Ontario Teachers' Pension Plan
Annual Meeting

Remarks
by

Jim Leech,
President and CEO

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The Carlu
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Thank you, Eileen, and good evening, everyone. Bonjour et bienvenue a toutes et a tous.

2009 was an invigorating time for management at Teachers'. We spent the year taking care of the business of the plan through the tail end of the financial market crash and its aftermath, while also fortifying the plan for the future. And that is the context for my remarks tonight.

I would like to start my address by thanking Eileen and our board members for their thoroughness and support during one of the most trying periods in economic history. The wisdom of the decision, made two decades ago, to install a professional board of investment, economics, actuarial, accounting and business experts was clearly demonstrated. Calm heads have prevailed since the start of the recent economic chaos. You have been open to management strategies for improving investment returns and augmenting our risk management structure. You asked the right questions when they needed to be asked. You encouraged us to continue to focus on our plan's circumstances and opportunities for success and not be distracted by the plight of others. And you backed several new investment ideas that have already started to pay off. Your confidence and encouragement have been invaluable and are benefitting the teachers and taxpayers of Ontario.

With retirements and appointments, we have some new members on our executive team. I hope you will have a chance to meet them during our reception.

You know Neil, of course. Eileen mentioned that Tracy is representing Rosemarie McClean today – Rosemarie is actually at home with her newborn twins ... I'm not sure if that is double trouble or twice as nice …

Please welcome the rest of the Executive Team. They are:

- David McGraw, Senior Vice-President and Chief Financial Officer
- Melissa Kennedy, General Counsel , Corporate Secretary and Senior Vice-President, Corporate Affairs
- Barbara Zvan, Senior Vice-President, Asset Mix & Risk and Chief Investment Risk Officer
- Russ Bruch, Vice-President and Chief Information Officer
- Peter Maher, Vice-President, Audit Services
- Marcia Mendes-d'Abreu, Vice-President, Human Resources
- Madhav Murti, Vice-President, Business Process Management

Melissa and Madhav joined us during the past year, and Marcia joined in mid-2008. Now, it's said there is nothing like a crisis to help a team to bond, and I think we can all attest to that!

I mentioned the tail end of the financial markets crash. Many forget that the financial crisis was not confined just to 2008. It spilled over through the first quarter of 2009, carrying with it continuing economic carnage. In fact, exactly one year and one month ago today … March 9, 2009… was the day the markets hit their lowest point. The Toronto Stock Exchange index. Dow Jones. S&P. Nasdaq. They all hit their troughs that very day.

So our fund's results - $10.9 billion in earnings, 13% rate of return, 4.2% above benchmark - are all the more remarkable, occurring in just the last nine months of the year.

Both sides of our business turned in stellar results. Our Member Services Division earned 9.1 out of 10 in our quality service index, which is a rating from our members. And they remain among the leading service providers of their kind in the world.

Last year I stood in front of you and recounted how humbling 2008 had been. Fortunately, 2009 marked a strong return to the black. But it was a confusing year for many people viewing our funding position. Although we turned in one of our best years of value added investment returns ever, the preliminary funding valuation shows a shortfall that is seven times the size of what we reported last year …. when we suffered an 18% loss. It seems to defy logic. Great returns on one hand, but a worsened shortfall on the other.

I will try to help you understand how that can be.

The reasons for the shortfall are three-fold:

- First, is our sensitivity to real interest rates, which continued their decline last year. Each 1% drop in the real rate impacts our projected cost of future pensions by more than $25 billion. The 2008 year-end interest rate was 2.1%, whereas the 2009 year-end rate was 1.5%. That 0.6% difference accounts for just over <u>$15 billion of our deficit</u>.

- The second reason for the shortfall is the continuing smoothing-in of last year's losses. Pension plans invest and pay benefits over many decades. That is why we, like other pension plans, "smooth" some investment results over five-year periods. We literally flatten out the peaks and valleys of investment returns to reduce volatility and the benefit and contribution rate increases or decreases that would result. During 2009 we recognized $6.8 billion of net losses from previous years. As we enter 2010, unamortized net losses still total $12.7 billion, and they must be absorbed in future years.

- The third factor is our $1.7 billion cash flow deficit, which is the difference between the $4.4 billion we paid out last year in pension benefits and the $2.7 billion we received in contributions.

So, while we earned nearly $11 billion, that total was outweighed by the impact of higher projected pension costs, unrealized losses from 2008 and annual net cash outflows.

That is the simultaneous, double-barreled "strong earnings-but-recurring shortfall" phenomenon that has preoccupied all of us at the plan this past year.

With that backdrop, let me explain how we approached 2009.

First, I must stress that the tough decisions we made in 2008 allowed us to enter 2009 with good assets and a strengthened investment team. Neil and his team were brilliant in executing to their investment plan.

They returned the fund to the black, by rolling up their sleeves and:

- repositioning our Fixed Income portfolio;
- continuing to look for investment opportunities while others remained frozen in their tracks;
- reinforcing our total fund management value-add approach; and
- starting the overhaul of our risk and data systems.

And on the funding front: as Eileen noted, a valuation was filed as at January 1, 2009 to provide our sponsors with more time to address anticipated further shortfalls, which they are doing through the Sustainability Working Group. This group has been active since October last year and, speaking for plan management, we are most encouraged by the spirit of engagement at the table. You will see a display in the lobby today, featuring the new website, FundingYourPension.com, that has been launched by this group's Education and Communications Committee. I know that pension funding is a complex subject, and I think you will find it most useful in understanding the various pieces of the puzzle and their impact on our funding position – from interest rates to assumptions to demographics. I hope you'll tune in to one of the upcoming webcasts, too.

At Teachers' we view all of our work through a lens of risk management. I echo Eileen's comment that risk management must begin at the top. If risk consciousness is to be part of our culture, all of us on the executive team, and in turn all employees, must be committed to successful risk management. We had this top of mind last year, when we decided to update

our Mission Vision and Values statements, through a grassroots effort, involving employees from across the organization at all levels.

In addition to our new Mission Statement: *Outstanding service and retirement security for our members – today and tomorrow,* a new aspirational Vision statement was adopted: *To become the world's leading pension plan organization*.

And our Values were refreshed. Perhaps most significant among these is the addition of a new value: *We champion accountability and risk consciousness*.

As we launched our revitalized Mission Vision Values internally, we went out to members and to our employees, and asked them about their impressions of RISK at Teachers'. We showed these video clips in a recent employee Townhall and thought you might find them interesting as well.

So, as you can see, we take your financial interest to heart.

It is this same risk consciousness that drives both our investment philosophy and our approach to plan valuation. Given our demographics, we must be more risk averse than other pension plans. It would not be fair to members to be otherwise, because it is working members' benefits and contribution rates that would have to be adjusted to make up for shortfalls. As a result, the same risk consciousness carries over to our assumption of what our long term rate of return is projected to be. We know it is too risky to have a high proportion of our assets in equities, because we could lose as much as we gain. That is why we must project a lower rate of return than other pension plans.

Economic projections are a planning tool. Nothing more. Nothing less. When our internal and external actuaries project the plan's future cost of pensions and rates of return, they are trying to equip us with the tools we need to plan our investment approach to funding your pension.

As part of a "sanity test", we recently accessed data from three of the top consulting firms in the country to compare plan maturities and rate of return assumptions. As you can see on this slide, Teachers' is in the *top decile* of maturity, compared to other plans in Canada. That means that less than 10% of all plans have a maturity level similar to ours.

On the other hand, as you see in this slide, 25% of all plans have *lower* rate of return assumptions.

Our comparative plan maturity is why our assumptions must be more conservative than many others. To do otherwise would not be prudent, as it would expose working and future teachers to undue risk of loss. As someone once said, the root of *conserv*ative is *conserve* .

Given the funding challenges that we face, and the retirement financing role we play in this country, we need our elected officials to do what they can to ensure we can compete on a level playing field. With that in mind, I want to thank the provincial government for signaling in its recent budget its willingness to consider eliminating two arcane pension rules:

- the maximum 30% ownership rule, and
- the requirement for jointly sponsored pension plans to fund under the solvency test.

I want to acknowledge the support of the Ontario Teachers' Federation in helping us advance the case for eliminating the solvency test requirements. I hope that we can count on your support for the elimination of the 30% rule as well.

It is noteworthy that the Arthurs Commission recommended both of these rules be dropped. They recognized that they harm our competitiveness, add extra costs and serve only obsolete policy considerations.

In the case of the 30% rule, for example a US or German or Asian pension fund could come into Canada and buy 100% of a local corporation, But, because of this outdated rule, we have to either bow out of the race, or construct costly, complex, time-consuming structures that eat into our rate of return. This is not a theory. This is a day to day reality that we live with that does nothing but cost teachers money.

So, as you can see, some areas affecting the plan are completely out of management's control. We cannot change the reality of plan demographics or interest rates. We cannot change legislation. What we *can* do, is *respond* to these factors as effectively as possible in all of the areas we *do* control, by, for example:

- adapting our investment program to do all we can to reduce the gap between assets and liabilities;
- managing our costs;
- attracting and retaining the best talent; and
- providing the OTF and the government with the best possible advice.

We are committed to delivering nothing less than excellence in all of these areas, because we are committed to delivering pension stability to our members.

It is now my pleasure to welcome Neil Petroff, our Chief Investment Officer, to provide details on your fund's investment performance.

Neil?