The fund achieved an 18% return in 2003, yet the plan has a funding shortfall. Let me explain.

Claude Lamoureux, President and Chief Executive Officer

Third best return in fund’s history

2003 was a good year for investments. In fact, it was the third best rate of return in the fund’s history, and the strong rebound in equity markets helped restore the asset side of the plan’s balance sheet.

- Net assets grew to $75.7 billion.
- Rate of return was 18% compared to 13.5% for the fund’s benchmark.
- Investment managers added $2.7 billion in value above market benchmarks.
- Fund earned $11.4 billion in investment income.

First shortfall for plan since 1990

Assets and benefits must balance for the pension plan to remain healthy over the long term. The responsibility for ensuring the plan is fully funded lies with the Ontario Teachers’ Federation (OTF) and the Ontario government.

An actuarial valuation showed the plan had a shortfall of $6.2 billion on January 1, 2004. This is the first time the plan has experienced a shortfall since the pension board was created in 1990.

What’s Inside

Why a Shortfall? p.2
Outperforming Markets p.4
Major Investments p.6

Rates of Return for the year ended December 31 (percent)

Net Assets as at December 31 ($ billions)

10% 10-year average

Long-term performance counts for pension plans.
**How did this shortfall happen?**

The fund’s investment performance alone does not determine the plan’s well-being. While net assets increased to $75.7 billion, future pension costs grew faster due to factors beyond our control.

Why? A combination of factors created a ‘perfect storm’ for most defined benefit pension plans.

1. **Dropping real interest rates** pushed future pension costs significantly higher. The independent actuary uses real interest rates (after inflation) to estimate how much the plan needs to pay all future promised pensions.

2. **Equity markets dropped** sharply producing negative returns for the plan in 2001 and 2002, although the fund’s investments performed better than the markets during this downturn.

3. **Surpluses were used** to eliminate the government’s special payments and to improve benefits, such as the 85 factor and improved pensions after age 65.

The net result is a plan shortfall. This is a serious shift from surpluses in recent years. However, the news is not surprising; we warned of a possible shortfall in last year’s *Report to Members*.

The funding valuation, conducted by an independent actuary, measures the plan’s ability to pay pensions over the next 70 years. It takes into account investment performance and the cost of future pensions as well as two factors outside our control: the levels of benefits and contributions. We cannot change the contribution rate or pension benefits. These are set by the OTF and the Ontario government, the plan’s co-sponsors.

“Assets and benefits must balance for the pension plan to remain healthy.”
How will this affect you?

The OTF and the Ontario government will decide how to respond to the current shortfall. As they deal with this challenge, it is important to remember your pension is secure and protected by Ontario law.

If the shortfall persists, there must be a plan to eliminate it by the end of 2005. The plan’s January 1, 2006 valuation must be filed with the regulators.

In closing

2003 brought new challenges for the pension plan. As always, we are fully committed to finding new ways to maximize returns to offset the impacts of difficult pension and investment realities.

Claude Lamoureux, President and Chief Executive Officer

Focus on Funding

The important balance between benefits and assets

The plan must maintain a balance over time between benefits and assets (contributions and investment returns). It must be healthy not just in 2004 and 2005 but 50, 60 and 70 years from now when it’s paying benefits to new teachers who won’t retire until well into the future.

That’s why the plan’s co-sponsors, the OTF and Ontario government, pay close attention to the long-term cost of benefits and the long-term value of contributions and investment returns, not just the immediate cost.

The funding valuation provides a snapshot of the future – the plan’s bottom line. It tells us whether, at a particular point in time, the plan is fully funded and has enough money to cover the cost of future benefits promised to all current plan members.

Currently, the cost of future benefits outweighs estimated contributions and returns creating an imbalance in the pension plan.

For more information, look for Focus on Funding under Publications at www.otpp.com.

Presentation of the 2003 Results will be webcast live at 5 pm, Thursday, April 1, 2004.

www.otpp.com
Investment Highlights

The fund’s 18% rate of return was the best ever one-year return compared to benchmark – and the third best overall performance in the fund’s history.

By outperforming the benchmark’s 13.5% rate of return, we generated $2.7 billion in value above market performance.

 inversión Highlights

In the table below, the fund’s annual rate of return of 18.0% for 2003 compared to -2.0% in 2002 is highlighted.

<table>
<thead>
<tr>
<th>Rate of return on investments (%)</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual</td>
<td>18.0%</td>
<td>-2.0%</td>
</tr>
<tr>
<td>Composite benchmark</td>
<td>13.5</td>
<td>-4.8</td>
</tr>
</tbody>
</table>

Average annual compound rates of return (%)

<table>
<thead>
<tr>
<th>1 yr</th>
<th>4 yr</th>
<th>5 yr</th>
<th>10 yr</th>
<th>Since 1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our return</td>
<td>18.0</td>
<td>5.4</td>
<td>7.7</td>
<td>10.0</td>
</tr>
<tr>
<td>Benchmark</td>
<td>13.5</td>
<td>1.9</td>
<td>4.8</td>
<td>8.5</td>
</tr>
</tbody>
</table>

“We reduced risk to the fund in 2003 while increasing returns through value-added activities.”

Investment Performance as at December 31

Value Added above Benchmarks for the year ended December 31 ($ billions)

$2.7 BILLION VALUE ADDED IN 2003

Investment Growth ($100 invested in 1990)

$12.8 BILLION CUMULATIVE VALUE ADDED

Since 1990, we have created $12.8 billion in additional value for the fund by performing better than market benchmarks.

Income for the year ended December 31 ($ billions)

The fund gained $11.4 billion in investment income and $1.4 billion in contributions in 2003.

Bob Bertram, Executive Vice-President, Investments
Fixed income accounted for 26% of the fund at year end. Excellent performances were delivered using absolute return strategies and hedge funds, as well as bonds and money markets. These investments, 28% of the fund, generally rise with inflation making them a good match for paying pensions.

Teachers’ Merchant Bank, the private equity arm of the fund, delivered a 40.6% one-year rate of return – outperforming its benchmark for $390 million in value added.

We have reduced exposure to equities to 46% of the fund and are actively seeking alternatives to public equity markets in infrastructure investments (electrical utilities, airports, highways, timberlands), fixed income and private equity.

### Rates of Return Compared to Benchmarks

<table>
<thead>
<tr>
<th>Investment returns</th>
<th>Benchmark</th>
<th>Composite Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed income and Absolute return strategies</td>
<td>18.8%</td>
<td>10.8%</td>
</tr>
<tr>
<td>Canadian equity</td>
<td>31.5</td>
<td>26.7</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>6.3</td>
<td>5.3</td>
</tr>
<tr>
<td>Non-North American equity</td>
<td>15.2</td>
<td>14.5</td>
</tr>
<tr>
<td>Inflation-sensitive investments</td>
<td>9.8</td>
<td>6.6</td>
</tr>
<tr>
<td>Total Fund</td>
<td>18.0%</td>
<td>13.5%</td>
</tr>
</tbody>
</table>

### Teachers’ Merchant Bank Portfolio

<table>
<thead>
<tr>
<th>Equities</th>
<th>as at December 31, 2003 ($ billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. $6.8</td>
<td></td>
</tr>
<tr>
<td>Canadian $15.2</td>
<td></td>
</tr>
<tr>
<td>Non-North American $12.4</td>
<td></td>
</tr>
</tbody>
</table>

### Fixed Income

<table>
<thead>
<tr>
<th>Fixed Income</th>
<th>as at December 31, 2003 ($ billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds $6.6</td>
<td></td>
</tr>
<tr>
<td>Absolute Return Strategies $10.7</td>
<td></td>
</tr>
<tr>
<td>Money Market $2.0</td>
<td></td>
</tr>
</tbody>
</table>

Fixed income accounted for 26% of the fund at year end. Excellent performances were delivered using absolute return strategies and hedge funds, as well as bonds and money markets.

### Inflation-Sensitive Investments

<table>
<thead>
<tr>
<th>Inflation-Sensitive Investments</th>
<th>as at December 31, 2003 ($ billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure &amp; Timber $1.9</td>
<td></td>
</tr>
<tr>
<td>Real-Return Bonds $7.1</td>
<td></td>
</tr>
<tr>
<td>Real Estate $9.9</td>
<td></td>
</tr>
<tr>
<td>Commodities $1.9</td>
<td></td>
</tr>
</tbody>
</table>

These investments, 28% of the fund, generally rise with inflation making them a good match for paying pensions.
Major Investments

As at December 31, 2003

Real Estate Managed By Subsidiary ($ billions)
Cadillac Fairview $9.9

Bonds and Real-Return Investments ($ billions)
Province of Ontario and provincial bonds $13.0
Government of Canada bonds 9.4
Real-return bonds and inflation indexed notes 7.0
Canadian and international corporate bonds 3.9
Canadian treasury bills 2.3
Commercial paper 0.8
U.S. Government agency and treasury bonds 0.6
Index-linked mortgages 0.3
Discount and interest-bearing notes 0.2

Largest Private Equity Investments
Absolute Return Fund, Limited
Baillie Gifford Emerging Market Fund
BC European Capital VII
Friedrich Grohe AG
Hancock Natural Resources Group Inc.
Luscar Energy Partnership
MidOcean Partnership
Maple Leaf Sports & Entertainment Ltd.
Relational Investors LLC
Western Sydney Orbital Funding Trust

Corporate Shares and Income Trust Units (millions) Shares Fair Value

Security Name
Nexen Inc. 19.5 $ 918.5
Fording Canadian Coal Trust 13.0 609.8
Shoppers Drug Mart Corporation 17.5 525.5
Maple Leaf Foods Inc. 42.7 448.6
Capital International Emerging Countries Fund 9.6 444.5
YPG LP\(^1\) 35.3 409.9
Macquarie Infrastructure Group 120.4 402.8
WestJet Airlines Ltd. 12.5 354.4
BCE Inc. 10.4 305.0
Royal Bank of Canada 4.8 296.4
Bank of Nova Scotia 4.3 284.9
Bank of Montreal 5.0 269.7
Alcan Inc. 3.8 232.5
Toronto-Dominion Bank, The 5.0 216.4
Transurban Group 48.2 209.0
Canadian Imperial Bank of Commerce 3.0 192.5
Macdonald, Dettwiler and Associates Ltd. 8.1 191.7
Sun Life Financial Inc. 5.4 174.0
Sobeys Inc. 5.1 168.8
Nortel Networks Corporation 30.7 168.4
Manulife Financial Corporation 4.0 166.7
EnCana Corp 3.0 152.3
Barrick Gold Corporation 5.1 150.1
Canadian National Railway Company 1.6 128.8
Suncor Energy, Inc. 3.5 114.7
Nestlé SA 0.4 113.2
Placer Dome Inc. 4.9 112.6
TransCanada Corporation 4.0 111.9
Petro-Canada 1.7 109.8
Southern Cross FLIERS Trust 1.0 109.2

\(^{1}\) Exchangeable for Yellow Pages Income fund units.
Outstanding Service to Members
We strive to serve each member’s individual needs with personal, immediate service every time out.

Quality Service Index
We define outstanding service as the ability to provide accurate, timely, personal and attentive service in a cost-effective way. In 2003, members gave our services a 9.0 rating on a 10-point scale.

Doing More Online
We’ve enhanced iAccess, our secure member Web site, adding a pension calculator, e-mail communications, educational presentations, and access to benefit statements. Once you’re registered, it’s easy to get personal information about your pension benefits whenever you need it.

“Innovation is aimed at giving members outstanding service in whatever manner or medium they choose – electronically, over the phone, or in person.”

Rosemarie McClean,
Vice-President, Member Services
Corporate Profile

There has been a pension plan for Ontario’s teachers since 1917. In 1990, the province established an independent corporation to invest the plan’s assets and administer the pensions of the province’s current and retired teachers.

Today, the Ontario Teachers’ Pension Plan is one of the largest pension plans in Canada with net assets of over $75 billion at the end of 2003, up from $17 billion at the beginning of 1990.

The Government of Ontario and the Ontario Teachers’ Federation, the plan’s co-sponsors, are responsible for ensuring the pension plan is fully funded and for setting plan benefit and contribution levels. The plan sponsors also appoint Teachers’ board of directors, with equal representation.

Teachers’ 500 employees and the 1,800 employees of our subsidiary, Cadillac Fairview, are responsible for setting and implementing investment strategies for the plan’s assets and for delivering immediate, personalized services to members in keeping with the corporation’s vision:

Outstanding service today, retirement security tomorrow.

Contact us

A full copy of the 2003 Annual Report is available on our Web site at www.otpp.com. Focus on Funding, a brochure providing more information on the plan’s funding status, is also available online. If you would like a copy of either, please contact us. We welcome your comments and suggestions for this Report to Members as well as other aspects of our communications program.

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