Ontario Teachers' Federation, Board of Governors

Remarks by Robin Korthals, Chair, Board of Directors
Ontario Teachers' Pension Plan

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Good afternoon, everyone, it is a pleasure for me to be here today to bring you up-to-date on activities at the pension board.

Bonne après midi à tous, c'est un plaisir pour moi de me retrouver parmi vous et de vous donner un complete rendu des activités de votre Regine de Retraite.

This summer the Plan has welcomed its 100,000th pensioner. It's a milestone that highlights our status as one of the largest payrolls in the country – and one that continues to grow. In addition, this is a pivotal year for your pension plan. Plan sponsors must submit proposals to eliminate the expected funding shortfall as of January 1, 2006.

So this is a good time to review the performance of the Plan and our outlook for the future.

We have a tremendous responsibility at the Ontario Teachers' Pension Plan Board, so let me review the exact nature of our mandate.

1. We are responsible for administering the pensions of Ontario's 260,000 current and retired teachers;
2. We set and implement the plan's investment strategies;
3. And, finally, we provide information on the Plan's funding status, and advise the Plan's sponsors – the Ontario government and the OTF – on the setting of benefit and contribution levels, which is their responsibility.

Today I'm going to deal with these three topics in that order, focusing first on our performance in providing day-to-day service to Plan members.

When it comes to providing service, the Ontario Teachers' Pension Plan sets a high standard.

Providing first-class service is not an easy task, but doing so year after year while managing costs – that is a real accomplishment. This is just what Rosemarie McClean and her team at the Plan manages to do. To test our performance, we survey Plan members constantly and we regularly benchmark our service levels against other pension plans around the world.

In the most recent benchmarking study comparing 62 pension plans internationally, we were ranked #2 in service levels in our peer group. It's worth noting, too, that the #1 plan is twice as expensive as we are on a cost-per-member basis. We were ranked #1 in the categories of Member Statements and Service to Employers.

At the same time, our cost for member services – on a per-member basis – is stable. In 2004, the cost of service per member was $127 compared to $129 the year before and we continue to look for opportunities to keep our costs under control.

The feedback from members on service quality has remained positive. In 2004, our Quality Service Index – the way we measure the feedback solicited from members – was 9.2 out of a possible 10 and we have continued to measure at this very high rate in 2005.

The Quality Service Index – or QSI – is compiled directly from member feedback throughout the year by a third party supplier. We listen to what you have to say, and we design training and other programs based largely on your views.

That's why we remain committed to providing the human touch, both in person and on the phone. At the same time we increasingly are using technology and web-based services to improve the speed, accuracy and completeness of the information we can offer to you.

Our surveys tell us you like the convenience and personalization of our new electronic information services. But they also indicate you want to be able to talk to a person when necessary – someone who is prompt, knowledgeable and helpful.

To be more helpful – and timely – we are becoming even more pro-active in meeting member needs. For instance, we are working on a project to identify member communication preferences. Do you like to get e-mail or regular mail? What time of the day should we call you? How do you feel about receiving calls in the evening? We are enhancing our database to better customize the type and nature of the services we provide to you.

Another aspect of being pro-active involves reaching out to you with service before you realize you may need it. The data we collect from employers is critical here. If we know you are planning a maternity leave, for example, we can send you a package before you even request one. The package would outline your options on continuing to build pension credits while you are away from the classroom.

To ensure the data we get on Plan members is accurate, we are working with Boards and other employers to audit the information that is sent to us. We are auditing four employers per year and have been able to identify some areas where data is incomplete or contains errors.

We are also asking the finance officers at your employers to certify the data that they send to us, much like public companies have to certify their financial results, to increase their focus on the reliability of the data.

Comprehensive, accurate data allows us to do a better job for you, eliminating costly mistakes and reducing inconvenience for our members.

Another pro-active initiative is our program to track down members who have lost touch with the Plan. These members may have been teachers for only a short while before deciding to pursue a different career. They have contributed to the Plan but are out of touch and don't have adequate length of service to receive a pension. So far in 2005, we have paid 6,408 refunds and we have a goal of 10,000 by year end. The average refund, including interest, is about $700. It's been a pleasant surprise for many former members.

While some inactive members may have lost touch with us, far more working teachers are becoming directly connected on-line and in real-time. As of today, about 59,000 members have registered for our secure website, *i*Access, so they could check on their personal pension accounts at any time of the day or night. That's an increase of about 14% since the end of the year.

Earlier this year, Teachers' was a winner in the eighth annual Benefits Canada communications awards, in the category of "Best Online Strategy". We won for the ease of use and quality of our interactive, on-line annual pension statement, which is available to those members who have registered for *i*Access.

The e-statement contains the same information as the print version. But it also offers many useful interactive features including a custom tool that allows users to build their own retirement scenarios and compare them. All the information is as up-to-date as the minute you sign in.

The biggest indicator of success for the e-statement was the fact that our call centre reported the fewest calls ever after an annual statement mailing.

While electronic services cannot and will not replace the personal touch, it is clear they are adding to the service we are providing while helping us to reduce costs. At the Board, we continue to be very pleased with the service levels we attain.

On the investment side, Teachers' is also enjoying another solid year. Our investment team has a tremendous track record over the past few years, and indeed since the inception of active investing of the Fund in 1990.

But there is no foolproof formula when it comes to investing. As valuations are almost universally high today in equity markets, real estate, energy and other commodities, the future remains uncertain.

The fund continues to actively search for ways to add value while closely managing risk. As Bob Bertram, our Executive Vice President of Investments, reminds me, very little in the investment marketplace is cheap these days, so you have to be more creative to add value.

That was the thinking when the fund adopted a more active investment philosophy in 1990 and that's our thinking today. And it has paid off – with $16 billion in value added to the Fund through successful investment strategies over the past 15 years.

Private equity, infrastructure and emerging markets are among the places the fund is looking at today to acquire assets at reasonable prices. We have been adding expertise and resources in all these areas. However, even in these areas, markets are increasingly competitive and expected returns are being driven lower.

The infrastructure category includes such assets as electrical and gas transmission systems, oil pipelines, toll highways, power generation, water supply services, and airports. We like these activities as they are often regulated, with high barriers to the entry of new competitors. And they offer healthy, stable returns that can be well matched to our pension liabilities.

What sort of opportunities are we talking about? Since the beginning of the year, Teachers' has completed or announced three large acquisitions of infrastructure assets as well as the closing of two significant private equity deals.

In April we formed a joint venture with another investor to purchase InterGen and 10 of its power plants around the world for about $2.2 billion. Most of the power from these plants is sold under long-term contract, so we expect solid, long-term cash flows from this investment. The InterGen power facilities are the most modern, efficient and cleanest thermal facilities in the countries where they operate.

With this acquisition in addition to our previous purchase of power generation plants in the U.S., we are co-owners with our partners AIG, of as much electrical generating capacity as exists in the province of Alberta. The closing of this acquisition in early August increased our infrastructure assets to more than $4.5 billion.

But we are not stopping there. In April, we announced an agreement to acquire 25% of Northumbrian Water Group for about $615 million. Northumbrian provides water and sewerage services to 2.6 million people in the northeast of England and water services to 1.7 million people in the southeast of England. We are interested in making long-term investments in the water sector and we like Northumbrian's focus on its regulated utility activities and the strength of its management.

Then in June, Teachers', OMERS and a UK based operating partner purchased gas distribution networks in Scotland and the South of England. The value of Teachers' holding is about $1.8 billion with the total transaction funded two-thirds by debt and one-third by equity and shareholder loans. In total, the two networks deliver gas to about 5.6 million industrial, commercial and domestic customers.

We have also been very busy in the private equity area, with the April closing of the acquisition of CFM Corporation. CFM is a leading manufacturer of fireplaces as well as barbecues in North America and the United Kingdom. It's headquartered in Toronto.

In January, we completed the purchase of Alliance Laundry Holdings, a manufacturer of industrial washers and dryers, for about US$450 million. The management of Alliance continues to hold a significant investment in the company and we are working with them to grow the business.

On August 3rd, we announced with a partner, a definitive agreement to buy National Bedding Co., the maker of Serta mattresses, one of the oldest and best known names in the bedding industry. The company's two founders will remain investors and continue as members of the Board of Directors.

We see real potential to add value to all these businesses.

All of these new investments are examples of how the fund is having to look a little farther afield to capture added value.

At the end of 2004, the board of directors approved a change in Teachers' investment policy, lowering our target exposure to public and private equities to 45% from 50%. It may not seem like much, but it's significant in the investment world.

Compared to five years ago, we hold more value-added assets, including real estate, private equity and infrastructure. We also have more foreign exposure, and have increased our interest in energy investments.

On the subject of foreign investments, we welcomed the recent removal of the 30% maximum that could be invested by pension funds outside Canada, not because it will allow us to invest more outside the country, but because it lowers our costs. Instead of having to use derivatives and other tools to allow us to invest outside Canada we can now do it directly. That should save the fund close to $10 million a year, not a trivial sum because it represents the pensions of close to 300 retirees for one year.

So how has the fund performed so far in 2005? At the end of June, assets had increased to $88 billion from $84 billion at year end – and that's after paying out $1.7 billion in pensions.

While this is a respectable increase, I asked Bob where we could have done better this year and he gave me a few examples – for instance:

- We have persistently underweighted the US dollar and bond duration on the expectation that both would drop in value. Neither has. We still expect a weaker dollar and long-term bonds but so far this year this strategy has cost the fund about one half of one percent or about $400 million.

- In addition, if we had invested more in the Toronto Stock Exchange we would have done better because the TSX has increased by 8% in the first six months and by around 14% up to now, which is better than we have done.

- Finally, we could have gone more into energy stocks.

Of course, all of this is with the benefit of hindsight. Our experience in the rest of the year could be completely different.

Speaking about energy stocks, I can tell you that our two largest investments at the end of June were still Fording Coal and Nexen, the oil and gas company. Combined, they have increased in value by close to $0.5 billion and were worth $2.9 billion at the end of last week.

My final item for discussion today is the difficult issue of the funding status of the Plan. We will not have an official estimate of the funding shortfall until the end of the year, but at June 30, we estimate that it will be slightly higher than at the end of 2004. One factor is real interest rates, which remain at historical lows. But, we should not forget that a low interest rate also helps increase the value of our assets and also increases the value of each pension. We think there is a possibility of some increases in real rates by the end of the year, but nowhere near enough to make a major difference to the shortfall.

I know that a number of potential remedies to the situation are being considered by the plan sponsors. At the pension plan board, we have been outlining potential scenarios to the OTF and the government.

It is not my place to offer a final solution to the funding shortfall. But let me close with a reminder of what all of us here – the Board, the OTF, the Ontario government – are trying to achieve.

In the end, it's all about our plan members. A good example is Donna, a special education teacher who retired in June from the Hamilton-Wentworth District School Board and is the 100,000th person on the Teachers' pension payroll.

Donna began teaching in 1972 and says if she hadn't gone into teaching, she doesn't believe she'd have the pension security she has today. That security is allowing Donna to travel with her husband, who retired from teaching three years ago, and to enjoy curling, tennis and other pastimes. Their first big trip is to Australia to visit one of their daughters.

If Donna follows the pattern of a typical teacher retiring today, she will collect a pension for the next 30-plus years.

Providing security of retirement income for people like Donna is what the Ontario Teachers' Pension Plan is all about. With almost $90 billion in assets, that seems easy to imagine for teachers retiring today. But security is a more difficult thing to guarantee for teachers who will begin work this September and who assume they will be able to rely on pension cheques arriving more than 60 years from now.

It's for people like Donna and for the new teachers that begin work in September, that the Ontario Teachers' Pension Plan Board was created to invest in the open market. There will be lots of uncertainty ahead; so we need a funding solution that minimizes the effect of that uncertainty on the future for all Teachers'.

Nous avons fait beaucoup de progrès durant les quinze dernières années, mais notre défi aujourd'hui est de remédier à la sous-capitalisation du régime.

In the meantime, your board of directors is very pleased about the progress of the plan. Teachers work hard, they make generous contributions to the plan and they deserve the best in investment performance and member services. I am delighted to say that is exactly what you have been receiving from the management and staff of the plan. We look forward to continuing to perform and innovate to deliver the best to our members.

Thank you for your time and attention. Merci de votre attention.