



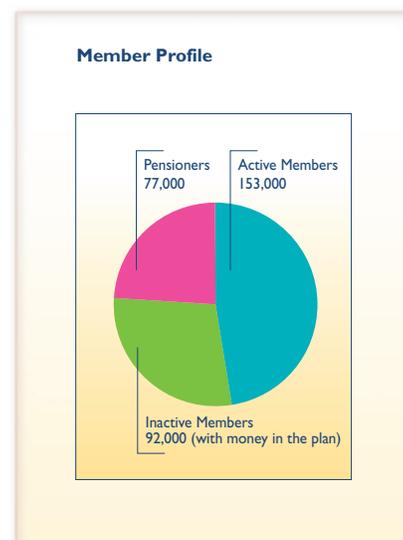
Teachers'
Pension Plan
Board

Conseil du régime
de retraite des enseignantes
et des enseignants

2000 ANNUAL REPORT



OUTSTANDING
SERVICE TODAY,
RETIREMENT SECURITY
TOMORROW



CORPORATE PROFILE

The Ontario Teachers' Pension Plan Board is responsible for the future retirement income of 153,000 elementary and secondary school teachers, 77,000 retired teachers and their survivors, and 92,000 former teachers with entitlements in the plan. The plan is sponsored by a partnership between the Ontario government and the plan members, represented by the Ontario Teachers' Federation. The co-sponsors negotiate the use of surplus and have an equal say in the plan's design, including changes in benefits.

The pension board's current asset-mix policy is 60 percent equities, such as shares in public and private companies and equity-return derivative contracts; 22 percent inflation-sensitive assets such as real estate, real-rate bonds and commodities; and 18 percent fixed-income securities, largely federal and provincial government bonds.

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AS AT DECEMBER 31

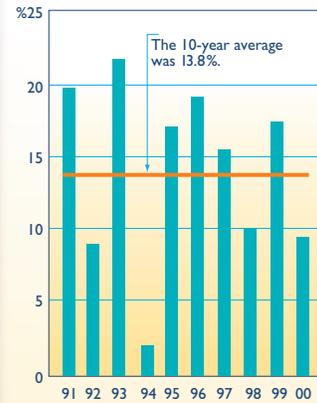
INVESTMENT PERFORMANCE

| Rate of return on investments (%) | 2000 | 1999 |
|-----------------------------------|------|-------|
| Annual | 9.3% | 17.4% |
| Composite benchmark | 5.3 | 17.6 |
| Four-year average | 13.0 | 15.4 |
| Four-year benchmark | 12.5 | 15.8 |

Average annual compound rates of return (%)

| | 1 yr | 4 yr | 5 yr | 10 yr | SINCE INCEPTION |
|------------|------|------|------|-------|-----------------|
| Our return | 9.3 | 13.0 | 14.2 | 13.8 | 13.1 |
| Benchmark | 5.3 | 12.5 | 13.6 | 12.7 | 10.7 |

Rates of Return



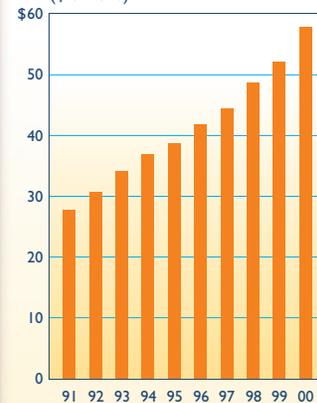
FINANCIAL OVERVIEW

| (\$ Billions) | 2000 | 1999 ² |
|---------------------------------|---------|-------------------|
| Net investments | \$ 72.0 | \$ 67.1 |
| Net receivables | 1.1 | 1.2 |
| Net assets | 73.1 | 68.3 |
| Smoothing reserve ¹ | 4.3 | 8.3 |
| Actuarially adjusted net assets | 68.8 | 60.0 |
| Cost of future pensions | 58.6 | 52.1 |
| Surplus | \$ 10.2 | \$ 7.9 |

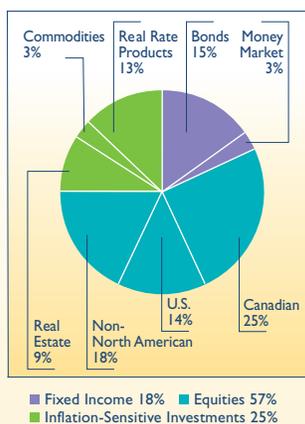
¹ We smooth equity gains (or losses) over five years to reduce the impact of market volatility on plan surplus. The smoothing reserve consists of investment gains in excess of the rate of return assumptions used in the financial statement valuation.

² Restated

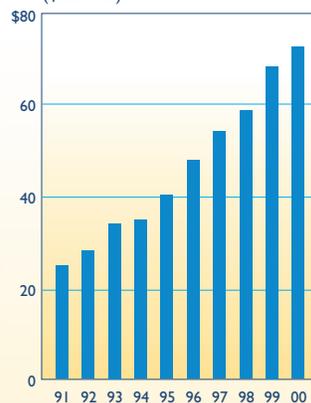
Cost of Future Pensions
(as at December 31)
(\$ billions)



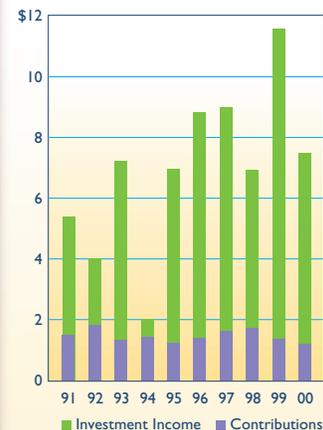
Asset Mix
(as at December 31, 2000)

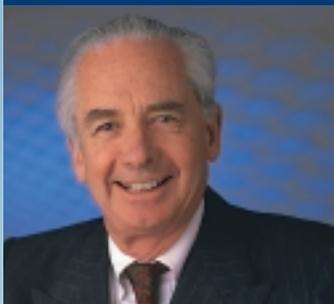


Net Assets
(as at December 31)
(\$ billions)



Income
(\$ billions)





ROBERT W. KORTHALS
CHAIR

Financial markets were highly volatile in 2000, a trend we expect to continue. Despite the less reliable investment climate, the pension board's investment staff have done a great

job of creating value by exceeding market returns.

Since 1990, strong stock markets around the world have helped the fund grow faster than the increase in the cost of future pension benefits. However, what has really made the difference are deliberate decisions that allowed us to do better than the market.

Over the past decade we have gained exposure to foreign markets through equity-based derivatives and partnerships with external managers to earn value-added returns from active equity selection. We have built one of the largest merchant banks in Canada to earn premium returns from private equity markets. We have introduced innovative portfolio management techniques to earn above-market returns from equity and fixed-income index funds. Most recently, we purchased The Cadillac Fairview Corporation, making us one of the largest Canadian owners of North American real estate.

BEST-EVER VALUE ADDED

These and other initiatives paid off handsomely in 2000, with portfolio managers achieving \$2.6 billion in value added. This amount is the difference between the total fund return of 9.3 percent and the 5.3 percent return for the composite benchmark. All this confirms the importance of actively managing the asset base and rewarding investment managers and senior executives for their effort.

Looking back at the value added to the fund over the last four years, the investment team averaged 13 percent against a benchmark of 12.5 percent. Since inception, they averaged 13.1 percent, beating the benchmark of 10.7 by 2.4 percent. In dollar terms, that

means our investment team has created \$6 billion in value added since 1990.

On behalf of the Board of Directors, I want to congratulate our entire investment team for their professionalism, foresight and innovation to meet the growing needs of the pension plan with value added investment income. It has been, and continues to be, a job well done.

AVOIDING UNDUE LOSS

The emphasis on maximizing returns also means trying to avoid unnecessary losses when markets turn for the worse. It is difficult, of course, for a large investment fund to predict short-term trends. Nevertheless, the pension board is attentive to prudent opportunities.

A good example in 2000 concerned technology stocks. Going into the year, we believed that most technology stocks were overvalued. The pension board took proactive action by reducing its technology holdings in Canadian and American stocks. As a result, we avoided substantial losses that would otherwise have occurred.

Managing Our Technology Exposure

| (percent) | Q1 | Q2 | Q3 | Q4 |
|---------------------------------|------|------|------|------|
| Technology Stocks | | | | |
| % of TSE 300 Index | 31.1 | 41.5 | 38.4 | 26.0 |
| % Underweight in our portfolios | 3.4 | 4.8 | 5.8 | 3.6 |

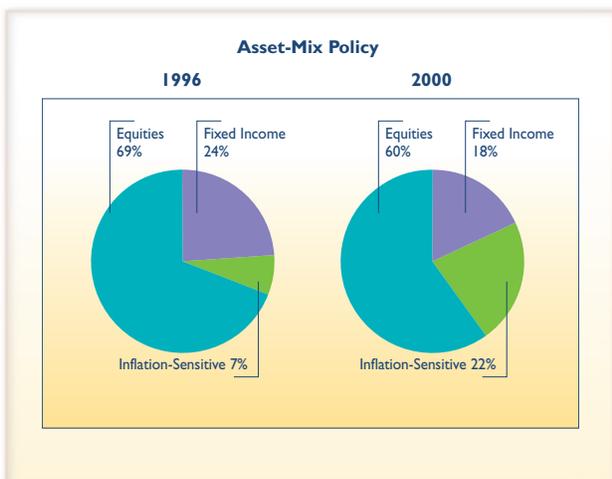
We reduced our exposure to technology stocks as a percentage of the TSE 300 Index throughout 2000.

PROTECTING THE FUND

Finding ways to add value by maximizing returns without incurring undue loss is a priority in view of the increasing number of pensioners. Since the mid-1990s, we have modified our investment approach to meet the changing needs of the pension plan.

Our asset mix continues to shift from equities and bonds to inflation-sensitive assets, especially commercial real estate properties, real-rate bonds and

commodities. These investment classes have been chosen specifically for their ability to rise in value with inflation, mitigating the long-term cost impact of inflation on growing liabilities, and safeguarding the fund if current expectations of lower returns from investment in stocks over the next decade are realized.



The asset-mix policy has changed over the past five years as we strive to better match assets that react to inflation with the indexed nature of pension benefits.

ACKNOWLEDGEMENTS

We are pleased with the investment performance of the pension fund in 2000 and prior years, and remain confident that our investment strategy, implemented by innovative portfolio managers, will continue to add value to the fund. We are impressed with the progress made to provide members of the plan with faster, more personalized service.

We are also pleased that both partners recognize the need for a strong and independent Board of Directors to oversee the pension board. We thank them for appointing directors with the skills and knowledge relevant to governing both a large investment and customer service organization.

ROBERT W. KORTHALS

CHAIR



ROBERT W. KORTHALS

Former President of the Toronto-Dominion Bank
Chair of the Board and Chair of Human Resources and Compensation Committee



JALYNN H. BENNETT

President of Jalynn H. Bennett & Associates Ltd., a consulting firm specializing in strategic planning and organizational development
Chair of the Investment Committee and member of the Governance Committee



GEOFFREY W. CLARKSON

Fellow of the Institute of Chartered Accountants of Ontario and former senior partner with Ernst & Young
Chair of the Benefits Adjudication Committee and member of the Audit and Actuarial Committee



ANN FINLAYSON

Journalist, speaker, freelance editor and consultant, author of three books, including *Whose Money is it Anyway? The Showdown on Pensions (1988)*
Member of the Audit and Actuarial Committee



LUCY G. GREENE

Former Vice-President of Human Resources with Sun Life Assurance Company of Canada
Chair of the Governance Committee and Vice-Chair of the Benefits Adjudication Committee



JOHN S. LANE

Former Senior Vice-President of Investments for Sun Life Assurance Company of Canada, and a Chartered Financial Analyst
Member of the Audit and Actuarial Committee



RALPH E. LEAN, Q.C.

Senior partner with the law firm Cassels Brock & Blackwell in Toronto
Member of the Governance Committee



DAVID J. LENNOX

Former Secretary of the Ontario Public School Teachers' Federation, former school principal
Chair of the Audit and Actuarial Committee



GARY PORTER

Chartered accountant and founding partner of the accounting firm Porter Héту International, and a past president of the Certified General Accountants Association of Ontario
Member of the Audit and Actuarial and Governance Committees

All board members serve on the Investment and the Human Resources and Compensation Committees.



CLAUDE LAMOUREUX
PRESIDENT AND CHIEF
EXECUTIVE OFFICER

The pension plan enjoyed another strong year in 2000, despite the negative performance of foreign equity markets, where we had about one-third of our assets invested. The total fund return of

9.3 percent produced \$6.2 billion in investment income, increasing the value of net assets to \$73.1 billion at year end. These results compared with a 17.4 percent total fund return and \$10.1 billion in investment income in 1999.

IMPORTANCE OF THE FUNDING SURPLUS

As most readers of annual reports know, the most important number is often hidden in a footnote in the back of the report. This report is no exception – if you look at page 41, you'll find the surplus based on the funding valuation. I want to explain its significance and the resulting funding surplus. It is this figure – the funding surplus – that is particularly important to active and retired teachers because it is the amount available to the co-sponsors for plan changes.

However, in our annual report, we focus on the “financial surplus” for financial statement purposes (sometimes called “management’s best-estimate”). Both the annual and funding valuations look to the future, estimating the length of a teaching career, inflation and salary increases, and how long teachers will live. However, the annual valuation only looks at the financial situation at year-end and does not include the benefits that members will accrue in the future. For example, if a teacher taught for 10 years, the financial statement surplus takes into account that the plan has enough money to pay the pension equivalent for 10 years’ credit.

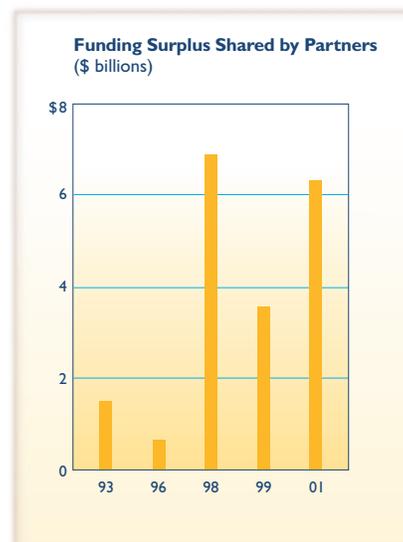
The funding valuation, used to determine the funding surplus available to spend on benefit improvements, is a different calculation. In addition to the

factors already mentioned, the funding valuation takes into account the pension that will be earned in the future, not just what has been earned up to the end of last year. In comparison, if a teacher taught for 10 years, the funding valuation includes 10 years of credit plus estimates how much money will be needed to pay the pension if he or she teaches to the 85 factor in 20 more years. It also includes how much more the teacher and the government will contribute over that time, and how much investments will grow.

USE OF SURPLUS

In 1998, the Ontario Teachers’ Federation (OTF) and the Ontario government signed an agreement under which they improved benefits and allowed the government to use surplus to eliminate the special payments it was making to pay off the pre-1990 unfunded liability. This occurred in 1998 and 1999. The OTF would then receive a similar amount, set at \$6.2 billion, for use at its discretion.

The plan started 2001 with a funding surplus of \$6.8 billion. Effective April 1 2001, \$6.2 billion of this surplus will be used by the OTF to improve benefits.



The partners will have used \$18.7 billion in surplus by April 2001 to pay off the pre-1990 unfunded liability and make benefit improvements, including early retirement incentives.

A funding valuation by an independent actuary is required at least every three years. It determines whether the plan has sufficient funds to meet all future pension obligations resulting in a funding surplus or deficit, and is used as a guide to set contribution rates.

The funding valuation is a comprehensive calculation about the pension plan's financial future. It estimates the length of a teaching career, inflation and salary increases, teacher and government contributions over the length of a career, how long teachers will live, and how much investments will grow in the future.

The accompanying chart demonstrates how the funding valuation surplus is calculated.

Funding Valuation Results (before surplus allocation)

| (\$ Billions) (at January 1) | 2001 | 2000 | 1999 | 1998 | 1996 | 1993 | 1990 |
|---------------------------------|------|------|------|------|------|------|-------|
| Net assets | 73.1 | 68.3 | 59.1 | 54.5 | 40.1 | 29.4 | 21.0 |
| Smoothing reserve | 4.3 | 7.3 | 5.1 | 6.0 | 1.8 | — | — |
| Value of assets | 68.8 | 61.0 | 54.0 | 48.5 | 38.3 | 29.4 | 21.0 |
| Future contributions | 14.4 | 13.4 | 12.0 | 12.6 | 14.5 | 14.3 | 12.2 |
| Future special payments* | — | — | 3.7 | 8.5 | 8.4 | 8.4 | — |
| Actuarial assets | 83.2 | 74.4 | 69.7 | 69.6 | 61.2 | 52.1 | 33.2 |
| Future benefits | 76.4 | 69.8 | 66.2 | 62.8 | 60.5 | 50.6 | 41.0 |
| Surplus (deficit) | 6.8 | 4.6 | 3.5 | 6.8 | 0.7 | 1.5 | (7.8) |

* Payments by the government toward the pre-1990 unfunded liability.

Most of the surplus will be used in April 2001 to improve benefits, including a permanent 85 factor.

Value of assets is the value of net assets minus the smoothing reserve.

Actuarial assets refers to the value of assets as determined by the market plus the present value of future contributions by existing plan members.

Future benefits is an actuarial estimate of what it will cost to pay promised pensions over the lifetime of all current members. The cost fluctuates with market conditions and is not smoothed.

Surplus refers to the "funding surplus" (or deficit) above the cost of all future pension benefits for current members.

ASSUMPTIONS

Underlying the valuation are economic and demographic assumptions. The three most important assumptions are identified in the accompanying table.

Funding Valuation Assumptions

| (percent) (at January 1) | 2001 | 2000 | 1999 | 1998 | 1996 | 1993 | 1990 |
|-----------------------------|------|------|------------------|------------------|------|------------------|------|
| Discount rate | 6.25 | 6.5 | 7.5 | 7.5 | 8.0 | 8.0 | 8.5 |
| Salary escalation | 3.20 | 3.25 | 4.5 ² | 4.5 ¹ | 5.0 | 5.0 ¹ | 5.75 |
| Inflation rates | 2.20 | 2.25 | 3.5 ³ | 3.5 ¹ | 4.0 | 4.0 ¹ | 4.5 |

¹ except 2% for 2 years.

² except 2% for 2 years, 3.25% for 1 year

³ except 2% for 2 years, 2.75% for 1 year

Salary changes affect the cost of future benefits because pension calculations are based on each member's best five years' salary. Pensions are fully indexed to inflation, which also increases pension costs.

Starting in 2000, we use the same assumptions for the annual valuation included in the financial statements.

Discount rate refers to the long-term market rate of return used to determine the present value of all future pension benefits and assets. It is assumed, as shown in the chart, that the discount rate will exceed inflation by approximately four percent.

Salary escalation and inflation rates It is assumed that, over the long term, increases in teachers' salaries will exceed inflation by one percent.

Even a seemingly small economic or demographic change can have a major impact on the plan's funding position. For example, a male teacher retiring at 57 years of age in 1995 had a life expectancy of 24.0 years, compared with 25.1 years for a similarly aged male teacher retiring in 2000. Changing the assumptions to reflect this improvement in the mortality experience of male retirees increases the plan's liability costs by \$800 million.

PARTNERSHIP

As sole plan sponsor from 1917 until 1992, the Ontario government was responsible for all funding deficits and entitled to all funding surplus.

In 1992, the Ontario Teachers' Federation negotiated a partnership with the government. Teachers are now responsible for half of any surplus or deficit. As stated earlier, the partners negotiate the use of surplus and also have an equal say in the plan's design, including changes in benefits. The past use of actuarial surplus is discussed in note 9 to the financial statements.

NEED FOR A SURPLUS POLICY

Since 1990, whenever a funding surplus has existed, it has been used to eliminate special contributions or increase benefits.

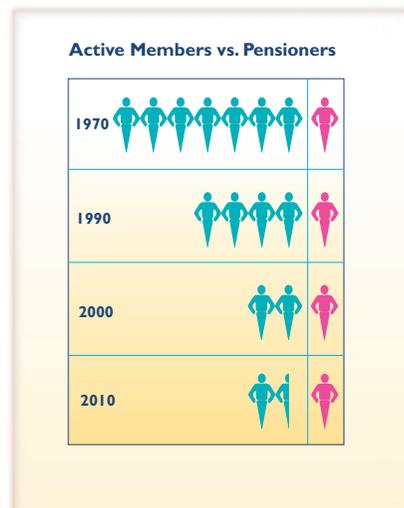
The partners know this level of yearly surplus creation is not sustainable. We are very concerned that current contribution rates will not be sufficient to cover the cost of future benefits, particularly if our current market forecasts for the next 10 years prove correct.

We encourage the partners to create a surplus policy, and we will commit resources to assist them. This policy would include the level above which the funding surplus would be used, and would be similar to the legislated capital reserve policies for banks and insurance companies. This would help to ensure some stability for contribution rates.

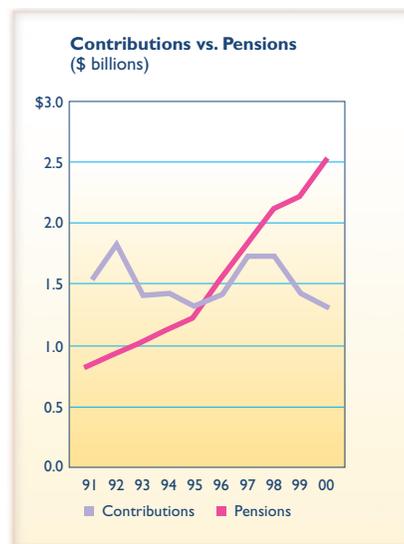
We believe it is essential to begin working today on a policy for the future because, if the plan is underfunded at a statutory valuation in the future, it will be the responsibility of the partners to make up the shortfall.

Small surplus The present value of all pensions is rising rapidly as the plan matures, totalling \$76.4 billion at January 1, 2001. Sufficient assets were in place to meet these obligations with actuarially valued assets of \$68.8 billion and future contributions valued at \$14.4 billion, leaving a surplus of \$6.8 billion. After these funds are assigned to plan improvements in April 2001, the plan will have only a small surplus of \$600 million, less than one percent of liabilities.

Changing profile The profile of the plan has changed leaving fewer contributors while the number of teachers on pension continues to grow. Therefore, even an increase in contribution rates will have a reduced ability to compensate for a deficit. Ten years ago, future contributions were sufficient to cover about one-third of future benefits. Today, those contributions would only cover 19 percent.

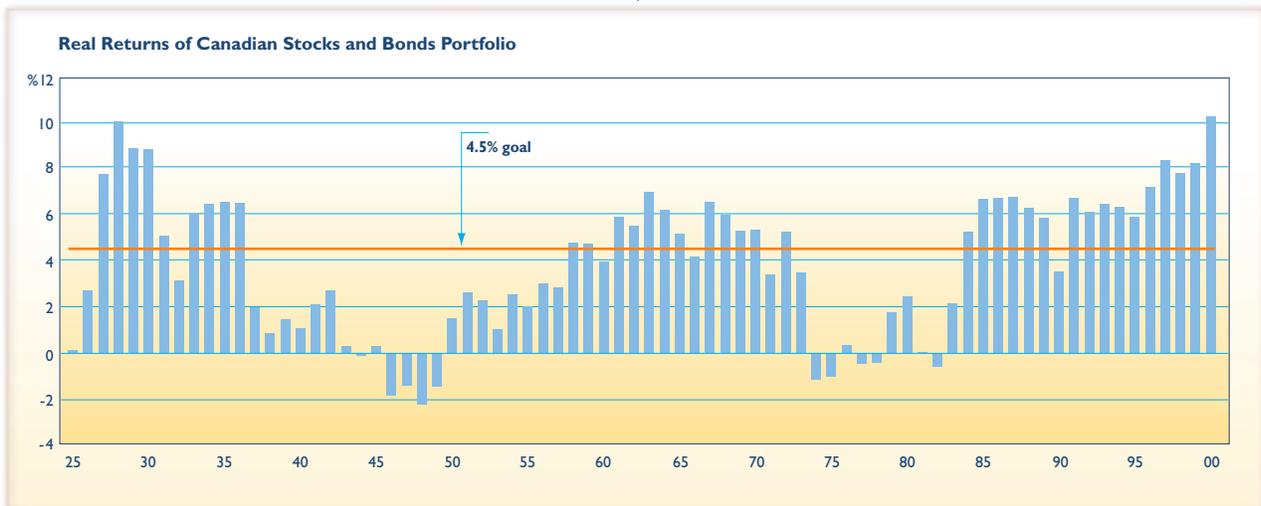


With only two active members for every pensioner today, there are half as many contributors per retiree as there were 10 years ago.



The gap between contributions and pension payments continues to widen. In 2000, 153,000 teachers and the government contributed \$1.3 billion and we paid out \$2.5 billion in benefits.

Increased risk In future, we expect modest real rates of return from stock and bond markets compared with the past 10 years. If history repeats itself, low or negative real-rate returns are possible over multiple years, as the accompanying chart illustrates. We are more concerned now about the impact of short-term market volatility on our ability to keep contributions stable than we were 10 years ago.



This chart tracks the rolling 10-year average real rate performance of an index-based portfolio consisting of two-thirds Canadian stocks and one-third Canadian bonds. The portfolio would reach our long-term investment target of 4.5% less than half the time.

WORKING WITH THE PARTNERS

Based on current valuation assumptions and the benefit improvements on April 1, the plan could require at least a 1.5 percent increase (matched by the government) in the contribution rates from the current average of 8 percent of salary. In the absence of such an increase in contribution rates, the plan must rely on investment returns above the actuarial assumption to make up the difference.

Our job as investment managers is to ensure that teachers receive the pensions they are promised. In the interest of prudent management, we will support the partners in developing a policy on surplus because we believe a large increase in the contribution rate would be unacceptable to plan members. Having a surplus policy in place would also help us plan our investment strategy, allowing us to build the most appropriate asset mix and investment programs around the policy.

In the meantime, we assure plan members that the pension board is committed to maximizing investment returns so that asset values have a better chance of keeping pace with the rising value of promised pensions.

STRIVING FOR EFFICIENCY

In seeking above-average investments, as well as providing timely and personalized member services, we strive to be an efficient organization. Last year, it cost \$133 million to operate the pension board. Ongoing administrative costs were \$106 per member. Investment expenses at 14 cents per \$100 of net assets were low compared with many other institutional investors. These costs are tabulated in note 12 to the financial statements.

ACKNOWLEDGEMENTS

Our bi-annual employee survey showed that the pension board continues to be an attractive place to work. The positive attitudes and professionalism of staff are behind our standing as one of the consistent top investment performers in the pension fund industry as well as our highest-ever customer satisfaction rating from teachers and retirees. We remain committed to doing an even better job in the future.

CLAUDE LAMOUREUX

PRESIDENT AND CHIEF EXECUTIVE OFFICER

*The
challenge of
faster, better
and friendlier
service*

We are a customer-focused organization with a broad mandate that covers dozens of benefit entitlements and we serve more than 300,000 clients. Our services extend far beyond calculating and paying pensions; we respond to the ever-changing needs of our plan members and pensioners.

Member Services Volumes

| | 2000 | 1999 |
|---------------------------------|--------|--------|
| Telephone calls | 94,296 | 78,654 |
| Purchase of credit | 12,541 | 18,021 |
| Pension inception | 7,034 | 6,397 |
| Pension estimates | 5,880 | 6,331 |
| Changes to survivor benefits | 3,358 | 3,455 |
| Termination estimates | 2,512 | 2,736 |
| Death benefits | 2,656 | 2,713 |
| Plan transfers | 2,019 | 2,208 |
| Marriage breakdown calculations | 806 | 836 |
| Commutated value payouts | 761 | 612 |

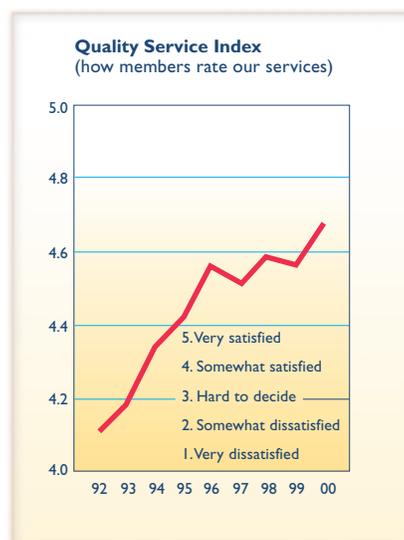
Last year, we advised more than 2,800 teachers on their options at retirement planning workshops throughout Ontario, sent out 153,000 personalized annual benefit statements to active members, and collected \$615 million in pension contributions from teachers through their employers. We paid out benefits of \$2.5 billion to approximately 77,000 pensioners and members who left the plan.

HIGHEST-EVER CUSTOMER SATISFACTION

Our commitment to providing outstanding immediate and personalized service to all plan members and

pensioners earned us the highest-ever customer satisfaction rating in 2000. The strongest improvements were in satisfaction with our services in providing pension inception, estimates, transfers, terminations and purchases of credit.

In 2001, we will replace the satisfaction survey, based on written member responses collated by staff, with an extensive random telephone survey conducted by an independent market research firm. The new approach



will measure a broader range of customer interactions, with the emphasis on services and service levels. This should provide a more informative evaluation of our personalized relationship with members.

EXPANDING PENSIONER POPULATION

In the past three years, 21,800 teachers retired with two out of three taking advantage of the 85 factor. This increased the pensioner population to 77,000 at the end of 2000.

A large proportion of teachers is in the 45 to 55 age range and will retire in the current decade. As they consider their retirement options, these teachers will require frequent interaction with the pension board by telephone, e-mail, the Internet and one-on-one meetings.

Rapidly Growing Pensioner Population
(thousands)



The pension board is positioned to handle the influx of personal service needs from an expected 50,000 retirements over the current decade.

To provide better and faster customer service, we believe we have put in place some of the best technology and information management systems of any pension plan in North America. Personal service is delivered by 60 pension benefit specialists, who deal

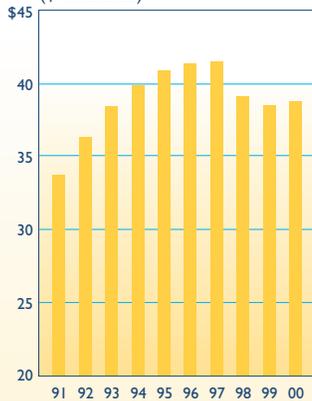
with situations ranging from members coping with the death of a spouse to requests for information on commuted value pay-outs. Staff are continuously retrained on best business practices, and we closely track our performance based on member feedback.

IMPROVED SERVICES

An example of how we use technology to improve service is our Computer Telephone Integration system that automatically recognizes a member's telephone number. By the time the member talks to a pension benefit specialist seconds later, the member's file is open on the specialist's computer.

The friendliness of our specialists is one reason why our customer satisfaction level is so high. Another reason for higher satisfaction is our new easier-to-read member's annual personal statement of benefits, including greater disclosure such as commuted value (the lump sum required to replace the individual's future entitlements).

Average Unreduced Pension at Inception
(\$ thousands)

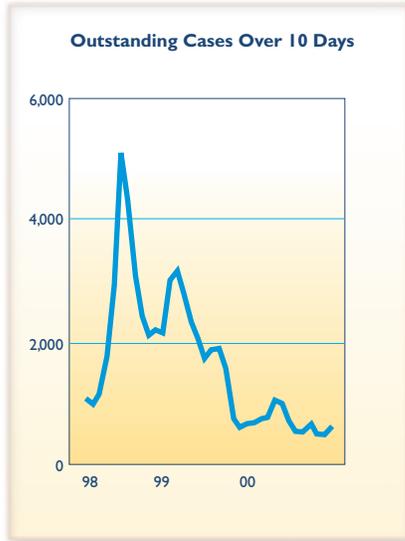


The average unreduced pension has declined from \$42,000 in 1997 to \$38,400 in 2000 due to early retirements under the 85 factor.

Age Distribution of Teachers and Pensioners
(thousands)

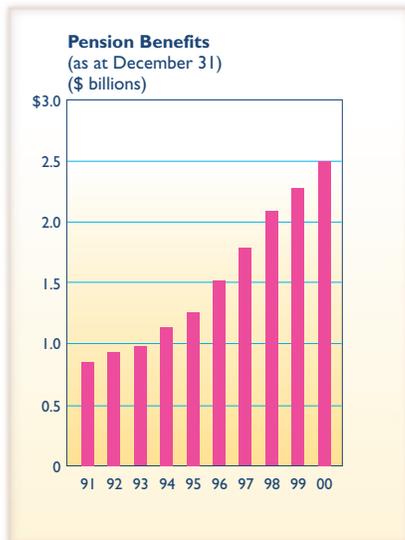


Over the past 10 years, retirees in their 50s have increased as a percentage of the pensioner population. The average pensioner age has decreased to 66.5 years.



Introduction of the 85 factor in 1998 caused a backlog in our workload. Our goal is to handle all member requests, no matter how complex, within 10 working days.

The commitment to outstanding service is evident in the time it takes to handle and complete requests from members. Outstanding requests more than 10 days old peaked at 5,000 in June 1998, following introduction of the 85 factor, and have remained well below 1,000 for most of the past year.

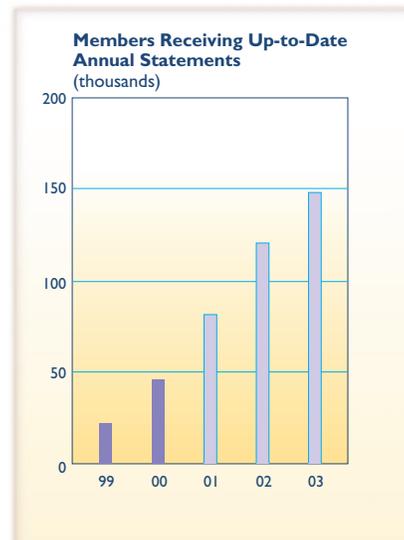


Benefits paid to retirees and their survivors continue to rise rapidly as a large number of teachers enter normal retirement or opt for early retirement.

We are also working with 218 employers to improve the quality and timeliness of member information we receive, including service credit and salary information on each active teacher.

By the end of 2000, 17 percent of employers, with more than 75,000 members, had been transferred from annual to payroll-based reporting. This also means that 75,000 members will now get annual statements that are one to two years more up to date than before.

With the continued cooperation of school boards, we expect to complete the transfer of all plan members to payroll-based reporting – and thus to up-to-date annual statements – by the end of 2003.

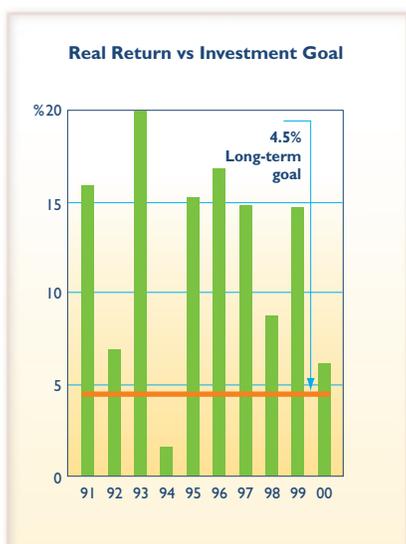


Typically, statements are only current as of August of the previous year, a situation we expect to correct for all members by the end of 2003.

*The
challenge
of earning
above-market
returns*

Our long-term goal is to create a surplus by growing assets faster than pension liabilities. To match average liability growth, assets must generate an annual real return of 4.5 percent (that is, 4.5 percent above the rate of inflation).

Over the long term, we believe that investing mostly in stocks will earn the level of real returns the plan needs. Consequently, our asset-mix policy has always been weighted much more to equities, a strategy that has paid off since 1990 with real returns substantially above the long-term goal. However, equity returns over the current decade could be below our target of 4.5 percent.



Because of exceptional investment markets, we exceeded the long-term investment objective in the 1990s, an achievement that will be more difficult over the next decade.

Because it will be more difficult to earn the required level of returns from passive investing alone – that is, by replicating market indices for stocks, bonds and commodities – we have reduced our index funds by shifting capital to active portfolios where we can add value. Over the past 10 years, active management and tactical asset allocation improved the returns we would otherwise have received from passive index investing by 1.1 percent.



Active management produces higher returns than the markets in which we invest can produce on their own. In 2000, this approach created \$2.6 billion in value added.

INVESTMENT MANAGEMENT TEAM

We employ about 95 investment professionals, from portfolio managers, bond traders and stock analysts to foreign exchange managers, merchant bankers, and derivative traders. In addition, we employ a large staff at our wholly owned real estate subsidiary, The Cadillac Fairview Corporation Limited.

About 60 finance professionals support our investment effort. They ensure compliance with rigorous operational controls, policy guidelines and risk management limits. Every day, they settle transactions, forecast liquidity requirements, and report on investment positions, portfolio risk and returns.

Approximately 35 information technology professionals maintain and enhance our trading, risk management and reporting systems. They are developing a system that instantly routes orders from portfolio managers to various trading desks and allows for electronic execution and settlement of trades.

MAXIMIZING INVESTMENT RETURNS

To maximize returns, we actively manage 36 percent of invested assets. Even the indexed equity and fixed-income portfolios are partially actively managed through quantitative, arbitrage and other performance-enhancing strategies. We also use derivative products to manage risk and maximize returns. As a result, we are one of the largest international traders of equity-based swaps, futures and options. Many of our active strategies are independent of market direction.

We allocate a risk capital budget to each investment portfolio with the expectation of earning a minimum 10 percent return on this risk capital. The budget allocation varies among portfolios and is proportionately smaller, for example, for fixed-income securities than for merchant banking. In aggregate, the risk capital budgets are approximately 5 percent of invested assets.

We also macro-manage the total fund through “overlay” programs. For example, the asset-mix policy allows equity exposure to vary between 50 and 70 percent of net assets relative to a target of 60 percent. In 2000, we under-weighted equities and reallocated capital to fixed-income securities and real-rate bonds.

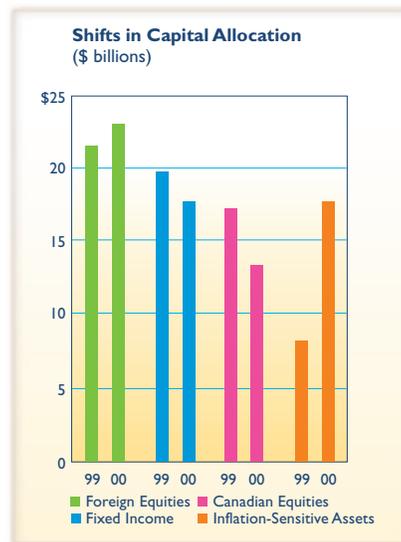
When we invest abroad, we earn a return on the investment and incur a gain or loss as a result of currency fluctuations. To reduce the volatility of returns from foreign currency fluctuations, we hedge 50 percent of investments in major foreign currencies that have a low correlation to the Canadian dollar.

Portfolio managers are rewarded for optimizing total assets and not just their own portfolios. An investment planning committee meets every two weeks to review the asset-mix policy and develop a tactical asset allocation response to current market conditions.

INDEX BANKING

We believe in being fully invested, and consider cash a drag on investment returns. Excess cash is normally invested in equity and fixed-income index funds until we identify opportunities that can earn above-market returns.

For example, to improve returns above the Canadian market benchmark, we have developed quantitative portfolios that invest in TSE 300 stocks based on models that attempt to identify strategies and stocks that should outperform the index. These portfolios have exceeded the TSE 300 returns for eight consecutive years. We account for about 4 percent of the value of trading volume in TSE 300 companies and have



We reduced most asset classes as we transferred capital to inflation-sensitive assets such as real estate, real-rate bonds and commodities.

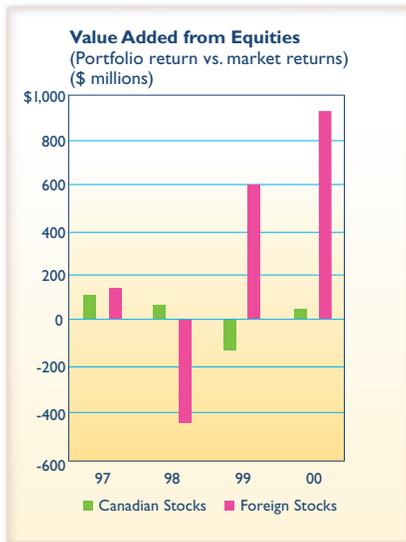
minimized transaction costs by trading large blocks of individual stocks or baskets of different stocks in a single transaction. Greater use of electronic trading is further reducing costs.

In the case of foreign equity index funds, our staff invest entirely in equity-based derivatives to earn market returns. Since the correlation of these investments to market performance is extremely high, these portfolios achieve market returns on a consistent basis.

ACTIVELY MANAGED EQUITY PORTFOLIOS

Stocks We have considerable experience as an active equity investor in Canada. In 2000, we began to expand this expertise to the global marketplace by transferring capital from foreign equity index funds to internally managed global equity programs. At the end of 2000, our staff managed more than \$640 million of a total \$8.3 billion in global equities.

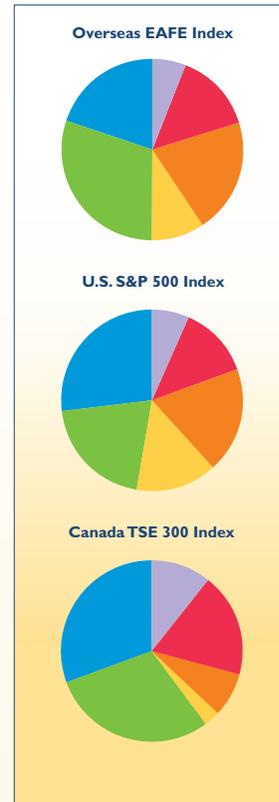
At the same time, we remain committed to external foreign equity managers who have earned exceptional returns for the plan for many years. Building our skills in active global investing will strengthen our relationships with these managers and improve our understanding of their investment decisions.



In Canada, we have added value above equity benchmarks (indicated as zero). Outside Canada, the value-added has been more volatile and more spectacular.

Opportunities to invest in public companies in Canada are limited. The Canadian market is relatively small compared to the capital held by large institutional investors. For this and other reasons, it is important to look beyond Canada for additional investment opportunities. Focusing on global opportunities should reduce fund risks and enhance returns because global markets provide a greater diversity of economic sectors. A more global focus also allows us to select companies that are world competitors with strong performance prospects.

Exposure by Economic Sectors



- Energy
- Industrial & Materials
- Consumer Products
- Health Care
- Interest-Rate Sensitive (Financial & Utilities)
- Technology

Greater economic diversification outside Canada offers investment opportunities that should reduce risk and improve long-term returns.

Corporate governance We attempt to improve shareholder value in public companies by voting our shares, encouraging boards of directors to practice good corporate governance, and being more involved in certain companies.

We now publish our proxy voting record on our web site www.otpp.com. Sharing our voting inten-

tions with management, shareholders and plan members in advance of shareholder meetings increases the transparency of our decisions and strengthens our corporate relationships with the companies in which we invest.

2000 Proxy-Voting Record

| | For | Against |
|--------------------------|-----|---------|
| Employee Stock Options | 46 | 89 |
| Shareholder Rights Plans | 1 | 36 |
| Other | 246 | 135 |

The most contentious issue is excessive stock options that dilute shareholders' value. In our view, the cost of options should be recorded in financial statements so that shareholders know the full financial impact of these awards.

The proxy voting record shown in the table has changed little over the past three years. We intend to be more active in working with other large investors to bring about change.

Our involvement with select companies is intended to support their boards of directors in requiring management to develop a value-added strategy with growth targets. In 2000, we made direct investments in four such companies in telecommunications, energy and industrial products. The investments are 10 to 20 percent of each firm's outstanding shares and totalled \$810 million. These commitments doubled the value of our relationship investing portfolio to \$1.5 billion with direct and indirect investments in eight U.S., seven Canadian and 21 U.K. companies.

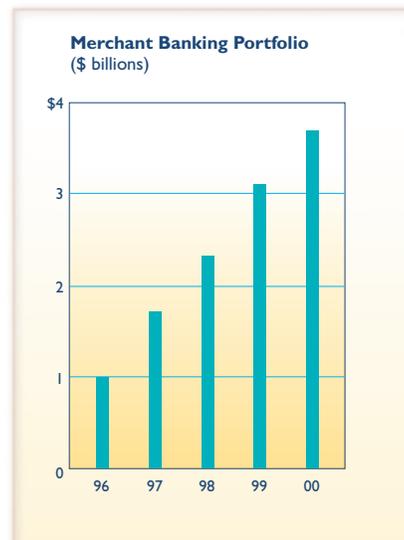
Merchant banking We have developed expertise in all facets of merchant banking and ended 2000 with \$3.9 billion in over 100 investments in the consumer products, communications, industrial products, entertainment & media, financial services, retail, and energy industries. We invest directly in Canadian firms, which represent 40 percent of the merchant banking portfolio. In the United States and Europe, we invest both directly and indirectly through limited partnerships.

There are many opportunities to earn premium

returns in the private market, where we are specialists in identifying value-added prospects. For example, we invested \$14.8 million in a Canadian technology company in 1992 as part of a management buyout. In late 1993, the refinanced and refocused company was taken public. We divested our interest in stages and, by the time the last shares were sold in 2000, had realized \$131 million in gains. In 2000, we sold positions in eight companies acquired for \$201 million to realize net proceeds of \$310 million.

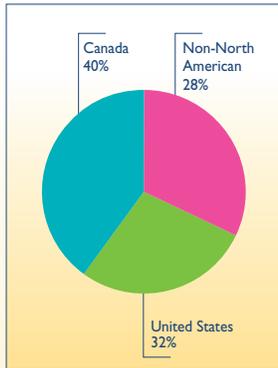
Our equity and mezzanine debt investments facilitate management buyouts, business expansions, acquisitions, financial restructurings, ownership changes and taking companies private or public. In 2000, we participated with four U.S. funds in the management buyout of Shoppers Drug Mart and acquired a significant minority interest.

We first offered mezzanine debt in 1999 and had \$244 million invested by the end of 2000. This product appeals to many companies as an alternative to equity and senior debt, filling the void in Canada served by the high-yield market in the U.S.



Our merchant bank has grown to be one of the largest in Canada, earning annual returns in excess of 23% since 1991.

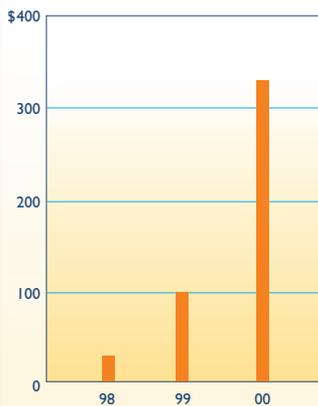
**Merchant Banking
Geographic Distribution**
(as at December 31, 2000)



We are increasingly adopting a global perspective in our search for premium investment returns from merchant banking.

Our merchant banking portfolio includes a venture capital fund launched three years ago that ranks among the top sources of early-stage capital in Canada. Investing in start-up enterprises carries higher risks in the expectation of higher rewards. Our size, long-term investment perspective and diverse asset base allow us to take risks in the most promising opportunities on

Assets in Venture Capital
(\$ millions)



We are committed to Canadian venture capital investments where there are reasonable prospects of earning good returns for the risks involved.

the assumption that the successes will exceed the costs of failures.

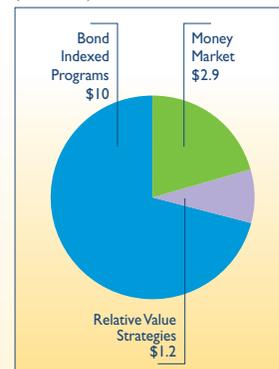
At the end of 2000, we had \$329 million invested in 24 companies and 12 venture capital funds, principally in life sciences and information technology. These investments typically involve multiple rounds of financing of \$3 million to \$20 million each. Approximately 54 percent of our venture capital investments are in Canada and 46 percent in the United States.

FIXED-INCOME PORTFOLIOS

During the past two years, our consolidated bond portfolios have been among the top quartile of fixed-income performers.

Our basic approach is to invest the majority of fixed-income assets in bond indexed programs to replicate the Scotia Capital Canada Universe, which contains federal government bonds. Our portfolio contains substantial holdings in Government of Canada bonds, more than three percent of the Bank of Canada's domestic public debt. However, we use relative value strategies to attempt to earn returns 20 to 30 basis points above this benchmark.

Fixed Income
(as at December 31, 2000)
(\$ billions)



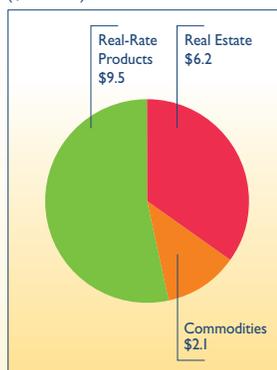
The fixed-income group manages \$14.1 billion in assets.

Fixed income includes \$2.9 billion allocated to the money-market portfolio and \$1.2 billion in programs where we use relative value strategies to enhance returns. We have also expanded the relative value approach to include Canadian high-yield corporate securities that are well diversified by industry and economic segment. At year-end, this portfolio totalled \$286 million. We are targeting the high-yield U.S. market for future expansion. We also continue to develop quantitative techniques to improve analytics, capture mispricing, and find other relative value opportunities in both bond and money markets. In this way we benefit from diversification by implementing strategies where expected returns have a low correlation to the fixed-income market overall.

INFLATION-SENSITIVE INVESTMENTS

The assets that best match the plan's liabilities have stable real returns and a high correlation with inflation. Nominal bonds are only a good fit during periods of stable inflation. Stocks have high average returns and a positive long-term correlation with inflation, but are highly volatile in the short run. Real estate, real-rate bonds and commodities are highly sensitive to inflation.

Inflation-Sensitive Investments
(as at December 31, 2000)
(\$ billions)



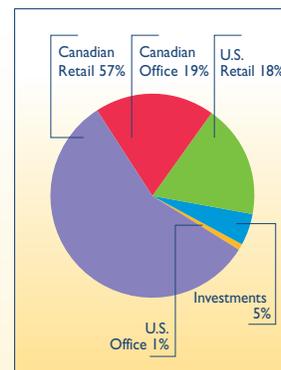
To better match inflation-indexed pensions, we are building up ownership of inflation-sensitive investments.

Since late 1998, we have managed these investments as a separate asset class. While we strive to maximize long-term real returns from these assets, their primary role is to shield the fund's surplus from the short-term risks we experienced in 2000 – a rapid rise in liabilities due to higher inflation from 2.6 to 3.2 percent and falling real interest rates from 4 to 3.4 percent.

Real estate We own a \$10.4 billion real estate portfolio (\$6.2 billion net of liabilities), managed by Cadillac Fairview, our wholly owned subsidiary. Approximately 95 percent of the portfolio consists of full or partial ownership of 69 shopping centres and 48 office buildings in Canada and the United States.

Our current strategy is to reposition the North American office and retail assets through a combination of redevelopment, acquisitions and dispositions with the goal of owning premier properties in key markets. This strategy is being implemented by Cadillac Fairview. We previously owned 22 percent of this company and acquired full ownership in March 2000 for \$2.4 billion. As a result, we own Canada's best property portfolio and the industry's top property management company.

Real Estate Portfolio
(as at December 31, 2000)

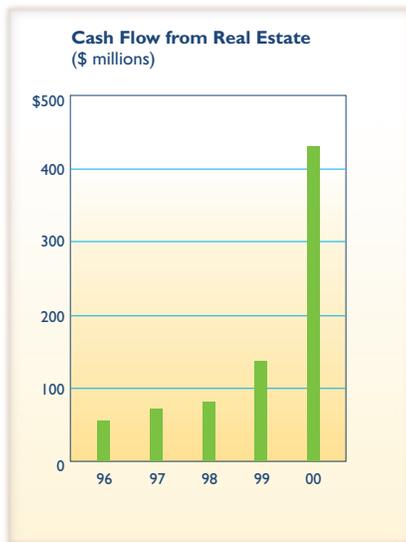


Our plan is to increase ownership of high-quality office buildings and large shopping centres in North America.

The Canadian portfolio includes premier properties, such as the Toronto Eaton Centre, Vancouver's Pacific Centre and the Toronto-Dominion Centre complex in Toronto. We recently purchased full ownership of these properties from the previous co-investor. We also strengthened our retail ownership in the Toronto area by acquiring Sherway Gardens. In the United States we own 23 shopping centres in the major markets of 10 states.

Owning Cadillac Fairview provides exclusive access to the expertise of 1,750 employees dedicated to maximizing the value of the plan's real estate assets. The Cadillac Fairview brand is internationally renowned and the company is the first call for major American and European retailers seeking a presence in the leading shopping centres. A testament to the market-draw of our shopping centres was the decision by Sears in 2000 to open five of its seven new Eatons stores in our properties.

The size and quality of our real estate portfolio provides large and predictable income. In 2000, the portfolio generated approximately \$427 million in cash flow from operations.



The cash flow from real estate in 2000 was equivalent to paying close to 13,000 annual pensions.

Real-rate bonds Real-rate bonds are an excellent match against plan liabilities and, along with index-linked mortgages, are risk free with respect to inflation. As a result, we continue to be a keen buyer of these securities. In 2000, we increased our holdings of Canadian real-rate products from \$4.2 billion to \$5.8 billion and entered the U.S. market by acquiring \$3.7 billion of U.S. Treasury Inflation-Protected Securities (TIPS). At year-end, our consolidated portfolio of real-rate securities totalled \$9.5 billion.

Commodities Commodities generally have high real returns when there is unanticipated inflation and provide a hedge against short-term inflation risks in the value of the plan's liabilities. We invest through derivatives in the Goldman Sachs Commodity Index, which is heavily weighted to oil and gas, and doubled the plan's holdings to \$2.1 billion in 2000.

This section of the annual report provides an overview of our operations and provides a more detailed explanation of the consolidated financial statements. It should be read in conjunction with the financial statements. Our objective is to present readers with a view of the pension board through the eyes of management by interpreting the material trends and uncertainties that affected the operating results, liquidity or financial condition of the pension plan in the last fiscal year. In addition to historical information, this section contains forward-looking statements that reflect management's objectives and expectations as at the date of this report, which involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements.

YEAR-END FINANCIAL POSITION

The plan's accrued pension liabilities increased from \$52.1 billion to \$58.6 billion during 2000. The actuarial assumptions used to determine these liabilities for financial statement purposes reflect management's best estimate of teachers' salaries, inflation, demographic factors, and market-based yields. These estimates at the end of 2000 were in line with the markets.

Valuation Assumptions

| (as at December 31) (percent) | 2000 | 1999 |
|-------------------------------|------|------|
| Discount rate | 6.25 | 6.75 |
| Salary escalation | 3.20 | 3.25 |
| Inflation rate | 2.20 | 2.25 |

Both the financial statement and funding valuations now use the same assumptions.

Benefit payments In 2000, the plan paid \$2.5 billion in benefits, an increase of \$200 million over the previous year. The increase principally reflected 6,200 teachers retiring, bringing to 77,000 the number of retired members and their survivors receiving benefits.

Accrued Pension Benefits

| (\$ Billions) | 2000 | 1999 |
|---|----------|----------|
| Accrued pension benefits, beginning of year | \$ 52.11 | \$ 49.63 |
| Interest on accrued pension benefits | 3.48 | 3.49 |
| Benefits earned | 1.36 | 1.30 |
| Benefits paid | (2.54) | (2.28) |
| | 54.41 | 52.14 |
| Changes in actuarial assumptions | 3.89 | 0.77 |
| Experience gains | 0.26 | (0.80) |
| Accrued pension benefits, end of year | \$ 58.56 | \$ 52.11 |

The 2000 payments included \$164 million in commuted value transfers (versus \$108 million in 1999) and a 1.5 percent cost-of-living adjustment. To calculate the inflation adjustment rate, we average the annual change in inflation for 12 months ending in September each year. The inflation adjustment paid in January 2001 was 2.5 percent.

Change in net assets The plan began 2000 with \$68.3 billion in net assets available for benefits. During the year, the plan gained \$7.5 billion of income – \$6.2 billion from investments, compared with \$10.1 billion in 1999, and \$1.3 billion from contributions, compared with \$1.4 billion a year earlier.

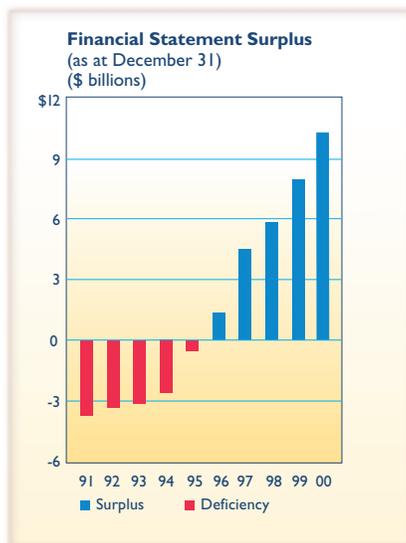
Changes in Net Assets

| (\$ Billions) | 2000 | 1999 |
|-------------------------------|---------|----------|
| Income | | |
| Investment income | \$ 6.21 | \$ 10.12 |
| Contributions | 1.28 | 1.41 |
| | 7.49 | 11.53 |
| Expenditures | | |
| Benefits | 2.54 | 2.28 |
| Operating expenses | | |
| Member services | 0.03 | 0.03 |
| Investments | 0.10 | 0.09 |
| | 2.67 | 2.40 |
| Increase in net assets | \$ 4.82 | \$ 9.13 |

Expenditures, including benefits paid to members and survivors, totalled \$2.5 billion and \$133 million to operate the pension board.

As a result of these changes, net assets available for benefits grew by \$4.8 billion to \$73.1 billion by the end of 2000.

Surplus The plan had a surplus for financial statement purposes of \$10.2 billion at December 31, 2000. This compared with \$7.9 billion a year earlier on a restated basis.



The year-end surplus, based on the financial statements, quantifies the plan's financial position from an accounting perspective.

In the past, management used its best estimate of the long-term rate of return to determine the present value of all future pension benefits and assets. Net asset gains that exceed the actuarial assumptions were amortized over five years to smooth out the impact of market volatility from one year to the next.

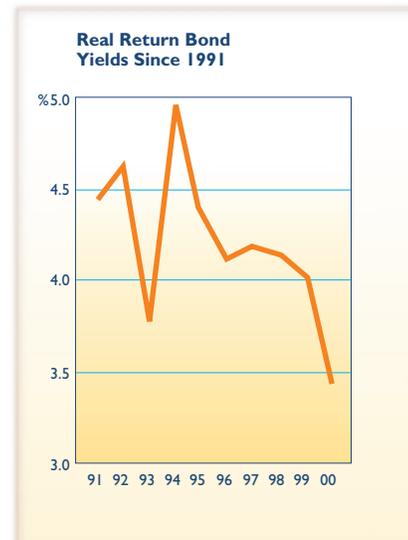
Beginning in 2000, and as explained in note 2 to the financial statements, a market interest rate is now used to determine fair value for both fixed-income assets and accrued pension benefits. The value of equities (including real estate and commodities) continues to be adjusted for actuarial purposes to reflect the difference between the actual equity asset returns

at year-end and management's best estimate of future equity returns. The difference in dollar terms (the actuarial asset value adjustment) is then amortized over five years. Strong performance by fixed-income assets increased our financial statement surplus.

MATCHING ASSETS AND LIABILITIES

To create a funding surplus we manage the relationship between investment assets and pension liabilities. Our goal is an asset mix that balances risks and rewards, avoids excessive volatility, and maintains stable contribution rates.

Because both assets and liabilities are sensitive to interest rate changes, one of our goals is to reduce the risk that liabilities will increase more than assets in response to lower real interest rates. Unfortunately,



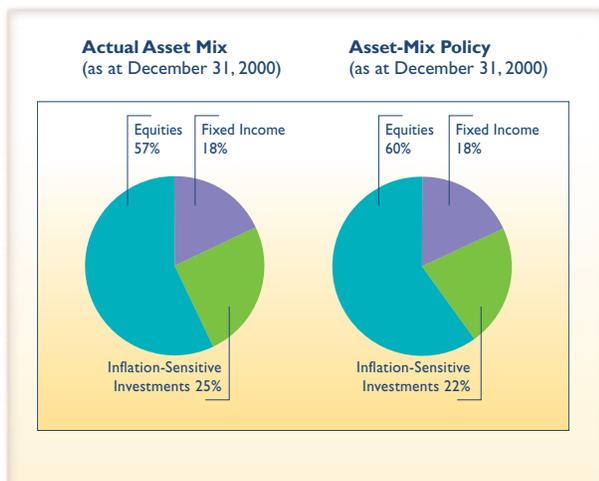
Real return yields declined by 59 basis points in 2000, after remaining within a 10 basis point range for the three previous years.

that is what happened in 2000. The sharp decline in real rates of return increased the value of total liabilities by \$3 billion. During the year, we shifted assets from fixed-income and equity portfolios to real-rate products and real estate. Debt securities, along with inflation-sensitive assets, outperformed total equities to produce the healthy accounting surplus.

ASSET-MIX POLICY

The asset-mix policy is reviewed annually by management and the board of directors and changes are made as necessary to reflect changes in our asset/liability model. The asset mix is crucial to long-term performance. Studies show that approximately 90 percent of the variability of returns over time is driven by the asset-mix decision with the remaining 10 percent influenced by active management. In recent years, we have reduced our exposure to both stocks and fixed-income securities and created an asset class of inflation-sensitive assets that correlate well with the inflation-sensitive nature of our liabilities. The change in asset-mix policy also recognized that stock markets, especially in Canada, were overvalued on both a short-term and long-term basis.

Our current asset-mix policy, set in early 2000, is 60 percent equities, 22 percent inflation-sensitive assets (specifically real estate, real-rate products, and commodities), and 18 percent fixed-income securities. This asset-mix policy has a high probability of ensuring assets grow at least as fast as the liabilities over the long term. We estimate that the change in asset-mix policy contributed \$600 million of value added during 2000 in addition to the \$2.6 billion in benchmark outperformance.



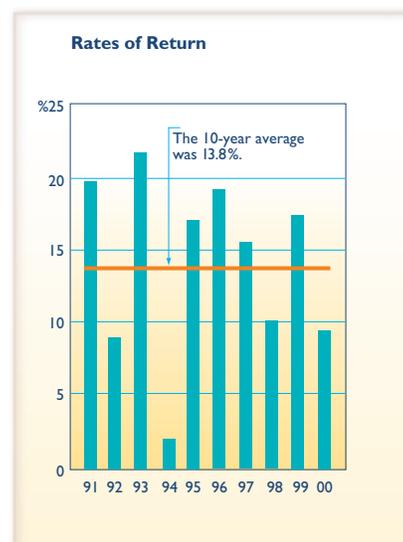
In 2000, we reduced equity investments below policy and ended the year overweight in inflation-sensitive investments compared with the new policy level.

INVESTMENT PERFORMANCE

Net investments increased to \$72 billion in 2000, compared with \$67.1 billion at the end of 1999.

2000 total fund performance During a year of volatile and generally negative stock markets, we achieved a 9.3 percent total fund rate of return in 2000, compared with 17.4 percent the prior year. After inflation of 3.2 percent, the real return was 6.1 percent, compared with 14.8 percent in 1999. The 2000 return generated \$6.2 billion in investment income, compared with \$10.1 billion a year earlier. Approximately one-third of equities are exposed to foreign markets, which had negative returns in 2000.

Four-year return We calculate average performance on a four-year cycle to produce a less volatile and more reliable measure than a single year's results. Our four-year average return was 13.0 percent, compared with 12.5 percent for the benchmark. The real rate of return (after inflation of 1.9 percent) was 11.1 percent – well in excess of the investment objective of 4.5 percent on average over the long term.



Over the current decade, returns are expected to revert to historical performance levels, which are closer to the long-term goal.

Rates of Return Compared to Benchmarks

| (percent) | Investment returns | Benchmark return | Composite Benchmark |
|--|--------------------|------------------|---|
| Fixed income and short-term securities | 15.6 | 13.7 | Scotia Capital Treasury Bills (91 days) Scotia Capital Canada Universe Scotia Capital Long Bond |
| Canadian equity | 13.5 | 7.4 | TSE 300 |
| U.S. equity | (4.1) | (5.5) | S&P 500 |
| Non-North American equity | (8.5) | (13.5) | Morgan Stanley EAFE, EMF National Index |
| Inflation-sensitive | 19.9 | 18.0 | Scotia Capital Real Return Bond Custom US Treasury Inflation-Protected Securities Goldman Sachs Commodities CPI plus 4% |
| Total Plan | 9.3 | 5.3 | Benchmark weighted by the policy asset mix |

Ten-year return The average annual compounded rate of return for the past 10 years was 13.8 percent. The real return (after inflation of 1.9 percent) of 11.9 percent was substantially above the long-term goal.

PERFORMANCE VS. BENCHMARKS

The **total fund benchmark** aggregates the benchmark returns for each asset class, using our asset-mix policy weights. In 2000, the 9.3 percent total fund return compared with 5.3 percent for the benchmark. As a result, our portfolio managers created \$2.6 billion of value above the returns that the markets in which we invested would have produced on their own. This was our largest one-year gain in value added. Included in our total fund return is our global tactical asset allocation program, which generated \$519 million of value above the composite benchmark. (Performance incentives are based on the results achieved versus the benchmark, less 34 basis points for implementation and overhead costs).

Fixed income securities returned 15.6 percent, a dramatic turnaround from two percent a year earlier. These assets exceeded their benchmark of 13.7 percent to earn \$229 million of value added.

Canadian equities (actively managed, enhanced index, and merchant banking) posted a 13.5 percent return versus 7.4 percent for the Canadian equity benchmark. Our enhanced quantitative index funds portfolio beat its benchmark for the eighth consecutive year to earn value added of \$252 million. Our actively managed Canadian equity portfolios earned \$21 million above their benchmark.

Merchant banking earned a 21.8 percent return – almost three times its benchmark to generate \$427 million in value added. This \$3.9 billion portfolio has contributed considerable value to total returns over the past 10 years.

Foreign equities (actively managed and enhanced index) returned a negative 4.1 percent in the U.S. and negative 8.5 percent for Non-North America (including \$30 million in implementation costs) compared with negative 5.5 percent and 13.5 percent for their respective benchmarks. We increased our exposure to foreign stock markets during the year and ended 2000 with \$23.1 billion in these assets. We also shifted capital from foreign equity index funds to actively managed programs. As a result, our actively managed programs produced \$894 million above benchmark.

Inflation-sensitive investments of real-rate products, commodities and real estate earned 19.9 percent versus 18 percent for the composite benchmark. Real-rate bonds had a return of 17.3 percent, or \$15 million better than the benchmark return. Commodities returned an exceptional 54.4 percent, though \$15 million less than the benchmark due to unavoidable implementation costs. Our real estate portfolio had one of its best years, earning 13.0 percent, versus 7.2 percent for its benchmark to add \$288 million in value.

RISKS AND RISK MANAGEMENT

We manage **surplus risk** using a Value at Risk (VaR) methodology. VaR has forced us to think of surplus risk as the aggregate of liability risk, asset-mix policy risk, and active management risk, taking into account correlation and diversification between the components.

The main source of **liability risk** is a drop in real interest rates, which increases the present value of future pensions accumulated up to that point. It makes new pension liabilities more difficult to finance, and puts upward pressure on contribution rates. Higher real interest rates have the opposite effect.

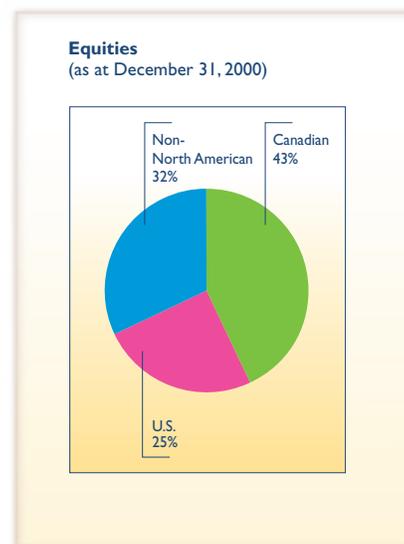
Asset-mix policy risk would be the mirror image of liability risk, and surplus risk would be zero, if investments perfectly matched the plan's long-term objective that asset growth will average a real rate of about 4.5 percent plus inflation. Real return bonds come close, but fall a bit short on yield.

The absence of a perfectly matching asset forces us to consider assets that individually do not always behave like our pension promise, but collectively give us the best trade-off between longer term expected surplus return and acceptable short-term surplus risk. Consequently, our asset mix is heavily weighted to equities because they meet our long-term goals, while our inflation-sensitive investments give more modest real returns but dampen surplus risk.

Active management risk is the potential risk of under-performing the benchmark by trying to improve on the return we get from passive implemen-

tation of asset-mix policy. The incremental surplus risk from active management is small. We control active risk through policy guidelines and procedures. Again using VaR, we assign each manager "risk capital" to go along with that manager's value added target with an expectation of a specific return on that risk capital. Risk from active positions is measured daily against the risk limits. One additional benefit from these risk measures has been an improvement in operational risk management.

Changes in the value of the Canadian dollar relative to foreign currencies can increase or decrease returns on our foreign investments, creating **foreign exchange risk**. We hedge 50 percent of our exposure to the main currencies in our asset-mix policy, and had \$11.8 billion of foreign currency hedges in place at the end of 2000 to reduce volatility.



Through global diversification, we aim to reduce **excessive sensitivity to Canadian asset returns** by investing in foreign stocks and equity derivative contracts. Overall, Canada remains our primary equity market, where the plan had \$17.7 billion invested in equities in 2000, followed by \$10.1 billion in the United States, \$2.8 billion in the United Kingdom, and \$2.3 billion in Japan. However, we are concerned about the limited availability of stocks on the TSE 300. Many leading

Canadian corporations are closely owned, or listed in the U.S., further diminishing the investment pool in Canada.

With respect to **liquidity risk**, after payment of pension benefits and operating costs, the increase in net assets available for benefits totalled \$4.8 billion in 2000. Cash flow came from \$6.2 billion of investment income (dividends, interest income, rental income, and realized and unrealized gains) and \$1.3 billion in contributions.

The cash needs for pension payments and operating expenses are predictable. On the investment side, our major liquidity risk is associated with our equity derivative contracts. A drop in foreign equity markets sustained for more than three months would require us to pay more cash to counterparties than we would otherwise expect.

We regularly assess the fund's ability to withstand the liquidity effects of a catastrophic 25 percent drop in all markets. Because the equity contracts have been profitable, we currently hold \$493 million in net cash collateral from counterparties. This cash collateral, along with marketable short-term securities, annual cash flow, and other liquid assets, is more than sufficient to cover the fund's liquidity risk.

Every investment exposes us to the risk that a security issuer could default on payments or become insolvent. **Credit risk** exists with security issuers, such as governments and corporations, as well as with financial institutions and investment dealers with whom we have investment contracts. The largest credit exposure (note 3e) is to the Province of Ontario, which owes the plan \$12.2 billion of non-marketable debentures valued at \$15.7 billion, and \$1.3 billion in contributions receivable. The next largest credit exposure is to the Government of Canada at \$14.5 billion.

In the case of security issuers and derivative counterparties, we continuously monitor credit risk and, depending on the credit rating, restrict debt and equity investment in a single corporation or financial institution to between one and five percent of total fund assets.

In the case of swap counterparties, we deal primarily with 19 financial institutions rated Single A or better. Unrealized gains and losses on equity swaps are exchanged every three to six months. We exchange cash flows on interest rate swaps every six months, reducing the potential impact of a counterparty defaulting on its contractual obligations.

OUTLOOK

Our current expectation is that returns will not be as strong in the future as they have been in the past 10 years. We will continue to monitor financial markets and adjust our asset mix to achieve the best possible performance in the coming years. In the meantime, we assure all members that our first priority is to maximize returns without incurring undue risk.