

# pensionwise™

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Great returns in  
2009, but funding  
challenges remain

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# Teachers' fund posts significant returns for 2009... but funding challenges persist

**C**ameron has questions. The Toronto-area elementary school teacher recently read about the annual results the Teachers' pension plan announced. After experiencing losses in 2008, the plan's assets rebounded in 2009 with earnings of \$10.9 billion and

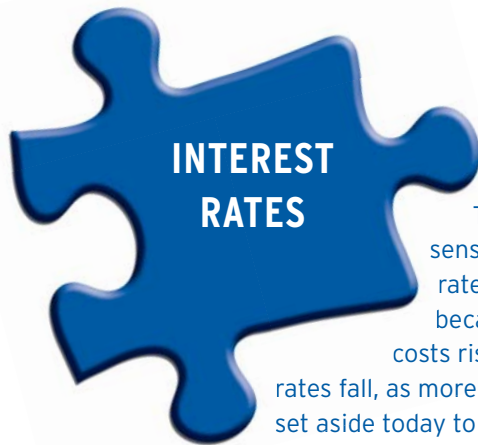
a rate of return of 13 per cent, which exceeded the fund's benchmark by four per cent.

When he considers this strong financial performance, Cameron is trying to understand how a \$17.1 billion funding shortfall could exist. He is not alone. Many members might find the

current funding position confusing.

"While we earned nearly \$11 billion last year, that total was outweighed by the impact of higher projected pension costs," said Jim Leech, President and CEO of the Ontario Teachers' Pension Plan. "That is the simultaneous, double-barreled 'strong earnings-but-recurring shortfall' phenomenon that preoccupied all of us in 2009."

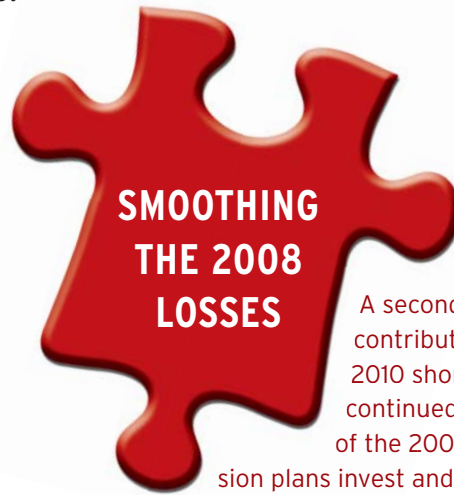
## THERE ARE MANY PIECES TO THE FUNDING PUZZLE, INCLUDING INTEREST RATES AND SMOOTHING.



### INTEREST RATES

The plan is very sensitive to interest rate changes because pension costs rise when interest rates fall, as more money must be set aside today to cover the projected cost of future pensions.

Real interest rates (interest rates after inflation) were at 2.1 per cent at the start of 2009, and declined to 1.5 per cent by the end of the year. This seemingly small shift had a huge impact. Each one per cent change in the real rate has more than a \$25 billion impact on the projected cost of future pensions. As a result, approximately \$15 billion of the \$17.1 billion shortfall is due to declining long-term real interest rates.



### SMOOTHING THE 2008 LOSSES

A second factor contributing to the 2010 shortfall is the continued "smoothing" of the 2008 losses. Pension plans invest and pay benefits over many decades. That is why

Teachers', like other pension funds, spreads out some investment results over five-year periods. The plan literally smoothes out the high peaks and low valleys of investment returns to reduce volatility in the plan's funding position and the subsequent benefit and contribution rate changes that would result. In each of the 2009 and 2010 valuations, we recognized over \$5 billion in losses from the 2008 economic downturn. ■

# Your funding questions answered



Many members from across the province have asked some good questions about how the plan is addressing the ongoing funding challenge.

## Will my pension be there for me when I retire?

The fund has \$96 billion in assets, which is enough to pay pensions for many years. Current Ontario legislation protects the value of pension benefits already earned by working and retired members. Only contribution rates and pension benefits to be earned in future years can be adjusted during a teacher's career in response to funding shortfalls.

## What will happen in light of the projected funding shortfall?

Nothing needs to happen now. A Sustainability Working Group, which includes representatives from the plan sponsors (the Ontario Teachers' Federation and the Ontario government) and plan management, is currently studying the long-term funding challenges. They expect to develop a strategy to address this issue in mid-2010.

If a shortfall persists, the sponsors must take steps to eliminate it before the next funding valuation is filed with the provincial pension regulator. The next valuation must be filed in 2012, but the plan sponsors could choose to file earlier. To address a funding shortfall, the plan sponsors can:

- increase contribution rates; or
- invoke conditional inflation protection

- for pension credit earned after 2009; or
- change other benefits members will earn in future years; or
- use a combination of these options.

## How can we have such a large funding shortfall when a funding valuation filed last September showed that assets and liabilities were in balance?

Funding valuations are conducted annually, using assumptions as of Jan. 1 of any given year. The Jan. 1, 2009 funding valuation was filed with the pension regulator last September. It showed that the fund had enough assets to meet its projected future pension obligations. The preliminary 2010 funding shortfall is based on assumptions as at Jan. 1, 2010, by which time the long-term real interest rate had declined. This was one of the major factors that contributed to the shortfall.

## Are you going to raise the 85 retirement factor back to 90 to help deal with the projected deficit?

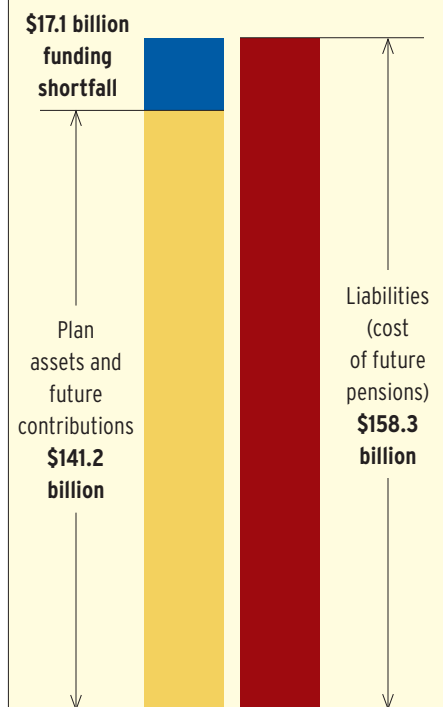
There are currently no plans to make changes to contributions or benefits. Raising the 85 factor (for future service) would cause our projected costs to decline somewhat. However, the plan would likely still have a large funding shortfall. Any changes of this kind would be up to the plan sponsors. ■

## PRELIMINARY FUNDING VALUATION

(as of Jan. 1, 2010)

A funding valuation is an assessment of a pension plan's long-term financial health. The valuation compares plan assets to liabilities, or the cost of future pensions.

The pension plan has more than \$141 billion in assets and projected future contributions. But the projected cost of future pensions is more than \$158 billion. That leaves a gap or funding shortfall of \$17.1 billion. Right now the pension plan is 89 per cent funded, meaning it has 89 per cent of the assets needed to meet its projected long-term pension obligations.



# Teachers' blazes direct investment trail

Teachers' investment program is designed to earn the income needed to pay future pensions 70 or more years from now. We look for the best new opportunities to earn the required investment returns, at an appropriate level of risk. The fund holds stocks and bonds, of course, but it also takes direct ownership stakes in real estate, infrastructure and private companies.

Because the fund is large and has about 200 experienced investment professionals, we have the ability to be direct investors. We can own companies—in whole or in part—directly, rather than invest through public markets or intermediaries such as investment funds. We make these investments after we have carefully analyzed a wide range of global opportunities in-house. We often partner with strong management teams that are experts in their industries.

## WHY TAKE THIS APPROACH?

We feel our employees can find and manage investment opportunities just as successfully as external managers—at

a fraction of the cost. Direct investments help to diversify the fund's risk and returns, because returns from direct investments typically do not move in tandem with traditional stock and bond markets (which can swing dramatically).

We have been building this in-house market and industry expertise for nearly 20 years, starting with private companies, and it is paying considerable dividends. Other pension plans are now starting to emulate our example.

At the end of 2009, our direct investments represented nearly one-third of our total holdings. We hold direct investments in public equities, private companies, real estate and infrastructure.

## PUBLIC EQUITIES



### At a glance

Some parts of this department provide financial support that can be a catalyst for companies. For example, the Relationship Investing group takes large stakes in companies, sometimes before they become public, and works with them to increase shareholder value. The Long-Term Equities group aims to be a long-term owner of companies with steady cash flow.

### Significant investments

- Brazilian oil and gas exploration company OGX Petróleo e Gás Participações S.A.;
- Canadian food company Maple Leaf Foods Inc.;
- MacDonald, Dettwiler & Associates, a Canadian company specializing in information products and systems.

### Recent developments

Brazilian public equities holdings did particularly well in 2009. Brazil's main stock market index, Bovespa, rose 83 per cent in 2009 while our own S&P/TSX Composite Index gained 31 per cent. And the Brazilian stocks that we own, such as OGX and port terminal company LLX Logística S.A., rose even more than their home country index last year. This, coupled with the fact that we were able to buy stocks in Brazil that offered better value when compared to similar stocks in Canada, has resulted in greater growth.

Why Brazil? It is rich in resources; it has grown to become the world's 10th largest economy; its fiscal affairs are healthy; and we have found good investment partners there.



## TEACHERS' PRIVATE CAPITAL



## REAL ESTATE



## INFRASTRUCTURE

This department makes direct private equity investments that are managed in-house, and also commits some of the fund's money to select private equity funds managed by outside experts in markets that are difficult to access. Teachers' Private Capital investment managers look at potential investments in four major industry sectors: telecom, media and technology, consumer and retail, diversified industries, and financial services.

- Aquilex Holdings, LLC, which provides maintenance and repair services to the energy industry;
- Maple Leaf Sports & Entertainment Ltd., owner of the Air Canada Centre, Toronto Maple Leafs, BMO Field and Toronto FC;
- health and wellness retailer GNC Corporation, Inc.;
- Canada Guaranty Mortgage Insurance Co., acquired in January this year.

Teachers' Private Capital has been busy wrapping up several investment deals in 2010. This team bought stakes in the world's largest specialty aluminum container maker, Exal Group, and in Munchkin, Inc., a private U.S.-based maker of infant and toddler products.

Our wholly owned subsidiary, The Cadillac Fairview Corporation Ltd., invests in and manages real estate on behalf of the plan. It focuses on premium shopping malls and office buildings in Canada and the U.S. It also has real estate investments in Brazil and Britain.

Commercial real estate assets are steady earners and they act as a partial hedge against inflation (since leases generally go up in line with inflation).

- Toronto Eaton Centre retail and office complex;
- Toronto-Dominion Centre office complex;
- Pacific Centre retail and office complex in Vancouver.

Cadillac Fairview opened the 1.2-million-square-foot RBC Centre in downtown Toronto in 2009, noteworthy for its high environmental standards.

The Shops at Don Mills, one of the largest redevelopment projects in Canada, opened in April 2009. Its 'urban village' concept combines stores, restaurants and public spaces in an outdoor setting.

We make direct investments in infrastructure assets such as water and gas utilities, airports, power systems and marine container terminals. These kinds of assets typically generate stable, long-term returns that mirror inflation and come with low risk. They're often in regulated industries.

- GCT Global Container Terminals Inc., which owns four North American marine container terminals;
- power generation company InterGen N.V.;
- Scotia Gas Networks PLC, Britain's second-largest gas distribution company.

In 2009, Teachers' Infrastructure group completed a deal to increase its stake in Bristol Airport, Britain's ninth-busiest airport.

At [www.otpp.com](http://www.otpp.com), you can read more about Teachers' investments, strategy, investment team and recent news.

# Your pension, explained...

We have made a commitment to provide members with a sound understanding of core funding concepts. With this in mind, we continue with our series *Your pension, explained...*



This issue

## Smoothing

**SMOOTHING REFERS TO** a practice of recognizing annual investment losses or gains over five years. The returns on all assets except bonds are smoothed, or amortized, when returns are above or below our expectation of earning six per cent plus inflation on non-fixed income investments.

The annual adjustment is calculated by taking part of the current year's gain or loss, and adding portions of the previous four years' gains or losses. In 2009, for example, we recognized 20 per cent of the gains from 2005, 2006 and 2009, and 20 per cent of the losses from 2007 and 2008.

Year incurred	YEAR RECOGNIZED						
	2007	2008	2009	2010	2011	2012	2013
2005	\$1,186	\$1,186	\$1,186				
2006	\$1,268	\$1,268	\$1,268	\$1,268			
2007	(\$819)	(\$819)	(\$819)	(\$819)	(\$818)		
2008		(\$5,198)	(\$5,198)	(\$5,198)	(\$5,197)	(\$5,197)	
2009			\$815	\$815	\$815	\$814	\$814
TOTAL			(\$2,748)				

Gains and losses (\$ millions) are recognized over a five-year period.

One-fifth of the large 2008 loss — outlined in red — will affect the annual smoothing adjustment every year until 2012. Hopefully, as markets improve, this will be offset somewhat by investment gains. For instance, a portion of the 2009 gains will be recognized every year until 2013.

Smoothing evens out short-term fluctuations in investment returns. Without being able to stretch out investment gains or losses over five years, the plan partners would have to change contribution rates, benefit levels or both much more frequently to keep the pension plan balanced.

Smoothing is a common practice among defined benefit pension plans. The Teachers' plan has smoothed assets since it began investing in public markets in 1990.

**FOR MORE INFORMATION** on smoothing and other key funding concepts, please visit the Funding Your Pension website at [www.fundingyourpension.com](http://www.fundingyourpension.com).

# A closer look at iAccess Web: My Profile

**S**pending the summer at the cottage? Want to receive e-mails at a different e-mail address? If you want to make changes like these, you need to update your My Profile page on iAccess Web, the secure member website.

“It’s important to keep your personal

and contact information up to date,” said Michael McAllister, Director, Client Services at Teachers’. “If your profile is as current as possible, we can let you know about important pension updates that may occur throughout the year. You’ll get the most timely, effective service possible.”

## **EVEN IF YOU ARE STILL UNDECIDED**

about whether or not to retire this June, consider sending us all of your documents (your birth certificate, marriage certificate, etc.) right now. This will help us to process your iAccess application promptly once you do make your decision to retire.

### **How to register for iAccess Web:**

Call **416-226-2700** or **1-800-668-0105**, weekdays from 8 a.m. to 5:30 p.m. or download and complete the **registration form**.

### **On the My Profile page on iAccess Web, you can update any of the following online 24 hours a day, seven days a week:**

Name	Mailing address	Marital status	Survivor pension election
Birthdate	Future address	Spouse's name	Beneficiary information
E-mail address	Phone numbers	Spouse's date of birth	

## You Asked Us...

In the last edition of *Pensionwise*, Teachers' announced five enhancements to the buyback experience, effective Sept. 1, 2010. The enhancements will stabilize costs, make payments easier and bring a new buyback experience to iAccess Web, the secure member website.

Members have been asking us questions about what absences they can buy back, and when.



**Q. I'm working full-time now, but starting in the 2010-2011 school year I will be moving to a part-time position. Can I buy back credit for the time I'm not working?**

**A.** No. If you move from full-time to part-time work, you're not entitled to

purchase credit for the reduced workload. Only if you are absent from education are you entitled to purchase time away from your part-time contract.

The five enhancements coming Sept. 1, 2010 will primarily affect the buyback experience. The actual provisions of what types of absences can be bought back have not changed.

**Q. Are the buyback enhancements retroactive? I bought back my maternity leave in 2003. Do these changes affect me at all?**

**A.** No. The buyback enhancements are effective Sept. 1, 2010, and will only affect buybacks where the payments

have not yet been completed as of that date.

**Q. I was on a leave of absence and taught overseas starting in 2002 for two years. Can I buy this service back?**

**A.** No. Once your leave ends, you have five years to complete your buyback. The rules surrounding the five-year deadline have not changed. If you took a leave of absence from 2002-2004, the deadline for you to buy back credit would have passed in 2009. Note: there is an exception — if your employer arranged for you to work outside of Canada, payment must be made during the period of the leave. ■

## Re-employment rules are changing

The Ontario Teachers' Federation (OTF) and the Ontario government recently announced changes to the plan's re-employment provisions. The first change will occur on Sept. 1, 2010 and others will follow in 2012.

### NEW 50-DAY LIMIT; EMPLOYERS TO REPORT RE-EMPLOYMENT SERVICE

Beginning Sept. 1, 2012, you will be able to work in education without affecting your Teachers' pension for up to 50 days in each school year you work following retirement. This single-tier limit means you'll only have one number to worry about if you become re-employed in education after retirement.

Under current limits, you can work in education without affecting your Teachers' pension for up to 95 days in each of the first three school years in which

you return to work. After that, you can work 20 days each school year.

Also, your employer will be required to report re-employment service beginning in the 2012-13 school year. Members will still be required to track their days and contact Teachers' if they exceed the new re-employment limit of 50 days.

### CLEARER DEFINITION OF "RE-EMPLOYED PENSIONER"

This plan change, effective Sept. 1, 2010, will make it clear and eliminate uncertainty as to what is considered re-employment: if you provide any services for compensation after retirement for an employer who participates in the pension plan, you will be considered a re-employed pensioner and subject to re-employment rules and regulations.



This applies whether you are employed, self-employed or hired through a third party. Also note that you can't forgo compensation to circumvent the rules.

Under current plan language, "re-employed pensioner" doesn't include any reference to compensation nor does it specify conditions of employment.

For more information on working after retirement, please visit [www.otpp.com](http://www.otpp.com).

**Pensionwise™** is published for members of the Ontario Teachers' Pension Plan.

We appreciate your comments about anything you read in *Pensionwise*. Please e-mail [member\\_communications@otpp.com](mailto:member_communications@otpp.com)

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Ce bulletin est disponible également en français.



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## iAccess Web winner

Congratulations to Beverly Plitnikas of Ottawa, who won a \$500 Cadillac Fairview gift card simply by registering for iAccess Web. Beverly won the card in a promotion designed to encourage teachers to sign up for the secure member website, a move that saves trees, eliminates clutter and reduces administrative costs.

Return undeliverable Canadian addresses to:

Ontario Teachers' Pension Plan  
5650 Yonge Street  
Toronto, Ontario  
M2M 4H5

## View the annual meeting at [www.otpp.com](http://www.otpp.com)

Interested in more details on the plan's 2009 investment and service performance? You can view an archived webcast of the pension plan's annual meeting online at [www.otpp.com](http://www.otpp.com). Follow the link from the home page to watch presentations from the Apr. 9 annual meeting. ■