Let us explain how the economic crisis has affected your pension plan's performance.

And what we're doing about it.

2008 Annual Report

2008 Highlights

State of the plan

The Ontario government and Ontario Teachers' Federation – the plan sponsors – introduced a change in the plan's cost-of-living provision for future retirees.

The change resolved the $12.7 billion funding shortfall projected at January 1, 2008, and provides some flexibility to adjust cost-of-living increases, depending on the plan's funding status. However, it will take many years for this change to make a meaningful impact on the cost of future benefits.

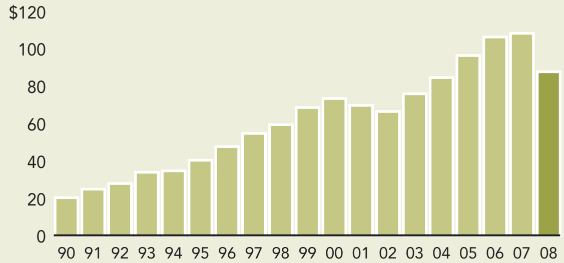
Net assets fell to $87.4 billion and a $2.5 billion funding shortfall was projected at the beginning of 2009. A balanced funding valuation must be filed with the pension regulator by 2011 at the latest. See State of the Plan for a full explanation.

Funding valuation
(as at January 1, 2009)

Net assets	$ 87.4
Smoothing adjustment	19.5
Future basic contributions	25.1
Future special contributions	5.5
Actuarial assets	137.5
Future benefits	(140.0)
Shortfall	$ (2.5)

Investments

Net assets: $87.4 billion
(for the year ended December 31) ($ billions)



The pension fund lost $19.0 billion in 2008 due to declines in equity and credit markets.

Investment performance

(percent)	*2008*	*2007*	*4-yr.*	*10-yr.*	*Since 1990*
Return	-18.0	4.5	3.3	6.6	9.6
Benchmark	-9.6	2.3	3.4	4.8	7.5
Return (below)/ above benchmark ($ billions)	(9.2)	2.3	0.1	12.3	15.8

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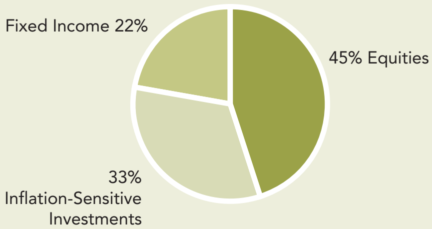
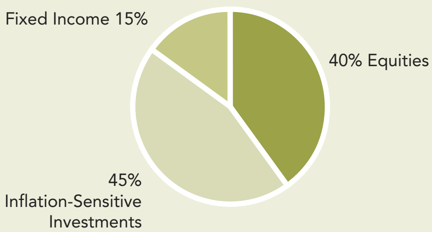
Member Services

Asset-mix policy

2008



2009



The asset-mix policy changed at the beginning of 2009. We decreased investment risk by reducing our exposure to equity and credit markets and increasing our allocation to inflation-sensitive investments that are well matched to paying teachers' pensions.

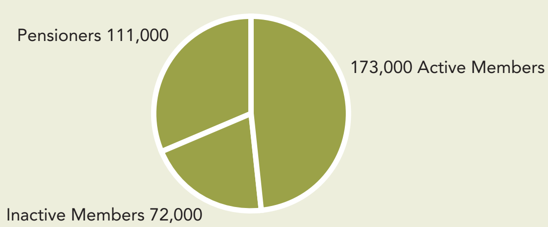
#1 for pension service worldwide

Your pension is a valuable benefit:

- Defined by a formula, not by the value of the pension fund on the day you retire
- Legislation protects benefits you have already earned
- Pension paid for life
- $42,000 – average starting pension for teachers retiring at the 85 factor
- 100% – inflation protection guaranteed for current pensioners and for pension credit earned until the end of 2009; between 50% and 100% of the increase in the Consumer Price Index for credit earned after 2009
- 30 years – how long a typical teacher is expected to collect a pension; longer than the average teaching career
- 5 years – how long a typical pension is paid to a survivor

Membership profile

(as at December 31, 2008)



Report from the Chair

Eileen Mercier, MA, MBA, FICB
Chair

The 2008 valuation filing and the economic crisis dominated the year for board members of the Ontario Teachers' Pension Plan (Teachers').

The plan sponsors, the Ontario Teachers' Federation (OTF) and the Ontario government, filed the funding valuation in October with a change in the cost-of-living provision for benefits earned after 2009. Cost-of-living increases for pension credit earned after 2009 will range from 50% to 100% of the change in the Consumer Price Index, depending on the plan's funding status; the decision as to whether or not this change is invoked is made by the plan sponsors. This change led to the elimination of the funding shortfall projected last year. Looking forward, it also strengthens the plan's ability to generate the long-term investment returns required to provide retirement security at an affordable cost.

The worst global financial crisis since the 1930s saw the pension fund realize a -18% rate of return in 2008. Although this was only the third loss in Teachers' 18-year history, it is the largest the fund has ever suffered, and it reversed the significant market outperformance achieved over the previous three years.

2008 shortfall resolved

The sponsors made the decision in mid-2008 to change the plan's cost-of-living provision in order to resolve the funding shortfall projected at the start of the year. Plan staff had begun researching options to deal with long-term funding shortfalls eight years ago. With the plan sponsors, they commissioned a number of third-party reports from pension and actuarial experts. The plan sponsors had been considering the various options since 2005, and deserve credit for weighing the implications and alternatives so carefully.

The solution they adopted – a change in the cost-of-living provision that the plan sponsors can invoke if necessary – calls for 50% to 100% inflation protection on benefits earned after 2009. Providing 100% inflation protection remains the goal. Over time, the change in the cost-of-living provision will help to reduce two risks the plan faces: (1) that benefits will become unaffordable for the plan, and (2) that contribution rates will become unaffordable for members. As a result, we now will be able to assume a somewhat higher rate of return in determining the fund's long-term financial health.

This higher rate-of-return assumption was instrumental in resolving the $12.7 billion shortfall projected at the start of 2008, and enabled the plan to file a balanced valuation with Ontario's pension regulator in the fall. The assumption also took into consideration the one-time cost of adopting new mortality data, which shows that teachers live and collect pensions longer than the plan previously had assumed.

The most valuable asset our board members bring to the table, in this chaotic environment, is their collective experience. Each has responded to the gravity of the economic crisis with diligence and dedication, which have been critical in allowing us to find a way to navigate through it. But the economic crisis – and the pressure on the board and management – continues.

The change in the cost-of-living provision will help the pension plan manage future funding challenges stemming from plan maturity, low interest rates, increased life expectancy and the risk that investment returns could fall short of the growth in plan liabilities. It is important to note, however, that this change cannot and will not keep shortfalls from occurring if future pension costs grow faster than plan assets; what it will do is give the sponsors a new tool for dealing with future shortfalls when they occur and, over time, will provide a degree of intergenerational equity in plan funding. But, it will take many years for the full benefit of conditional inflation protection to be realized, and there is no guarantee that this measure alone can cover all future shortfalls.

Market conditions

The economic story was the same everywhere around the world in 2008: credit markets were frozen in uncertainty and apprehension and then stock markets plummeted, losing as much as 50% of their value. The financial crisis advanced into a full-scale economic downturn, stressing every one of our systems and investment assumptions. Credit products were at the epicentre of the economic crisis. The decision to remain in certain credit markets turned out to be the wrong strategy for the times. This resulted in losses that, in better economic times, might have been offset by gains in other areas, given our investment diversity. That was not possible in 2008, however, when virtually all markets and asset classes, outside of government bonds, were under siege.

The most valuable asset our board members bring to the table, in this chaotic environment, is their collective experience. Each member of this board has responded to the gravity of the economic crisis with diligence and dedication, which have been critical in helping us navigate through this crisis. As we enter 2009, the economy remains in a deeper and wider recession than any of us could have predicted and none of us has seen before. We believe that, despite the best efforts of governments around the world, the recovery from this collapse will be gradual; we do not expect it to begin before 2010. The pressure on the board and management continues.

Risk management

Teachers' will benefit from this year's analysis of our investment risk management systems. They have served us well, but we believe that no system could have forecast the extent of this year's market rout, and ours did not. Enhancements have been made and more are planned to ensure that our risk management system keeps pace with investment product complexities and possibilities of loss. Coincidentally, the enterprise risk management system, which identifies and addresses all major business risks, including investment risk, was revamped this year. A senior management committee has been given this responsibility. It will deliver more frequent, comprehensive total risk reporting to the board members.

Executive compensation

Teachers' believes we should practise the same executive compensation principles we demand from the companies in which we invest. In short, we believe that variable incentive compensation should reflect performance. We have further advocated that incentive payments should not be based on a single year's results, but should reflect performance over a number of years. Both our short-term and long-term incentive payments for investment staff reflect performance over four years; in aggregate these payments are down $27 million. Total incentive compensation for named executive officers is reduced by 48% from 2007 (shown on page 60).

The use of four-year performance periods is aimed at ensuring that managers are rewarded fairly for consistently outperforming relevant market benchmarks, but not for periods of underperformance. This is especially important in years of performance extremes – good and bad – as it removes the volatility of extreme compensation highs and lows. This compensation structure precludes executives from receiving windfall payments one year for investments that subsequently turn negative, but also avoids wiping out bonuses for several years because of one particularly bad year, which could lead to a major loss of investment talent.

Variable compensation is primarily linked to performance relative to the markets. This year's incentive bonuses reflect one bad year (2008), and three very strong years (2007, 2006 and 2005); 2008's underperformance will significantly reduce compensation through 2011.

Our three highest paid executives have deferred receipt of their 2008 short-term bonuses for two years. Provided that they remain in our employ, they will receive these amounts, adjusted for any investment gains or losses in the fund in 2009 and 2010, in April 2011. Agreeing to leave money they have already earned in the fund for two years demonstrates their faith and confidence in the plan's investment strategy. In addition, no executives reporting to the Chief Executive Officer or the Executive Vice-President, Investments, will receive salary increases in 2009.

Please see page 57 for further details on our compensation plans.

Executive transitions

2008 was Jim Leech's first year as President and CEO. His leadership has been, and will continue to be, invaluable in ensuring the plan's ability to withstand the ongoing economic aftershocks and the long-term funding challenges facing the plan.

2008 was also Bob Bertram's last year as Chief Investment Officer, as he retired at year end. Anything I say about Bob Bertram is an understatement. He has been critical to Teachers' success since becoming our first Chief Investment Officer in 1990. He is a legend in the art of pension investment management – worldwide. He also is a rarity, in that he is both brilliant and humble. The board members extend to him our sincere appreciation and best wishes.

Looking forward

Because it takes longer to climb than to fall, we expect market recovery to be slow. 2009 will be another challenging year.

Decisions taken in 2008 will determine if we are well-positioned for the market recovery, when it does commence. Your board members are confident that management has and will continue, with our oversight, to make the right long-term decisions for the plan's membership.

Eileen Mercier
Chair

Report from the CEO

Jim Leech, MBA, ICD.D
President and Chief Executive Officer

We expect plan members to have two fundamental questions as we announce our 2008 annual performance: How much did the fund lose? What does this mean for my pension?

The answer to the first question is that net assets dropped to $87.4 billion in 2008, compared to $108.5 billion a year earlier, as a result of market movements, a series of investment decisions made in 2006 and 2007, and the $1.9 billion annual gap between pension payments and contributions.

The answer to the second question lies in the fact that the Ontario Teachers' Pension Plan is a long-term investor with a long-term perspective, and that it is a defined benefit plan. Unlike RRSPs or defined contribution plans, a defined benefit plan is based on a formula of service and salary, not the value of the fund on the day a person retires. And, of course, your pension credit earned to date also is protected by legislation.

What does this mean? If you are retired, legislation protects your lifetime pension benefits. If you are working, the pension credit you have already earned is also protected by legislation – your accrued pension cannot be reduced retroactively. Only contributions and future benefits can be adjusted during your career in response to funding surpluses and shortfalls. This is how defined benefit pension plans work. A few years ago, benefits were enhanced using surplus. Subsequently, contributions were increased in response to funding shortfalls. So, notwithstanding these periodic adjustments to benefits and contribution rates, your pension is a valuable asset.

Pensions are a long-term business. Our decision-making, year in and year out, is focused on that long-term view. Our job as stewards of the pension fund is to support the plan sponsors in their commitment to providing this benefit. We do so by managing assets and risk appropriately to generate the growth needed to pay pensions with affordable benefits and at reasonable contribution rates. Investment decisions made today are not expected to create value next month or next year, but rather over the long term.

2008 market conditions

2008 was a sobering year. Teachers' investment managers fought hard against the downward pressure of the global credit freeze and stock, bond and real estate market crashes throughout the year. At year end, however, negative market forces retained the upper hand.

The fund's overall performance was -18.0%. This compares with an average 2008 return of -18.4%[1] for large Canadian pension plans. After eight consecutive years of beating market benchmarks by a wide margin, we underperformed the fund's composite benchmark by 8.4 percentage points. Underperformance was largely a result of exposures to non-government fixed income securities, external hedge funds and real estate.

[1] RBC Dexia.

2008 performance

DOLLARS EARNED/LOST BY ASSET CLASS	PERFORMANCE VS. BENCHMARK*	2008 ASSET-MIX POLICY
Equities ↓ $12.5 billion loss largely due to global equities market slide**	Equities (public and private) lost money but performed better than the benchmark ↑ Return: -23.2% Benchmark: -26.4%	45%
Fixed income ↓ $6.7 billion loss in credit products and hedge funds	Majority of below-benchmark performance attributed to fixed income asset class ↓ Return: -43.6% Benchmark: 12.0%	22%
Inflation-sensitive investments ↑ $200 million gain from infrastructure assets and real-return bonds	Inflation-sensitive asset class made money but did not meet the CPI-related benchmark primarily due to lower real estate valuations ↓ Return: 0.2% Benchmark: 6.8%	33%
↓ $19.0 billion total loss	↓ Total fund return: -18.0% Composite benchmark: -9.6%	

* Portfolio benchmarks are listed on page 34. The composite benchmark is weighted according to the asset-mix policy.

** Includes investments held outside the asset class and included in the total fund return.

A large part of our losses resulted not from investments we sold at a loss, but investments we still hold whose values have been marked down in the current climate. We expect that many of our higher quality assets will regain their value under normal market conditions.

As the performance table indicates, 2008 offered virtually no investment safe haven.

We were caught in the downward equities spiral, although we did manage to outperform our benchmark. As this was our largest asset class at the beginning of 2008, it accounted for the largest share of our losses. It is small consolation that, on a basis relative to the market, our performance was better than the benchmark.

We reduced our equity exposure several years ago to lessen the impact of severe stock market downturns. In recent years, when equities performed well, our performance lagged other investors with higher allocations to stock markets. In 2008, this approach saved the fund from the heavier losses we would have suffered if our target had been rapid growth without considering the possibility and consequences of a serious market decline.

That brings me to our fixed income asset class, where some investment strategies that had been successful for us in previous years reversed and turned negative. Because government bond interest rates had been extremely low in recent years, we had increased our exposure to credit products and hedge funds to gain the higher returns needed to meet our rising pension obligations. This worked well for the fund for several years; the portfolio surpassed market benchmarks consistently. Then the credit crisis hit.

Although we had started to unwind our positions in many of these products in late 2007 and early 2008, this became more difficult to do as market liquidity evaporated, leaving us overexposed to credit. In mid-2008, with the door closing on the credit markets, we changed our fixed income portfolio strategy. We reorganized this department to concentrate on more traditional fixed income products and continued reducing our credit product and hedge fund exposures. I wish we could have moved faster; however, had we not changed course when we did, losses would have been considerably worse.

Our inflation-sensitive investments were the only asset class to earn a positive return, but did not beat the benchmark. Assets are marked-to-market (the price for which you could sell them currently) and did not grow as quickly as the CPI-related benchmark.

In response to 2008, we have decreased risk. We reduced our exposure to equity and credit markets and increased our allocation to inflation-sensitive assets that are well matched to paying pensions.

Periodic losses are an inherent part of investing. We are not accustomed to broad-based investment losses at Teachers', though, having experienced only two other years of total fund losses since our investment program began in 1990. We registered losses in 2001 and 2002, but they were primarily due to the bursting of the tech bubble. This year's decline was brought on by the global credit freeze and asset liquidation that followed, crashing markets across the board. Even our sophisticated asset diversification program could not protect us, as virtually every asset class and market was negatively affected. This was further exacerbated by the fixed income situation I noted above.

The reality is that, like all investors, we are subject to market forces; we will have setbacks. That is why we hesitate to view the market in one-year periods of isolation. It is the cumulative effect of many years of investing that is most meaningful. The market is dynamic, changing from year to year, sometimes dramatically, but the returns will be there for long-term investors like Teachers'.

BCE transaction

Our report on 2008 would not be complete without reference to BCE Inc. In December, it was announced that the agreement to acquire BCE had been terminated in accordance with its terms. While the conditions precedent to the completion of the proposed transaction could not be satisfied and the acquisition was not completed, we are proud of our team's efforts through the course of this unprecedented transaction. Notwithstanding that the acquisition did not proceed, we believe that our initiatives have been successful in effecting significant change at BCE that we believe should result in improved value for BCE shareholders.

Serving our members

Markets may go down, but the quality of our service to members continues to go up. I am pleased to report that our Member Services group was cited as the very best in its field among similar North American pension plans in 2008. We also tied for number one overall among 58 other leading pension plans in Canada, the U.S., the Netherlands and Australia. These scores are based on an evaluation of 11 service categories, ranging from the payment of pensions to contact with members. This recognition of the team's innovation and excellence further confirms our commitment to our members.

Plan funding

In times like these, the value of a defined benefit pension plan is clear. Yes, the fund experienced significant losses this year, and it will be a challenge to recover them. But your pension is not dependent on any one year's results. It will be there for you when you retire.

The pension plan is allowed to smooth investment gains and losses over five years which softens the annual impact of market volatility on the plan's funding status. As a result, in spite of the $19.0 billion loss in 2008, the plan began 2009 with a funding shortfall of only $2.5 billion. This shortfall is due to the combined result of low real interest rates, the continuing increase in the cost of pension obligations and investment losses.

It is important to understand, however, that the plan must recognize this large loss from 2008 over the next four years; thus the funding shortfall will automatically grow unless the investment climate turns sharply positive.

As mentioned in the Chair's report, the OTF and government now have the ability to change the cost-of-living provision for pension credit earned after 2009, if necessary. This decision paved the way for the elimination of the $12.7 billion shortfall projected in our 2007 annual report, by allowing for a change in a key assumption used to value pension plan assets. (A full explanation of the filed funding valuation and assumptions used is provided on pages 13 and 14.)

The plan sponsors' forward-thinking action provides some flexibility in dealing with future funding pressures and eases the potential need for higher contribution rates as the sole means for balancing the fund. With the added flexibility afforded by the new cost-of-living provision, we have more leeway to take advantage of investment opportunities at prices far below levels of recent years. Without this provision, given plan maturity, our investing would have to become increasingly conservative to avoid the possibility of prohibitively high contribution rates.

Recognizing a pension legend

Eighteen years ago the little-known treasurer of Alberta Government Telephones arrived for a job interview with the newly created Ontario Teachers' Pension Plan.

Bob Bertram was hired and stayed on, pioneering one creative solution after another as he led Teachers' in building a fully diversified portfolio and multiplying its value. Recently, Bob was recognized by *Institutional Investor* magazine as one of the 75 most influential people in the world of finance today. Without his efforts, pension fund management would be much different and substantially more costly.

Three years ago, Bob informed us of his desire to retire in 2008. This provided time to identify the key attributes we wanted for the next chief investment officer. We considered several candidates and identified Neil Petroff as the best. Neil took over the reins from Bob as Executive Vice-President on January 1, 2009. Bob will remain available to Neil as a senior investment advisor for the next two years.

In addition to demonstrated expertise and commitment to Teachers', Neil had worked for Bob since 1993, and has been instrumental in producing our next 10-year investment strategy.

In conclusion

Capital markets remain under pressure in 2009, as the grip of the global recession tightens. Because this recession is so broad and deep, we expect the recovery will be slow, and perhaps fitful. We are facing challenges that are substantial, but not daunting. While our current stance remains primarily defensive, we continue to seek investment opportunities.

Our employees are first rate; they proved last year that they can remain focused even in times of turmoil and distraction. They all share the organization's commitment to the goals of pension security, long-term performance and first class service for members, as you will see in the pages that follow.

Jim Leech
President and Chief Executive Officer

Management's Discussion and Analysis

Our objective is to present readers with a view of the pension plan through the eyes of management by interpreting the material trends and uncertainties affecting the results and financial condition of the plan.

As well as historical information, this MD&A contains forward-looking statements regarding management's objectives, outlook and expectations. These statements involve risks and uncertainties and the plan's actual results will likely differ from those anticipated. Key elements of the plan's consolidated financial statements are explained and should be read in conjunction with these forward-looking statements.

State of the plan

Let us explain the three main factors affecting the plan

2008:

Preliminary shortfall resolved with plan changes

A funding shortfall projected at the beginning of 2008 was resolved last year by the plan sponsors – the Ontario Teachers' Federation and the Ontario government – through the introduction of conditional inflation protection for future retirees and other measures.

2009:

Shortfall projected

The pension plan began 2009 with a $2.5 billion funding shortfall due to a continuing increase in the cost of future pensions, low real interest rates and investment losses. However, the shortfall will grow as $19.5 billion in losses held back in the smoothing adjustment are recognized over the next four years, unless the investment climate turns sharply positive.

The funding valuation is conducted by an independent actuary to determine the long-term health of the pension plan.

In preparing the valuation, the actuary projects the plan's benefit costs (including benefits for retired members and the pensions working teachers will earn in the future) and compares them to plan assets, plus future contributions.

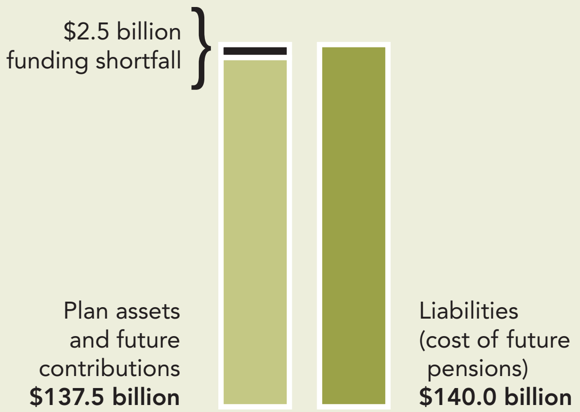
When real interest rates used in the funding valuation are low, the plan needs more money today to earn returns required to pay future pensions.

Securing a typical $40,000 pension requires 30% more money when real interest rates are at 2% – approximately their current level – than at 4%.

By late 2011:

File next balanced funding valuation

Funding valuation
(as at January 1, 2009)



The plan is a mature plan – the ratio of working teachers to retirees is 1.6 to 1.

In 2008, the plan paid $4.2 billion in benefits and collected $2.3 billion in contributions.

The pension plan must file a balanced funding valuation with the pension regulator at least every three years. The next valuation is due to be filed by September 2011, but the plan sponsors may choose to file before then.

If there is a shortfall by the time the next filing is due, it must be addressed before the valuation can be filed. To resolve a shortfall, the plan sponsors can increase contribution rates; invoke conditional inflation protection for future pension credit; reduce other future benefits; or a combination of these options.

Overview

The Ontario Teachers' Pension Plan (Teachers') is Canada's largest single-profession pension plan. It was created for Ontario's teachers in 1917 and until 1990 was administered by the Teachers' Superannuation Commission of Ontario, with the pension fund invested in non-marketable Ontario debentures.

The Ontario government established the Ontario Teachers' Pension Plan Board as an independent corporation in 1990. Together, the board members and management have three key responsibilities: (1) investing the plan's assets in financial markets and managing the plan's liabilities; (2) administering the pension plan and paying benefits promised to members and their survivors; and (3) reporting on the plan's funding status.

At the end of 2008, we managed $87.4 billion in net assets. We administer the pension benefits of Ontario's 173,000 elementary and secondary school teachers and 111,000 pensioners. Teachers' has one of the largest payrolls in Canada, paying out a total of $4.2 billion in benefits in 2008. We employ 750 people at our office in Toronto, Ontario, 10 in our London, England, office and another 1,500 at our real estate subsidiary, Cadillac Fairview.

Plan description

The Ontario Teachers' Pension Plan is a defined benefit arrangement. The plan promises pensions based on a pre-set formula, not according to the amount of money contributed or the returns earned by the plan's investment program. The plan pays 2% per year of service multiplied by the average salary of the member's best five years, partially integrated with the Canada Pension Plan (CPP). It includes full inflation protection for current retirees and for pension credit earned up to the end of 2009. In 2008, a change was made to the plan's cost-of-living provisions making inflation protection for credit earned after 2009 conditional on the plan's funding status as described on page 15. The plan is sponsored by the Ontario government and the Ontario Teachers' Federation (OTF). They jointly decide:

- the benefits the plan will provide;
- the contribution rate paid by working teachers and matched by the government and other employers; and
- how any funding shortfall is addressed and any surplus is used.

These decisions are largely governed by two Ontario statutes, the Teachers' Pension Act and the Pension Benefits Act, and by the federal Income Tax Act.

Pensions are financed with investment income generated by the pension fund plus contributions from working teachers, the government and other designated employers. Contributions in 2008 consisted of approximately $1.1 billion from working teachers, $1.2 billion from the Ontario government and $38 million from other employers and transfers.

Funding valuation filed in September 2008

A balanced funding valuation must be filed with the pension regulator at least every three years. On October 1, 2008, the plan filed a funding valuation as at January 1, 2008. To prepare for the filing, the Ontario Teachers' Federation (OTF) and the Ontario government – the plan sponsors – resolved a projected $12.7 billion funding shortfall as at January 1, 2008 and reported in last year's annual report.

The shortfall was addressed with the following decisions by the plan sponsors and board members:

1. The plan sponsors increased the basic contribution rate to 9% from 8%, increasing the value assumed for future contributions. (The current contribution rate is above that level due to special contribution increases effective until 2021, which are necessary to resolve a previous funding shortfall.)
2. The plan sponsors introduced a change in the plan's cost-of-living provision for pension credit earned after 2009, providing a new measure to deal with funding shortfalls.
3. These changes, introduced by the plan sponsors, partially addressed concerns about possible intergenerational inequity in plan funding and prohibitively high contribution rates. As a result, it was appropriate for the independent actuary to use a higher expected rate of return on plan investments for the final funding valuation. The filed funding valuation used a rate-of-return assumption based on the real interest rate plus 1.5%, compared to the real interest rate plus 1.0% used in the preliminary funding valuation.

For the future, the independent actuary has approved the use of a broader range in the real (after inflation) rate-of-return assumption than that previously used for the plan's funding valuations. This range has been approved by the plan's board and included in the sponsors' current Funding Management Policy. The funding valuation now uses an assumption based on the real interest rate plus a premium of either 0.5% or 1.4%. The Funding Management Policy calls for the lower basis (0.5%) when the plan is in a strong financial position, and has the effect of enabling the plan to build up an asset cushion in good times. The policy calls for the higher basis (1.4%) when the plan's finances are weaker, and has the effect of enabling the plan to keep contributions and benefits stable in less favourable times. Previously, the assumption was based on the real interest rate plus either 0.5% or 1.0%.

The lower basis (plus 0.5%) is applied when the plan is in a surplus position. Using a more conservative basis for the funding valuation helps ensure that the pension plan can afford the use of any surplus (for lower contribution rates or improved pension benefits) over the long term.

The higher basis (plus 1.4%) is used when the plan is experiencing funding challenges and the cost of future pensions is not fully funded. Using a higher rate-of-return assumption helps to absorb short-term market volatility and other temporary impacts and avoids the need for short-term changes to contributions or benefits to keep the plan fully funded. Funding valuations prepared on this basis and showing a funding shortfall would require the plan sponsors to rebalance the fund before filing the plan's triennial funding valuations with the pension regulator.

The board members felt comfortable adopting the new assumption range because of the change in the cost-of-living provision. The board is mindful that this pension plan is mature, with 1.6 working teachers per retiree, hence it pays out more in benefits annually than it collects in contributions, and that returns on investments in capital markets can fluctuate with market volatility. The ability to adjust the level of inflation protection, if necessary, offers a safety valve for offsetting future shortfalls (in part or whole). It will take many years for the full effect of this measure to be realized and there is no guarantee it can cover all future shortfalls.

The board and the plan sponsors also agreed to the creation of a consultative mechanism through which the two sponsors may provide input and feedback to the board concerning the assumptions used in plan valuations.

In combination, these decisions resolved the shortfall and a balanced funding valuation was filed. The following tables detail the 2008 preliminary and final filed funding valuations and the assumptions used for each.

FUNDING VALUATION[1]
(as at January 1) ($ billions)

	2008 Preliminary	*2008 Final*
Net assets	$108.5	$108.5
Smoothing adjustment	(3.6)	(3.6)
Value of assets	104.9	104.9
Future basic contributions for current members	21.8	23.6
Special contribution increases[2]		
Current members	6.1	4.2
Future members	2.1	1.4
Actuarial assets	134.9	134.1
Future benefits for current members[3]	(147.6)	(134.1)
Surplus/(Shortfall)	$ (12.7)	$ 0.0

[1] Funding valuations include the cost of 100% inflation protection because it is assumed the plan will provide full inflation protection, depending on the plan's funding status.

[2] To 2021 required to address the 2005 preliminary funding shortfall.

[3] Present value of future benefits for current members.

FUNDING VALUATION ASSUMPTIONS[1]
(percent)

	2008 Preliminary	*2008 Final*
Rate of return	5.15	5.65
Inflation rate	2.20	2.20
Real rate of return	2.95	3.45

[1] The final valuation used a slightly higher assumption (real interest rate plus 1.5%) than the assumption in the current Funding Management Policy (real interest rate plus 1.4%) explained on page 13. The 0.1% difference accommodated the transition to a new mortality table based on the results of an independent study commissioned in 2007. Updated mortality projections reflect current experience that pensioners are living longer than previously assumed and thus collecting pensions for a greater period of time.

Funding approach

The plan's funding approach is aimed at providing pension security for all generations of plan members. The goal is to be able to pay benefits as they come due while keeping contribution rates affordable. This requires ongoing effort and a spirit of cooperation and consensus among the plan's board members and the two plan sponsors – the Ontario government and the OTF – who are responsible for all funding decisions.

The plan sponsors have adopted a Funding Management Policy that sets out guidelines indicating when funding surpluses can be used and how shortfalls may be addressed. Under the policy, the plan is considered fully funded when plan assets are equal to, or up to 10% greater than, the cost of future benefits. When assets exceed future benefits by more than 10%, the surplus can be used to lower contribution rates, improve benefits, or a combination of both.

When assets fall below the plan's fully funded zone, the plan sponsors must rebalance the plan.

At the time of the 2008 filing, the plan sponsors introduced a change in the plan's cost-of-living provision – commonly known as "conditional inflation protection" – that will act as a safety valve to help manage funding shortfalls in the future. It gives the plan sponsors four options for resolving shortfalls: (1) increase contribution rates; (2) invoke conditional inflation protection; (3) reduce other future benefits; or (4) a combination of these measures.
If conditional inflation protection were invoked, annual cost-of-living increases for current retirees would not be affected. However, annual cost-of-living increases for future retirees would be based on two components:

1. The portion of a member's pension credit earned before 2010 would still be 100% protected against changes in the cost of living.
2. The portion of a member's pension credit earned after 2009 would be adjusted to between 50% and 100% of the change in the CPI, depending on the plan's funding status.

Any reduction in the inflation factor for future retirees will remain in effect until a subsequent funding valuation for filing shows there are sufficient funds to provide full inflation protection again. If there is enough surplus, inflation protection at the 100% level could be restored on a go-forward basis. On the other hand, if a funding shortfall continues to exist following the implementation of conditional inflation protection, further contribution increases or future benefit reductions would be required.

If the sponsors were to invoke conditional inflation protection, subject to the Ontario legislature passing amendments to the Teachers' Pension Act, the Ontario government and designated employers participating in the plan would continue to share pension costs by making extra contributions equal to any cost-of-living increases members forgo.

Plan maturity

The Teachers' pension plan is continuing to mature. The cost of future benefits is increasing as pensioners live longer and the current low interest rate environment limits prospects for investment returns, thereby driving up projected pension liabilities. Nearly all defined benefit pension plans worldwide face these concerns and are having to make the decisions needed to balance assets and pension liabilities.

There are currently 1.6 working teachers for each retiree in the plan. This ratio is projected to fall to as low as 1.2 to 1 in 10 years. As a result, a declining proportion of the membership carries increased responsibility for meeting the plan's funding requirements. Meanwhile, new life expectancy projections show that retirees will receive payments for a longer period of time than before. The average teacher retiring in 2008 worked 26 years and is expected to receive a pension for 30 years, with five additional years of pension expected to be paid to a survivor. This means the average pension entitlement is expected to run nearly nine years longer than the average contribution period.

DECLINING RATIO OF WORKING-TO-RETIRED MEMBERS

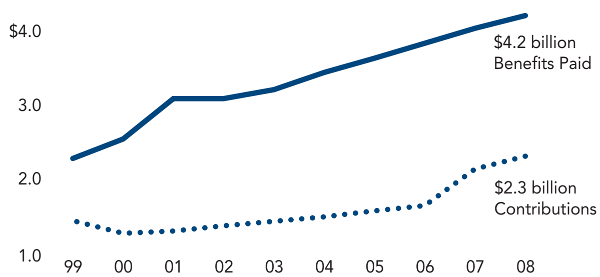
	1970	*1990*	*2008*
Active members per retiree	10:1	4:1	1.6:1
Expected years on pension	20	25	30
Value of contributions as a percentage of net assets[1]	93%	42%	28%
Increase in contribution rate for 10% decline in asset values	0.56%	1.9%	4.2%

[1] Assuming the plan is fully funded and current contribution rates.

Today, contributions comprise a much smaller percentage of the plan's assets. Consequently, the required contribution rate increase to cover a 10% decline in asset values would be more than double what it was in 1990. For example, assuming full inflation protection, a 10% decline would result in a contribution rate increase to more than 16% from 12%.

In addition to the retirement period exceeding a teacher's working life, the plan is also experiencing negative cash flow as benefits exceed contributions on an annual basis. In 2008, benefits paid out exceeded contributions received by $1.9 billion. This has been the trend for many years and is projected to continue in the future. As expected in a mature pension plan, in which annual benefit payments exceed pension contributions, investment returns play an increasingly critical role in enabling the plan to meet its long-term obligations.

CONTRIBUTIONS RECEIVED VS. PENSIONS PAID
(for the year ended December 31) ($ billions)



Benefits paid exceeded contributions from members, the government and other employers by $1.9 billion in 2008.

Another key measure of the plan's maturity is the ability of contributions to absorb funding shortfalls and keep the plan fully funded. This capacity has changed dramatically over the past 18 years. In 1990, future contributions represented 42% of the plan's assets. If the plan had experienced a shortfall, contributions could have been increased to close the gap. Future contributions now represent only 28% of net assets and this percentage is projected to fall in coming years. Consequently, the low ratio of working teachers to pensioners and the small percentage of contributions to total assets make it increasingly difficult to overcome funding deficiencies using contribution rate increases alone.

Interest rate environment

Real interest rates – the return above inflation – for bonds substantially affect the amount of money required now to fund pensions in the future. Securing a typical $40,000 pension requires 30% more money when real interest rates are at 2% – approximately the current level – than at 4%. Though rising slightly since 2005, the real interest rate for bonds remains low compared to the 1990s.

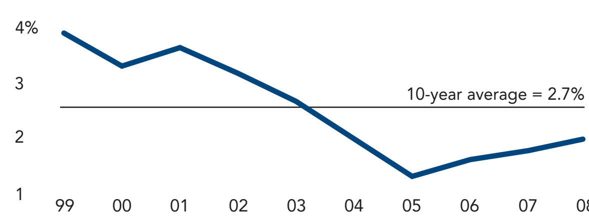
Rising real interest rates cause the estimated present value of the fund's liabilities to fall, which improves the plan's funding status. Inversely, declining real interest rates increase the present value of liabilities but benefit the fund by increasing the value of portfolio assets such as bonds, real estate and other income-oriented assets.

ASSETS REQUIRED FOR A TYPICAL $40,000 PENSION

Real Interest Rates	*Amount Required*[1]
2.0%	$855,000
3.0%	$745,000
4.0%	$660,000
5.0%	$585,000

[1]For retirement at age 58.

REAL INTEREST RATES



When real interest rates are low, bond yields are low. As a result, the cost of future pensions is higher because the pension plan needs more money today to earn the value of pensions to be paid in the future.

Managing assets in relation to plan liabilities

Teachers' investment program faces a two-fold challenge in managing plan assets in relation to the liabilities. The portfolio must generate relatively high returns because the goal is to provide 100% inflation protection to plan members. However, the low ratio of working teachers to pensioners and the desire for stable contribution rates and indexation levels, combined with the legal requirement for triennial balanced funding, restrict the ability of plan managers to increase returns by taking on more risk. When financial markets fall significantly, it becomes difficult, if not impossible, for higher contributions to make up any investment loss that might arise.

Teachers' investment managers have addressed these competing concerns by operating within an asset mix with a moderate equity allocation, while exploiting opportunities and using innovation to maximize returns within that mix. In the future, conditional inflation protection will, over time, provide some flexibility and ease reliance on contribution increases as the only means available to meet funding challenges. This will also allow us to continue with our current investment strategy, rather than having to become more conservative as the pension plan continues to mature. But we will still be more constrained than managers of other large pension funds, because of the maturity of this plan.

Measuring the state of the plan

Achieving balance between plan assets and the cost of future benefits is an ongoing job for the OTF and the Ontario government, the plan sponsors. Teachers' management assesses the funding position of the plan each January, and offers the sponsors technical advice and analytical support on plan funding issues.

We use two methods to value the plan annually:

- **Financial statement valuation:** Prepared by an independent actuary, this valuation, based on best estimates proposed by management and approved by board members, takes into account only the benefits already earned to date by current retirees, inactive and active members, and contributions already received by the plan.
- **Actuarial valuation for funding purposes:** The funding valuation, also prepared by an independent actuary, determines the long-term financial health of the plan at current contribution rates. In preparing the funding valuation, the actuary projects the plan's benefit costs (including the cost of 100% inflation protection) and compares them to plan assets, then adds in future contributions from current teachers, the government and other designated employers (and future special contributions from the government and designated employers as well as current and future teachers until 2021) using assumptions approved by the plan's board members. The projection includes the cost of pensions for current members, but does not include the cost of benefits for teachers who are expected to be hired in the future. The plan is required by law to file a balanced funding valuation with the pension regulator at least every three years. It must show that the scheduled contribution rates will, when added to the plan's assets, be sufficient to cover the cost of future benefits for current members.

	FINANCIAL STATEMENT VALUATION	ACTUARIAL VALUATION FOR FUNDING PURPOSES
CONDUCTED	Annually	Annually. Filed with the pension regulator at least every three years as required by law
BY	Independent actuary hired by Teachers'	Independent actuary hired by Teachers'
COVERS	Benefits earned to date	Benefits earned to date plus projected future benefits and contributions

COMPARING THE FINANCIAL AND FUNDING VALUATIONS[1]

($ billions)	*Financial at Dec. 31, 2008*	*Funding at Jan. 1, 2009*[1]
Net assets	$ 87.4	$ 87.4
Smoothing adjustment	19.5	19.5
Value of assets	106.9	106.9
Future basic contributions for current members		25.1
Special contribution increases[2]		
Current members		4.2
Future members		1.3
Actuarial assets	106.9	137.5
Future benefits for current members[3]	(118.1)	(140.0)
Shortfall	$ (11.2)	$ (2.5)

[1] Based on assumptions in the current Funding Management Policy (page 13).

[2] To 2021 required to address the 2005 preliminary funding shortfall.

[3] Present value of future benefits for current members.

Both the financial and funding valuations show a shortfall. The smoothing adjustment will recognize large losses from 2008 over the next four years. Unless the investment climate becomes sharply positive in the short term, these deficits will grow.

SMOOTHING ADJUSTMENT

	Unamortized (Gains)/Losses	*Unamortized (Gains)/Losses To Be Recognized In*			
($ millions)	***2008***	*2009*	*2010*	*2011*	*2012*
2004	**$ –**	$ –	$ –	$ –	$ –
2005	**(1,186)**	(1,186)	–	–	–
2006	**(2,536)**	(1,268)	(1,268)	–	–
2007	**2,456**	819	819	818	–
2008	**20,790**	5,198	5,198	5,197	5,197
	$19,524	$3,563	$4,749	$6,015	$5,197

Funding valuation

The plan began 2009 showing a funding shortfall of $2.5 billion to cover benefits already earned plus those projected to be earned in the future by current members. The cost of future benefits at January 1, 2009, is estimated at $140.0 billion, while assets (actuarial) are estimated at $137.5 billion.

The real rate-of-return assumption is based on the real interest rate plus 1.4% (see page 13 for explanation), and therefore mirrors the relatively low real interest rates of the past five years. The assumption used in the funding valuation takes into account the expected rates of return for this fund's asset mix, as well as the required risk balance needed to achieve a greater degree of intergenerational equity.

Valuation assumptions change over time. While actual experience mirrors some assumptions closely, annual market returns (excluding fixed income and real-return bonds) typically fluctuate much more significantly compared to the assumption and so are smoothed over five years. The following table shows the assumptions used in this valuation. (Assumptions used for valuations filed previously with the pension regulator are found on page 22.)

FUNDING VALUATION ASSUMPTIONS

(percent)	*2009*
Rate of return	4.90
Inflation rate	1.35
Real rate of return	3.55

Financial position of the plan

Use of estimates

Canadian generally accepted accounting principles require us to make estimates when we account for and report assets, liabilities, investment income and expenses, and to disclose contingent assets and liabilities in the plan's financial statements. We are also required to continually re-evaluate the estimates that we use. We have reviewed the development and selection of critical accounting estimates with the Audit and Actuarial Committee of the board.

Actuarial assumptions used in determining accrued pension benefits reflect best estimates of future economic and non-economic factors proposed by management and approved by board members. The primary economic assumptions include the discount rate, salary escalation rate and inflation rate. The non-economic assumptions include mortality, withdrawal and retirement rates of the members of the plan. The plan's actual experience will differ from these estimates and the differences are recognized as experience gains or losses in future years.

The fair value of each investment and investment-related liability is an estimate of the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Management's and third-party appraisers' best estimates are used in selecting the assumptions to determine the fair value of investments that are not publicly traded.

Financial statement valuation at December 31, 2008

The plan ended 2008 with a financial statement deficit of $11.2 billion. This compares to a deficit of $10.5 billion for 2007. The discount rate used in the financial statement valuation was 4.0%, based on long-term Government of Canada bonds plus 0.5%. The financial position of the plan is summarized in three accompanying tables on pages 20 and 21.

- **Table 1:** year-end financial position
- **Table 2:** changes in net assets available for benefits
- **Table 3:** accrued pension benefits

As **Table 1** shows, net assets available for benefits totalled $87.4 billion – down $21.1 billion from 2007. The impact of investment losses is mitigated by a smoothing adjustment that amortizes, over five-year periods, the impact of non-fixed income gains and losses when returns are above or below the rate of inflation plus 6%. There are $19.5 billion in losses to be recognized over the next four years. After allowing for this smoothing adjustment, actuarially-adjusted net assets totalled $106.9 billion – up $2.0 billion from 2007.

As **Table 1** also illustrates, the cost of future pensions on a financial statement basis was $118.1 billion ($115.4 billion in 2007). The actuarial assumptions used to determine the cost of future benefits include management's best estimates of teachers' future salaries and demographic factors.

The $11.2 billion deficit represents the difference between the cost of future pensions and actuarially-adjusted net assets.

TABLE 1: YEAR-END FINANCIAL POSITION

(as at December 31) ($ billions)	*2008*	*2007*
Net assets available for benefits		
Net investments	$ 85.1	$108.0
Contributions receivable from Province of Ontario	2.2	1.8
Other net assets/(liabilities)	0.1	(1.3)
Net assets	87.4	108.5
Financial status		
Net assets	87.4	108.5
Smoothing adjustment	19.5	(3.6)
Actuarially-adjusted net assets	106.9	104.9
Cost of future pensions	(118.1)	(115.4)
Deficit	$ (11.2)	$ (10.5)

Table 2 notes that investment returns in 2008 amounted to a loss of $19.0 billion compared with investment income of $4.7 billion in 2007. Contributions received totalled $2.3 billion, while $4.2 billion was paid out in benefits. This compares with contributions of $2.1 billion and benefit payments of $4.0 billion in 2007.

The member contribution rate was increased on January 1, 2009, as the final increase required to balance the January 1, 2005 actuarial funding valuation. The contribution rate for teachers in 2008 was 9.6% of earnings up to the Canada Pension Plan (CPP) limit of $44,900 and 11.2% of earnings above that. The contribution rate for 2009 is 10.4% of earnings up to the $46,300 CPP limit and 12.0% of earnings above that. The remainder of the amount required to resolve the 2005 funding shortfall has been addressed by the OTF with a credit reserve from the 1998 to 2001 pension negotiations and by Ontario government and other employer contributions at 10.4% of member earnings to the $46,300 level and 12.0% of earnings above that.

TABLE 2: CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

(for the year ended December 31) ($ billions)	*2008*	*2007*
Income		
Investment (loss)/income	$(19.0)	$4.7
Contributions	2.3	2.1
	(16.7)	6.8
Expenditures		
Benefits	4.2	4.0
Operating expenses	0.2	0.3
	4.4	4.3
(Decrease)/increase in net assets available for benefits	$(21.1)	$2.5

The benefits paid shown in **Table 3** include the addition of 4,700 retirement pensions and 800 survivor pensions during 2008, as well as a 1.8% cost-of-living increase effective January 1, 2008. The annual cost-of-living adjustment effective January 1, 2009, was 2.5%.

TABLE 3: ACCRUED PENSION BENEFITS

(for the year ended December 31) ($ billions)	*2008*	*2007*
Accrued pension benefits, beginning of year	$115.4	$110.5
Interest on accrued pension benefits	5.3	5.1
Benefits accrued	3.5	3.3
Benefits paid	(4.2)	(4.0)
	120.0	114.9
Changes in actuarial assumptions	(2.3)	0.5
Experience losses	0.4	–
Accrued pension benefits, end of year	$118.1	$115.4

David McGraw, CA, MBA, ICD.D
Senior Vice-President and Chief Financial Officer

Barbara Zvan, M.Math, FSA, FCIA
Senior Vice-President, Asset Mix and Risk

Funding valuation history

Funding valuations must be filed with the pension regulator at least every three years. Valuation dates and voluntary filings are determined by the OTF and the Ontario government. Filings must show the plan has sufficient assets to pay all future benefits to current plan members. For reference, all previously filed funding valuations and decisions made to use surplus or address shortfalls are detailed in this section. Assumptions used for each valuation are also reported below.

FILED FUNDING VALUATIONS[1]

(as at January 1) ($ billions)	*2008*	*2005*	*2003*	*2002*	*2001*	*2000*	*1999*	*1998*	*1996*	*1993*
Net assets	$ 108.5	$ 84.3	$ 66.2	$ 69.5	$ 73.1	$ 68.3	$ 59.1	$ 54.5	$ 40.1	$ 29.4
Smoothing adjustment	(3.6)	(1.5)	9.7	3.0	(4.3)	(7.3)	(5.1)	(6.0)	(1.8)	–
Value of assets	104.9	82.8	75.9	72.5	68.8	61.0	54.0	48.5	38.3	29.4
Future contributions										
Current members	23.6	16.7	14.7	13.7	14.4	13.4	12.0	12.6	14.5	14.3
Special contribution increases[2]										
Current members	4.2	4.3	–	–	–	–	–	–	–	–
Future members	1.4	1.9	–	–	–	–	–	–	–	–
Special payments[3]	–	–	–	–	–	–	3.7	8.5	8.4	8.4
Actuarial assets	134.1	105.7	90.6	86.2	83.2	74.4	69.7	69.6	61.2	52.1
Future benefits										
Current members	(134.1)[4]	(105.6)	(89.1)	(84.3)	(76.4)	(69.8)	(66.2)	(62.8)	(60.5)	(50.6)
Surplus	$ 0.0	$ 0.1	$ 1.5	$ 1.9	$ 6.8	$ 4.6	$ 3.5	$ 6.8	$ 0.7	$ 1.5

[1] Valuation filings determined by the plan sponsors.

[2] The preliminary 2005 funding valuation showed a $6.1 billion shortfall. The plan sponsors introduced special contribution increases to 2021 to address the shortfall, allowing a balanced funding valuation to be filed as required by the Ontario Pension Benefits Act.

[3] Owed by the Ontario government to pay off the plan's initial unfunded liability in 1990. The government used its portion of plan surpluses in the 1990s to eliminate the remaining payments.

[4] Assumes 100% inflation protection.

ASSUMPTIONS USED FOR FILED VALUATIONS

(as at January 1) (percent)	*2008*	*2005*	*2003*	*2002*	*2001*	*2000*	*1999*	*1998*	*1996*	*1993*
Rate of return	5.65	6.475	6.40	6.30	6.25	6.50	7.50	7.50	8.0	8.0
Inflation rate	2.20	2.750	2.05	1.90	2.20	2.25	3.50	3.50	4.0	4.0[1]
Real rate of return	3.45	3.725	4.35	4.40	4.05	4.25	4.00	4.00	4.0	4.0[2]

[1] 2.0% per year in 1993 and 1994 (select period) and 4.0% per year thereafter.

[2] After select period.

The real rate of return is an assumption used in the funding valuation. It estimates the real rate (i.e., after inflation) at which the plan's assets will grow in the future and assumes a premium over the yield on long-term Government of Canada Real-Return Bonds (RRBs).

Funding decisions

The plan is sponsored by the Ontario government, through the Ministry of Education, and the Ontario Teachers' Federation (OTF). The plan sponsors jointly decide: what benefits the plan will provide; the contribution rate paid by working teachers and matched by government and other employers; and how any funding shortfall is addressed and any surplus is used. A history of plan funding decisions follows:

1990: Unfunded liability of $7.8 billion to be amortized over 40 years by special payments from the Ontario government; basic contribution rate increased to 8% from 7%

1993: $1.5 billion surplus; $1.2 billion used to reduce government's special payments; $0.3 billion used to offset government cost reductions in the education sector (social contract days)

1996: $0.7 billion surplus; $0.6 billion used to reduce early retirement penalty to 2.5% from 5% for each point short of 90 factor and lower the CPP reduction after age 65 (to 0.68% from 0.7%)

1998: $6.8 billion surplus; $2.2 billion to pay for the 85 factor window from 1998 to 2002 and further lower the CPP reduction to 0.6%; $4.6 billion to reduce the value of special payments owed by the government; OTF and Ontario government agree future surplus would be used to eliminate the government's remaining special payments, and the next $6.2 billion would be available to the OTF for benefit improvements

1999: $3.5 billion surplus; $3.5 billion to eliminate government's remaining special payments

2000: $4.6 billion surplus; no changes to benefits or contribution levels

2001: $6.8 billion surplus; $6.2 billion to pay for benefit improvements: permanent 85 factor; 10-year pension guarantee; reduced pension as early as age 50; lower CPP reduction (to 0.45%); 5-year average Year's Maximum Pensionable Earnings (YMPE) to calculate CPP reduction; pension recalculation based on approximate best-5 salary for older pensioners; and top-up waived for Long-Term Income Protection (LTIP) contributions; of the $6.2 billion, $76 million was set aside in a contingency reserve to be used by the OTF at a later date

2002: $1.9 billion surplus; no changes to benefits or contribution levels

2003: $1.5 billion surplus; no changes to benefits or contribution levels; Funding Management Policy adopted by plan sponsors

2005: $6.1 billion preliminary funding shortfall resolved, leaving plan with a $0.1 billion surplus; plan sponsors introduced special contribution rate increases until 2021, totalling 3.1% of base earnings by 2009, for teachers, the Ontario government and other employers; the OTF used the $76 million contingency reserve set aside in 2001 to reduce contribution rate increases for members in 2008

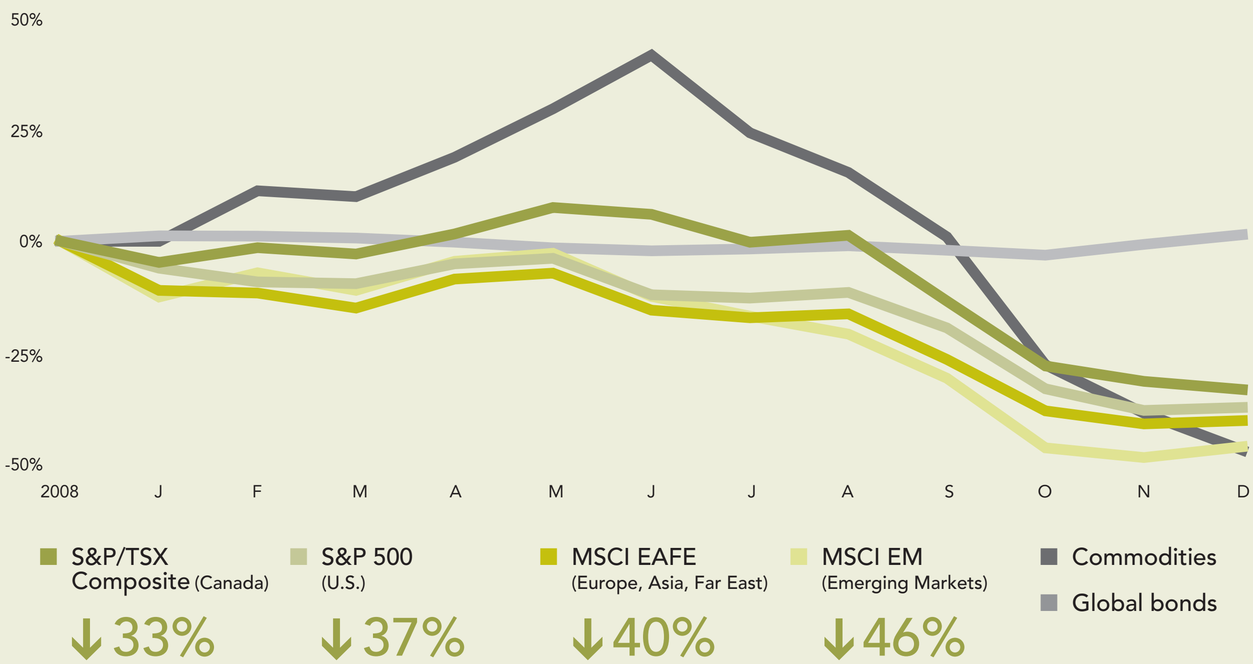
2008: $12.7 billion preliminary funding shortfall resolved, leaving the plan in a balanced position; plan sponsors introduced a change in the plan's cost-of-living provision for pension benefits earned after 2009 and increased the basic contribution rate to 9% from 8%. (The January 1, 2009 scheduled contribution rate increase remains in effect.)

Investments

With a global recession underway, the pension fund lost 18.0% in 2008, only the third loss in Teachers' 18-year history. Since the investment program began in 1990, our average annual return is 9.6%.

The collapse of global equity markets and exposure to global credit markets were the primary causes of our investment losses, which exceed fund benchmark returns.

Global market performance



- Broad market collapse in 2008 was unprecedented
- Worst year for global equity markets since 1931
- Markets for nearly all major asset classes dropped, as the financial crisis triggered an economic crisis resulting in a global recession

Investment losses and gains

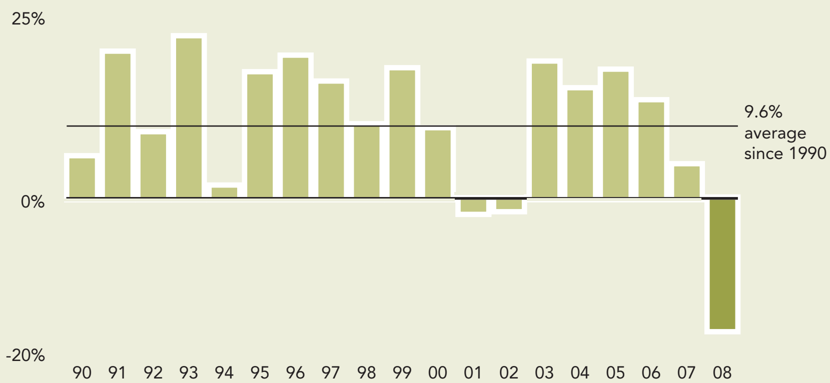
↓ **$12.5 billion loss**
in equities

↓ **$6.7 billion loss**
in fixed income

↑ **$200 million gain**
in inflation-sensitive investments

↓ **$19.0 billion total loss**

Rates of return
(for the year ended December 31)



Losses exceed fund benchmark

↓ **-18.0%**
Fund return

↓ **-9.6%**
Fund benchmark return

- -18.4% average loss for Canadian pension funds greater than $1 billion. (Source: RBC Dexia)
- Underperforming the fund's composite benchmark by 8.4 percentage points – or $9.2 billion – cost us the extra value we had added above market benchmarks over the past three years.
- Much of our below-benchmark performance resulted from credit products held in our fixed income asset class.
- We have reduced our equities exposure and changed our fixed income strategy, returning to more traditional assets.

Goals

The investment program exists to earn returns to meet the plan's long-term funding requirements. We manage risk carefully and have built investment expertise to increase the chance of outperforming market benchmarks over the long term. Paying close attention to the job of maximizing returns at an appropriate level of risk helps to offset challenges presented by a maturing plan membership and attempts to minimize contribution rate volatility and other plan changes.

Contribution rate stability can best be achieved by minimizing the difference between asset values and liability costs. The intent is to generate strong enough investment performance so that, together, plan assets and contributions equal the cost of promised benefits over the long term at an affordable contribution rate.

OUR STRATEGY HAS THREE COMPONENTS:

Determine a level of investment risk acceptable for the plan's membership profile

Select the most appropriate asset mix for providing investment income and protecting the fund from undue losses

Use active management and innovative thinking to add value above the returns available from passive investing

Managing for Value

The investment team must consider and balance a number of variables in establishing our priorities and executing our strategy. Guiding our efforts at all times is our duty to manage the investment fund prudently, in the best interest of present and future plan members and their survivors.

Understanding risk

Risk plays a critical role in our investing activities. We spend considerable resources determining the optimal level of risk and ensuring the types of risk we take are appropriate. As part of the investment process, investment managers must be as concerned about the potential for loss from an investment as they are about how much could be earned.

With this in mind, the plan's investment managers perform an ongoing balancing act between the need to fund promised benefits and the need to control the risk of a loss that would have to be covered by increasing contribution rates, invoking conditional inflation protection, reducing other benefits for future service, or a combination of these measures.

Setting asset-mix targets

This understanding of risk is used to determine our asset mix. We use an asset-liability model that incorporates long-term historical data and current economic outlooks along with decisions to be made by the plan sponsors on contribution and benefits levels, according to the Funding Management Policy. Using this model, together with management experience and judgment, we establish a weighting for each asset class that reflects its long-term risk and return trade-offs in relation to those of the other classes.

As the ratio of active-to-retired members declined, the portfolio's asset mix was adjusted to reflect a lower tolerance for risk. While protecting the fund from undue loss in equity markets, this more conservative asset mix:

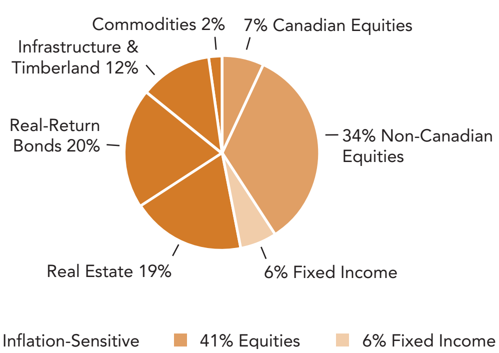
1. may not achieve the level of returns needed over the long term to meet the future cost of benefits; and
2. may cause the fund's investment returns to lag behind those of other investors capable of taking on more risk, especially during periods of large market gains.

As discussed on page 15, the plan sponsors introduced conditional inflation protection for benefits earned after 2009. This will increase the plan's tolerance for asset-mix risk and, over time, should enable investment managers to generate higher returns. Risk cannot be avoided but is being managed as much as possible through the search for enhanced returns from the active management strategies discussed below.

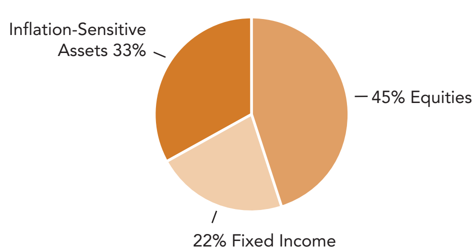
The board members approve the asset-mix policy annually, making modifications as required and giving management discretion to adjust the equities weighting by up to 5% in either direction to take advantage of investment opportunities as they arise. The fund's overall exposure to equities was reduced in the late 1990s, reflecting the lower risk tolerance required to avoid unduly burdening the declining proportion of working teachers.

It was further reduced at the beginning of 2009 (as shown). The steep drop in equity markets during late 2008 underweighted the fund to its 45% equities policy target. We decided to remain underweight to equities given the uncertainty in these markets. At the same time, we saw excellent opportunities to buy real-return bonds (which are a good match to paying pensions) at attractive yields. Accordingly, we ended the year underweight to equities and overweight to inflation-sensitive assets. Management subsequently recommended changes to the asset-mix policy and a new policy was approved for January 2009.

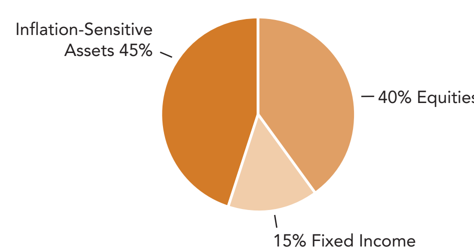
ACTUAL ASSET MIX
(as at December 31, 2008)



2008 ASSET-MIX POLICY
(as at December 31)



2009 ASSET-MIX POLICY
(as at January 1)



Our equities portfolio declined in proportion to the total fund due to market declines. We decided to stay underweight to our equities target in late 2008, and the asset-mix policy was changed for 2009 in light of continuing uncertainty in equity markets.

NET INVESTMENTS BY ASSET CLASS

(for the year ended December 31) ($ billions)	*2008*	*2007*
Equities	**$34.9**	$ 50.0
Canadian	6.2	13.7
Non-Canadian	28.7	36.3
Fixed income[1]	**5.3**	18.7
Bonds	11.5	20.0
Absolute return strategies and hedge funds	14.9	12.3
Money market and related liabilities	(21.1)	(13.6)
Inflation-sensitive investments	**44.9**	39.3
Real estate	16.2	16.4
Real-return bonds	17.4	11.1
Infrastructure and timberland	10.0	8.8
Commodities	1.3	3.0
Net investments[2]	**$85.1**	$108.0

[1] See page 37 for a definition of the fixed income asset class.

[2] Net investments plus contributions and other net assets (liabilities) equal net assets available for benefits of $87.4 billion at year-end 2008. Net investments are defined as investments ($132.0 billion) minus investment-related liabilities ($46.9 billion) as noted on the Consolidated Statement of Net Assets Available for Benefits and Accrued Pension Benefits and Deficit (page 66).

Approach to long-term value creation

We use several methods in the attempt to maximize returns by adding value greater than the performance of the markets in which we invest. We also seek to identify new markets and opportunities.

We use a total-fund management style that encourages the sharing of information and movement of capital among managers of asset classes and portfolios to optimize risk-adjusted returns. We reward portfolio managers for maximizing value-added returns within the risk limit on total assets, not just their own portfolios.

Active management is instrumental in the ongoing success of the plan. While our asset mix and risk management processes are aimed at covering the impacts of inflation and portfolio volatility, the focus of the active management process is to earn returns above benchmarks. We strive to generate higher returns than those available from investing passively in a set of established, generally accepted benchmark indexes weighted to match our asset mix.

Active management means selecting securities we believe are undervalued, as well as under- or overweighting various asset classes relative to the asset-mix policy approved by the board members, as opposed to passive management, or simply "buying the index" at policy weights. Our active management goal is to outperform benchmarks and add value. Management is committed to this approach in the belief that passive investing through conventional public equity and fixed income market indexes cannot, with confidence, generate the risk-adjusted returns the plan requires.

We actively manage approximately half of the fund's investments and employ composite indexes for the fund's remaining index weightings, providing the fund with broad market exposure and liquidity.

We allocate risk to asset classes that can generate superior returns. The fund's largest active risk budgets are found in private equity, public equities and real estate. These assets have earned significant returns above their benchmarks over time. We are able to allocate risk to illiquid assets (such as real estate and private equity) because of our long-term investment horizon.

We also over- or underweight individual index components, a strategy known as overlays, which aims to exploit medium-term investment opportunities. The Chief Investment Officer leads an Investment Planning and Risk Committee that meets regularly to consider over- or underweighting asset classes, sectors and foreign currency positions during the year, based on fundamental and quantitative analysis.

Over the last decade we have added absolute return strategies, including hedge funds, to enhance returns. Their main advantage is that these returns normally have little correlation with those from public equity and fixed income markets. Those markets did not function normally in 2008, however. As a result, this strategy, which had worked well for us from 1996 through 2006, was not successful in 2007 and worked against us in 2008.

Corporate governance

Finally, we pursue corporate governance activities. As a long-term investor, we believe that adherence to proper corporate governance standards creates long-term shareholder value. Conversely, if corporate governance is compromised, so is shareholder value.

To encourage improved corporate practices in public companies, we publish our recommended corporate governance policies and proxy voting guidelines each year. As well, proxy voting decisions are posted in advance on our website and we communicate regularly with boards of directors to advance the interests of our plan members. Teachers' is active in the Canadian Coalition for Good Governance (Wayne Kozun, Senior Vice-President, Public Equities, was named to the coalition's board last year), the Global Institutional Governance Network, the International Corporate Governance Network, the U.S. Council of Institutional Investors, the Institute of Corporate Directors and the corporate governance subcommittee of the Pension Investment Association of Canada.

In late 2008, we distributed our updated proxy voting guidelines to the boards of the major companies in which we invest, with an explicit reminder not to reprice existing stock options and other forms of equity-based compensation in response to slumping markets. We also added a new voting guideline on 'say on pay' proposals and revised our guidelines on board independence, the separation of board and management roles, purchase transactions, increases in authorized shares, and stakeholder proposals, all of which are described in detail on our website.

In 2007, Teachers' acquired Glass, Lewis & Co., LLC, a highly respected San Francisco-based global proxy-voting advisor. In 2008, the company established an international panel of advisors on governance that, among other things, guides the development of Glass Lewis' separate and independent proxy voting policies and guidelines. We encouraged this initiative, but played no role in selecting its members, to ensure its independence.

We also have a longstanding record of recovering losses on behalf of the fund and other shareholders through the courts. In 2008, we focused on U.S. class action lawsuits alleging lack of proper disclosure by American International Group, Inc. (AIG) and Washington Mutual, Inc. (WaMu). We were approved as lead plaintiff in the class action against WaMu.

Looking after members' best financial interests

The investment program exists to secure the pension income of Ontario's teachers. We base our investment decisions on an assessment of each investment's risk factors and potential return. Like other Canadian pension plans, we are required under Ontario's Pension Benefits Act to invest prudently with members' best financial interests in mind, and cannot select or exclude investments solely on the basis of political, social, environmental or any other non-financial criteria.

We believe companies that are responsible, well governed, and compliant with social and industry standards and regulations make good long-term investments. Our analysis and due diligence process takes environmental, social and governance considerations into account. This helps us understand how a range of issues could affect a company's long-term performance and potentially impact its long-term value.

We also subscribe to information from two social investment monitoring services that cover Canadian and U.S. companies to ensure we are aware of emerging issues and how companies are responding. In addition, we are signatories to the U.K.-based Carbon Disclosure Project and the Extractive Industries Transparency Initiative. We support these initiatives because of their focus on enhanced disclosure for investors, which assists us in understanding all the risks that could impact the value of the fund's investments.

Managing risk

The shaded area of this MD&A represents a discussion of risk management policies and procedures relating to credit, market and liquidity risks as required under the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3862, *Financial Instruments – Disclosures*, which permits these specific disclosures to be included in the MD&A. It forms an integral part of the audited consolidated financial statements for the year ended December 31, 2008.

Our goal always is to maintain market and credit risks at both the overall fund and individual portfolio levels within the allowable ranges set by members of our board for the fund and by senior management for individual portfolios.

We manage investment risk on a daily basis in accordance with our investment objectives and policies. The responsibility for risk management is enterprise-wide. The overall investment risk exposure is monitored by the Investment Committee of the board, which comprises all board members and meets a minimum of 10 times a year. The board members review and approve risk management policies that affect the total portfolio and new investment programs that introduce incremental risk to the plan.

Our risk management activities concentrate on the ultimate risk facing the plan – the risk that the plan's assets will fall short of its liabilities (i.e., benefits owed to members). We recognize that funding risk can come from assets or liabilities; a 1% decline in real interest rates increases liabilities by 21% on a funding basis, and by 17% on a financial statement basis. The biggest risk to plan assets is a decline in equity markets.

We have developed a robust risk system that provides the investment managers with the flexibility to examine and compare a wide range of strategies and different asset classes, and to calculate the benefits of diversification across strategies, asset classes, departments and portfolios.

We use risk budgeting to allocate risk across the fund's asset classes. The risk budget is presented to board members annually for review and approval. To understand the long-term dynamics of the total risk in the plan, we also review the economic conditions for the different asset classes and maintain a comprehensive asset-liability model.

Through our risk system, we measure the potential loss within each portfolio, series of portfolios, across departments, across asset classes and finally at the total fund level. Risk calculations are also computed relative to the plan's liabilities and benchmarks. We monitor and report the observed risk values against those budgeted.

The fund's current liquidity position is governed by the plan's liquidity policy and reported regularly to the Investment Committee and the board members. Sufficient liquidity is necessary to meet short-term mark-to-market payments resulting from the plan's derivative exposure and to allow the plan to adjust the asset mix in response to market movements. The fund's liquidity position is analyzed daily and periodically tested by simulations of major events such as significant movements in the markets.

We enhanced our risk management system in 2008, and more enhancements are planned to ensure the system is keeping pace with investment product complexities and loss probabilities.

More information on our risk management activities is provided in note 2 to the consolidated financial statements.

Investment expertise is key

Managing the pension fund is a complicated task. The most important factor in our success is our ability to attract and retain innovative and effective investment professionals.

This team works within a culture of disciplined investment management and innovation. Teachers' embraced the concept of in-house pension investment management early. Now, as one of Canada's largest pension funds, we provide the resources, expanded training and advancement opportunities for our people to seek, and meet, the highest professional standards. These are all important factors in our ability to attract and retain leading investment professionals.

Our commitment to cultivating talent internally was demonstrated during 2008 as the Investment Division underwent a significant leadership change: Wayne Kozun was promoted to Senior Vice-President, Public Equities; Ron Mock was promoted to Senior Vice-President, Fixed Income and Alternative Investments; and Stephen Dowd was promoted to Senior Vice-President, Infrastructure. Six others were promoted to vice-president positions in fixed income, infrastructure and timberland, private capital and tactical asset allocation. Three of these new vice-presidents have more than a decade of experience at Teachers'. Finally, at the end of the year, Group Senior Vice-President Neil Petroff succeeded retiring Bob Bertram as Executive Vice-President, Investments and Chief Investment Officer.

Also very important to our success are the business leaders and professionals who serve as Teachers' board members. They offer a wealth of experience in finance, business management, accounting, economics and actuarial science.

Investment Performance

GOAL	MANAGING FOR VALUE	PERFORMANCE
Produce value-added returns above the policy asset-mix benchmark within our total fund risk limits	Define asset-mix policy and investment plan for the year and manage within market conditions	Underperformed the fund's composite benchmark amid crisis-driven capital market conditions

Market overview

There were three powerful financial market drivers in 2008. Emanating from the United States, they spread worldwide, sparking a particularly sharp fourth quarter sell-off. The drivers were: (1) the impact of the 2007 subprime credit crisis continued, as eroded investor confidence in credit-based products led to a complete freeze of the world's secondary debt markets, which had rapidly grown to finance over half of the world's capital needs; (2) the implications of derivatives exposure among major institutions exceeded all estimates and threatened the financial system. This forced governments and central banks into unprecedented rescues; and (3) recession took hold in the U.S. and economic contraction quickly spread around the globe, affecting even emerging markets, previously thought to be immune.

The year can be divided into two parts: before and after the Lehman Brothers bankruptcy in September. Prior to September, the credit crisis that began in 2007 was being largely controlled by measures put in place by central banks. The economy and debt and equity markets, although weak, were functioning moderately. The failure of Lehman Brothers was the tipping point that propelled the financial crisis worldwide. This rapidly escalated into a global economic crisis, as cash-strapped asset managers sold equities below value to satisfy immediate liquidity needs. Global equity markets plummeted as a result. Real estate and commodities markets were also affected by the economic turmoil, leaving little safe haven beyond government bonds.

Fuelled by concerns about both the financial crisis and recession, volatility was extreme with indexes often moving several percentage points in a single day. Some major stock markets lost 40% to 50% in 2008. Canada fared somewhat better. Buoyed by high prices for oil and other commodities, the S&P/TSX Total Return Index outperformed until the fourth quarter's preoccupation with global recession sent those prices plummeting. The S&P/TSX Composite Index lost 33% for the year.

Global bond markets suffered from growing risk aversion. Credit markets tightened further and the market for credit-based products continued to evaporate, resulting in excess demand for riskless securities (cash and government bonds). In this environment, private sector debt was marked down relative to government debt as funds flowed out of higher risk investments, raising fears of default. To stimulate the economy, the U.S. Federal Reserve cut federal interest rates to near zero and injected substantial liquidity into the banking system. In addition, the Federal Reserve directly supported secondary debt markets in an effort to normalize the flow of liquidity through banks and credit markets and sustain the broader economy.

Commodities – particularly oil and corn – had risen to record highs by mid-summer and then suffered a downward slide that accelerated in the year's final three months. The only exception was gold, which benefited from the rise in risk aversion and concerns about the inflationary impact of massive fiscal aid by the world's central bankers. For much of the year, the rising cost of oil and food drove fears of resurgent inflation.

Inflation fears reversed course toward year's end, as the recession took hold and commodity prices plunged, raising the spectre of deflation instead. On balance, and despite the potential inflationary nature of the government financial stabilization and stimulus programs, the prospect of deflation means that low inflation (in the range of 1% or lower) is probable for the next one to five years.

Last year's annual report noted that liquidity was a global problem caused by the growing U.S. debt crisis and predicted ongoing volatility as the financial system needed time to recover. This view remains unchanged after 12 months despite unprecedented financial support by governments and central banks around the world. Our current outlook is cautious, as we anticipate that the global policy response to the capital markets crisis – although significant – may not stop a further weakening of the global economy in 2009; rather, economies everywhere will likely continue to shrink. Consequently, we do not expect a recovery to begin before 2010.

The sell-off in capital markets has created opportunities, but the financial crisis has also created some sharp economic risks – deepening recession and the potential for deflation in the near term followed by the spectre of rampant inflation caused by stimulus packages. The fiscal and monetary response to the financial crisis since September 2008 has been swift and powerful. Accordingly, looking forward 10 years, we retain our previously expressed view that major central banks will remain faithful to their inflation target of 2.0%; however, actual inflation rates in the medium term will likely average below that level.

As inflation is a key component of estimating the plan's liabilities, the real returns of stocks and bonds must be compared to determine the impact on the plan's liabilities.

Consolidated returns

We are a long-term investor. We measure our investment performance against one- and four-year benchmarks for each asset class and the portfolio as a whole within acceptable risk parameters.

INVESTMENT PERFORMANCE

(percent)	***2008***	*2007*	*4-year*	*10-year*	*Since 1990*
Rate of return	**-18.0**	4.5	3.3	6.6	9.6
Benchmark	**-9.6**	2.3	3.4	4.8	7.5
Return (below)/above benchmark *($ billions)*	**$(9.2)**	$2.3	$0.1	$12.3	$15.8

We lost $19.0 billion in 2008. Net assets fell to $87.4 billion from $108.5 billion at the end of 2007. As detailed in the accompanying table, the fund returned -18.0% for 2008. That was 8.4 percentage points below the return for the composite benchmark.

Asset declines in 2008 include the impact of significant unrealized losses for assets we continue to hold (primarily due to lower marked-to-market asset values), as well as some realized losses. The reduced asset values largely reflect steep declines in global equity markets during the year, lower real estate valuations worldwide, and widening credit spreads. It has long been our practice to follow rigorous, established procedures, known as mark-to-market accounting, to measure the fair value of the fund's assets at year end. The process includes reviews by third-party advisors.

As shown in the table above, despite this negative year – only our third in 18 years – the fund's long-term performance remains in a strong value-added position.

RATES OF RETURN COMPARED TO BENCHMARKS

(percent)	*1-Year Return*	*1-Year Benchmark**	*4-Year Return*	*4-Year Benchmark**
Equities	**-23.2**	**-26.4**	**2.1**	**-0.1**
Canadian equities	-27.5	-31.2	5.3	2.4
Non-Canadian equities	-23.0	-26.4	-0.4	-2.3
Fixed income	**-43.6**	**12.0**	**-7.6**	**8.6**
Inflation-sensitive investments	**0.2**	**6.8**	**7.8**	**5.3**
Real estate	-4.3	7.0	11.7	6.8
Real-return bonds	4.4	6.2	3.7	4.1
Infrastructure and timberland	6.3	13.5	9.7	5.1
Commodities	-33.1	-33.1	-6.1	-6.1
Total fund**	**-18.0**	**-9.6**	**3.3**	**3.4**

*The return available from passive indexed investing. The total fund benchmark is weighted according to the asset-mix policy.

**Total fund return includes Investment Planning and Risk Committee returns, which are not attributable to an asset class.

BENCHMARKS USED TO MEASURE FUND PERFORMANCE

Equities	S&P/TSX Composite Total Return Index (Jan. – Feb.) S&P/TSX 60 (Mar. – Dec.)* S&P 500 Total Return Index MSCI EAFE+EM Total Return Index MSCI All Country World ex Canada Total Return Index MSCI Emerging Markets Total Return Index Custom Non-Canadian National Total Return Index** Custom Global Private Capital Benchmark Total Return Index**
Fixed income	Custom Canada Bond Universe Total Return Index** Custom Currency Policy Hedge Index (Jan. – Feb.)** Custom Long Duration Index (Mar. – Dec.)*
Inflation-sensitive investments	Real Estate: CPI plus 5% Infrastructure and Timberland: Local CPI plus 4% plus country risk premium Scotia Capital Real-Return Bond Total Return Index Custom U.S. Treasury Inflation Protected Securities Index** S&P Goldman Sachs Commodities Total Return Index

*Benchmarks changed effective March 1, 2008 to reflect changes in portfolio composition.

**Weighted average of published indexes and bond data.

Asset class gains and losses in dollars are as follows:

- $12.5 billion loss in equities, largely due to steep declines in global equities markets (includes stocks held in other portfolios)
- $6.7 billion loss in the fixed income asset class, primarily due to exposure to credit markets and hedge funds
- $200 million gain in inflation-sensitive investments, because gains from infrastructure and real-return bonds more than offset drops in commodities markets and depressed values for real estate

The past year was unusual for capital markets and the fund itself. Among other things, it was a year when the benefits of portfolio diversification were largely lost as virtually all asset classes fell amid the worst global financial crisis since the Great Depression of the 1930s.

Credit markets were frozen for much of the year and equity markets plummeted, a casualty of the loss of investor confidence and a severe shortage of liquidity. As the worldwide economic crisis deepened in 2008, other asset classes were impacted; real estate values and commodity markets dropped, and valuations for businesses in our infrastructure and private equity portfolios were affected. High-quality government bonds stood out as the only investment class that fared well.

We underperformed the fund's composite benchmark as well as benchmarks for most asset classes and individual portfolios. This was due primarily to underestimating the severity and global contagion of what started as a U.S. credit crisis.

Decisions we made several years ago for our fixed income portfolio hurt the fund's performance against our composite benchmark. Those decisions were made when interest rates for government bonds were at or near historic lows and the pension plan was experiencing funding shortfalls. While we had no material exposure to asset-backed commercial paper (ABCP) covered by the Montreal Accord, we invested in hedge funds and fixed income credit products (commercial mortgage-backed securities (CMBS) swaps, credit default swaps and other structured products) to earn above-benchmark returns to help meet rising pension obligations and close the funding gap.

This strategy was working as expected, surpassing market benchmarks significantly for several years running, but was fundamentally affected by the credit crisis that began in 2007. It then became apparent that this strategy could not continue to produce sustainable value-added results for the fund. We started unwinding these exposures when the subprime mortgage crisis emerged in late 2007, but could not completely get out of these investments before the credit markets closed. The resulting losses in the fixed income asset class represented more than half of our below-benchmark performance.

In 2008, we further revised our fixed income strategy to return to more traditional, fixed income products. We also changed the leadership team to manage this more traditional portfolio.

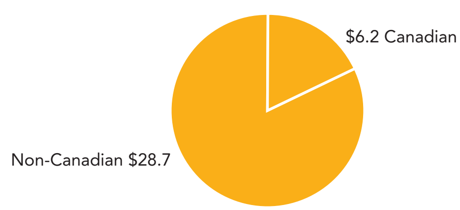
While the value of the fund was negatively impacted by market turbulence in 2008, the pension fund continues to be solidly built on a diversified portfolio with high-quality assets. Throughout 2008, we maintained adequate liquidity (cash and other assets that could be easily sold) for trade settlements and pension payments, and solid collateral. As a result, we were never in a position of selling good assets at a loss to cover liquidity needs. Consequently, the pension fund continues to hold valuable assets and is well-positioned for the next market cycle, with an investment strategy that remains defensive, but flexible enough to take advantage of market opportunities as they present themselves.

Performance by asset class

Equities

Equities (both public and private) totalled $34.9 billion at year end compared to $50.0 billion at December 31, 2007. They returned -23.2% compared to a benchmark return of -26.4%, or $1.2 billion in value added above market benchmarks. On a four-year basis, equities generated a 2.1% compound annual return, outperforming this category's four-year benchmark by 2.2 percentage points for $3.0 billion in total value added. This asset class includes public and private equity investments made by Teachers' Private Capital, discussed below.

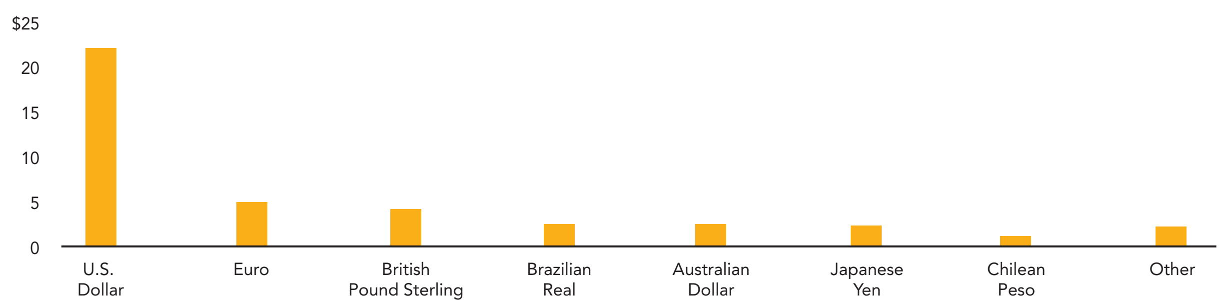
EQUITIES
(as at December 31, 2008) ($ billions)



Canada is a relatively small segment of the global economy. We invest outside Canada to properly diversify our equity holdings.

Losses in equities (mostly unrealized) were mitigated by the decline of the Canadian dollar against the U.S. dollar. The lower Canadian dollar reduced losses on foreign assets when home country performance was expressed in Canadian currency. For example, the S&P 500 – which reflects major U.S. companies – lost 37.0% for 2008, but only 21.2% when expressed in Canadian dollars.

NET CURRENCY EXPOSURE
(for the year ended December 31, 2008) ($ billions)



Our most significant currency exposures are to the world's largest economies plus the countries of Brazil, Chile and Australia where we also have some sizeable investments.

Canadian equities

Canadian equities (both public and private) totalled $6.2 billion at year end compared to $13.7 billion at December 31, 2007. They returned -27.5% compared to a benchmark return of -31.2%. On a four-year basis, these equities generated a 5.3% compound annual return, outperforming this category's four-year benchmark by 2.9 percentage points for $0.8 billion in total value added.

Non-Canadian equities

Non-Canadian equities (both public and private) totalled $28.7 billion at year end compared to $36.3 billion at December 31, 2007. They returned -23.0% compared to a benchmark return of -26.4%, adding $1.3 billion in value. On a four-year basis, these investments generated a -0.4% compound annual return, outperforming this category's four-year benchmark by 1.9 percentage points for $2.2 billion in total value added.

Our non-Canadian equities – in the U.S., Europe, Asia, the Far East and emerging markets – are overseen by both internal and external managers using a combination of active strategies and derivative-based index funds. In 2008, we continued to diversify our equity portfolio by reducing our bias to Canadian stocks. We increased our exposure to emerging markets in 2008 and graded the various countries to recognize that the emerging markets now vary widely in terms of their stage of development and prospects.

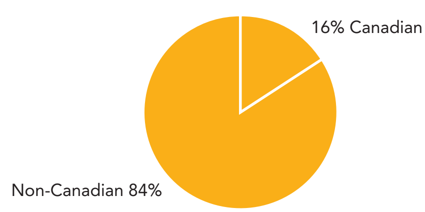
Our largest emerging markets exposure is to Brazil. After extensive due diligence, we began acquiring Brazilian resource equities, real estate and bonds in 2005. A boom that began in 2005 has propelled millions of Brazilians into the middle class and the country is now the world's 10th largest economy.

Brazil is not only resource-rich, but the government's fiscal affairs are in order and, at US$200 billion, its foreign reserves almost equal those of all other Latin American countries combined. Brazil's debt was rated investment grade in 2008, one year sooner than we expected and three years earlier than the general view of other major investors.

Teachers' Private Capital

Private equity investments (included in the above totals for Canadian and non-Canadian equities) totalled $9.9 billion at year end compared to $9.0 billion at December 31, 2007. Teachers' Private Capital returned -12.7% compared to a benchmark return of -19.3%, adding $137 million in value. On a four-year basis, these assets generated a 12.0% compound annual return, outperforming this category's four-year benchmark by 7.9 percentage points for $1.7 billion in total value added.

PRIVATE EQUITY
(as at December 31, 2008)



Our $9.9 billion private equity portfolio includes direct private equity investments, as well as investments in leading private equity funds and venture capital around the world.

Fixed income

Our fixed income asset class includes more than government bonds and treasury bills. It also includes corporate bonds, absolute return strategies, external hedge funds and money-market securities. In addition, this asset class provides funding for investments in other asset classes, equivalent to a treasury department in a corporation.

Assets in this category (net of related liabilities) totalled $5.3 billion at year end compared to $18.7 billion at December 31, 2007. They returned -43.6% compared to a benchmark return of 12.0%. On a four-year basis, these assets generated a -7.6% compound annual return, underperforming this category's four-year benchmark by 16.2 percentage points.

The rate of return is calculated on the broad activities of the asset class, including its funding obligations. (The return specifically for bonds was 6.4% as explained on page 38.) Benchmark underperformance is largely explained by losses incurred through credit market and hedge fund exposures.

Assets net of related liabilities
Net holdings for the fixed income asset class declined primarily for four reasons: (1) credit markets froze causing losses on credit products; (2) the cost of funding assets in other asset classes (such as the purchase of real-return bonds explained below); (3) payment obligations on derivatives; and (4) net pension payments of $1.9 billion.

FIXED INCOME ASSET CLASS
($ billions)

	2008	*2007*
Bonds	$ 11.5	$ 20.0
Hedge funds	7.8	9.9
Absolute return strategies	7.1	2.4
Money market and related liabilities	(21.1)	(13.6)
Total	$ 5.3	$ 18.7

This asset class holds our traditional fixed income investments as well as credit products and hedge funds that incurred losses in 2008. We are returning to more traditional fixed income investments.

Bonds
These assets totalled $11.5 billion at year end compared to $20.0 billion at the end of 2007. The debt on the plan's real estate assets, valued at $2.7 billion at year end compared to $2.9 billion in 2007, is deducted from the bond portfolio. Bonds include Government of Canada bonds, Province of Ontario debentures, and high-yield corporate debt, emerging market, mezzanine and private debt. Bond holdings earned income of $1.2 billion in 2008, returning 6.4%.

Absolute return strategies and hedge fund assets
Absolute return strategies, which are managed internally, and external hedge funds totalled $14.9 billion at year end compared to $12.3 billion at the end of 2007. Some assets were reclassified from the previous year to be included in absolute return strategies, which explains the increased value shown despite losses. The goal of these strategies is to generate positive returns regardless of movements in the broad markets. We include absolute return strategies in this asset class because they *normally* provide steady income, similar to bonds, but with an additional risk allocation aimed at adding value above the benchmark; however, these strategies were the main contributor to losses and underperformance in 2008.

Losses of $3.7 billion on absolute return strategies resulted mainly from credit products, including commercial mortgage-backed security (CMBS) swaps, credit default swaps, and other structured credit products. All of these strategies were exposed to credit markets at the beginning of 2008. During the year, credit spreads reached extraordinary levels in all sectors of the market including investment-grade securities. We took steps to reduce our credit and hedge fund exposures early in the year, which prevented larger losses. We expect that we could see further volatility in our returns in this portfolio as credit markets continue adjusting to global liquidity problems.

External hedge fund assets were valued at $7.8 billion at year end compared to $9.9 billion at the end of 2007. These assets are managed both directly and in fund-of-funds structures, and are designed to earn consistent market-neutral returns while diversifying risk across multiple managers, strategies and styles. During the year, we repatriated $2.0 billion from external managers to reduce our overall hedge fund exposure. Even with these mitigating actions, $0.9 billion in losses were incurred.

Money market and related liabilities

We held $3.1 billion in treasury bills and short-term debentures at year end to meet the plan's short-term liquidity needs. The plan's liquidity position is governed by a policy and reported regularly to the board.

Repurchase agreements and swaps that are used for funding other asset classes are reported in the fixed income asset class and rate of return, totalling $24.2 billion at year end. Historically, we have reported this amount as part of our combined money-market and bond holdings. Due to the size of these liabilities at the end of 2008, we are providing additional information in our MD&A to explain their impact on the net value of this asset class.

Both derivative contracts and repurchase agreements for bonds have played a large part in our investment program since the early 1990s. For efficiency reasons, we use derivatives to gain passive exposure to global equity and commodity indexes in lieu of buying the actual securities. We also use repurchase agreements for bonds to fund investments in other asset classes because it is cost-effective and allows us to retain our economic exposure to government bonds.

These related liabilities increased in 2008 as we took advantage of opportunities to buy real-return bonds at attractive yields. The liabilities are reported here and the value of real-return bonds is reported in the inflation-sensitive asset class because they are an inflation hedge. Throughout the year, these liabilities also increased as a proportion of the total fund as declining equity and credit markets decreased the plan's net assets.

In 2008, due to the Canadian dollar's decline against foreign currencies, as well as interest rate movements, we suffered an additional $3.3 billion loss primarily on two fronts: (1) settling swap contracts for equities and commodities that are payable in U.S. dollars; (2) our 50% policy currency hedge.

For several years, we have applied a 50% policy currency hedge to mitigate certain foreign exchange risks for our foreign investments. During 2008, we removed the hedge (currency is now actively managed) but not before losses were incurred due to the weakening of the Canadian dollar against many global currencies. The removal of the hedge policy proved to be a good decision as losses could have been much larger had the program remained in place for the entire year.

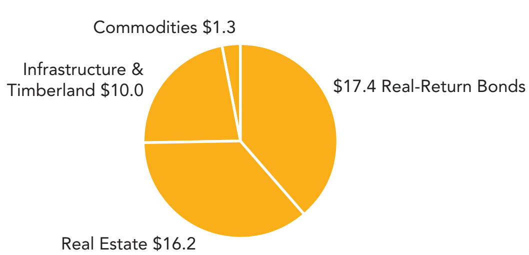
Change in strategy

Consistent with our revised strategy for the fixed income asset class, we are reducing the risk allocation and are returning to more traditional fixed income investments.

Inflation-sensitive investments

The inflation-sensitive portfolio includes real estate, infrastructure and timberland, real-return bonds and commodities. Inflation-sensitive investments totalled $44.9 billion at year end compared to $39.3 billion at December 31, 2007. The inflation sensitive benchmark is designed to reflect the fund's long-term return objectives, rather than a comparison to other similar investments as is the case in equities. These assets returned 0.2% compared to a benchmark return of 6.8%, or $2.6 billion below benchmark. Although performing below benchmark, this asset class earned positive investment income of $0.2 billion. On a four-year basis, these assets generated a 7.8% compound annual return, outperforming this category's four-year benchmark by 2.5 percentage points for $2.7 billion in total value added.

INFLATION-SENSITIVE INVESTMENTS
(as at December 31, 2008) ($ billions)



At $44.9 billion, this asset class is now our largest and plays an important role in decreasing risk and meeting our long-term pension obligations.

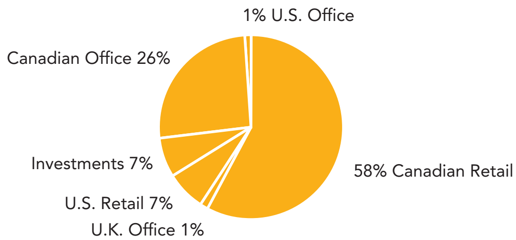
Investments that tend to correlate closely with changes in inflation act as a hedge against increases in the cost of future pension benefits. Over the past few years, inflation-sensitive investments have played an increasingly important role in meeting our performance objectives and decreasing risk.

Real estate

The real estate portfolio totalled $16.2 billion at year end compared to $16.4 billion at December 31, 2007. The portfolio returned -4.3% compared to a benchmark return of 7.0%, or $1.8 billion below the benchmark. On a four-year basis, these assets generated an 11.7% compound annual return, outperforming this category's four-year benchmark by 4.9 percentage points for $2.1 billion in total value added.

Real estate is considered a good fit for the pension plan because it provides strong, predictable income. These assets are managed by our wholly owned subsidiary, Cadillac Fairview. Its aim is to maintain a well-balanced portfolio of retail and office properties that provides dependable cash flows.

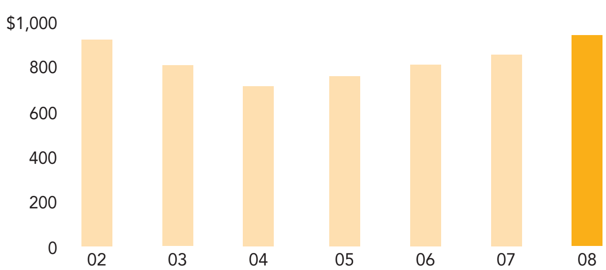
REAL ESTATE PORTFOLIO
(as at December 31, 2008)



Our real estate portfolio was valued at $16.2 billion at year end. It is managed by our subsidiary company, Cadillac Fairview, one of North America's largest managers of commercial property.

The real estate portfolio earned income of $936 million in 2008 primarily from lease arrangements for retail and office space. At year end, the occupancy rate of the retail space was 95%, while the office occupancy rate was 94%. In addition, new investments and development activities were undertaken during the year. Despite these results and activities, the overall portfolio value decreased in 2008 as the global slowdown forced property valuations lower worldwide. Publicly-traded real estate investments also declined along with equity markets.

REAL ESTATE OPERATING INCOME
(before debt costs) (for the year ended December 31) ($ millions)



Income from real estate has been steadily increasing over the past several years and is a growing source of cash flow to the pension plan.

Infrastructure and timberlands

Infrastructure and timberland investments totalled $10.0 billion at year end compared to $8.8 billion at December 31, 2007. These assets earned $580 million, returning 6.3% compared to a benchmark return of 13.5%, or $0.6 billion below benchmark. On a four-year basis, these assets generated a 9.7% compound annual return, outperforming the four-year benchmark by 4.6 percentage points for $0.8 billion in total value added.

The CPI-related portfolio benchmark reflects high inflation throughout much of 2008 in the countries in which we invest. Returns for infrastructure assets typically lag inflation because rates for regulated utilities and contractual agreements are adjusted for changes in inflation after the fact, which partially explains why the portfolio performed below benchmark. Performance against the benchmark was also hurt by the portfolio's publicly listed holdings that were affected by the crash of global equity markets and currency conversions for foreign timberlands.

Infrastructure and timberlands offer stable long-term cash flows. We began building this portfolio – which includes toll roads, airports, pipelines, electrical power generation, water and natural gas distribution systems, marine terminals and managed forests – in 2001. Teachers' is regarded as a "first mover" into this sector among pension funds worldwide.

Real-return bonds

Real-return bonds totalled $17.4 billion at year end compared to $11.1 billion at December 31, 2007 as we increased our exposure to real-return bonds at attractive yields. They returned 4.4% compared to a benchmark return of 6.2%. On a four-year basis, these assets generated a 3.7% compound annual return, underperforming this category's four-year benchmark by 0.4 percentage points, or $0.2 billion below benchmark. We took advantage of a brief spike in real interest rates late in the year to increase our holdings of Canadian and U.S. real-return bonds.

These securities pay returns that are indexed to inflation, as measured by the Consumer Price Index. Our holdings include real-return bonds issued by the Ontario, Quebec, Canadian and U.S. governments, and the manager of Highway 407 in Ontario. We also hold inflation-linked mortgages guaranteed by Canada Mortgage and Housing Corporation.

Commodities

Investments in commodities totalled $1.3 billion at year end compared to $3.0 billion at December 31, 2007. They returned -33.1%, equalling the benchmark return. On a four-year basis, these assets generated a -6.1% compound annual return, also matching the four-year benchmark.

We invest in commodities through swap agreements linked to the Standard & Poor's Goldman Sachs Commodity Index. Though diversified across industrial metals, precious metals, agricultural crops and livestock, this index has a weighting of approximately 70% in energy. It rose through the first half of 2008, but then went into steep decline as the financial crisis spread from the U.S. throughout the world. We sold significant exposure to commodities in the summer prior to market declines. The roller coaster nature of commodities returns – up 21.6% in 2005, down 15.1% in 2006, up 12.8% in 2007 and down 33.1% in 2008 – demonstrates why we place more emphasis on long-term performance than any one year's return.

Investment costs

Total investment management costs were $155 million, compared to $229 million in 2007. This is equivalent to 15 cents per $100 of average net assets, compared with 22 cents in 2007. These costs exclude the commissions paid when trading securities, and management and performance fees for private equity and certain other externally managed funds. However, all such costs are deducted in determining net investment returns.

Neil Petroff, MBA
Executive Vice-President, Investments and Chief Investment Officer

Member Services

We are committed to providing Ontario's working and retired teachers with prompt, reliable pension services and information. And, in 2008, members continued to rate our services at the top of the scale.

We strive to provide outstanding service through our professional staff and our convenient and secure member website, *i*Access web. To assess how we're doing, we ask members to rate our services and compare ourselves to major plans around the world.

#1 for pension service

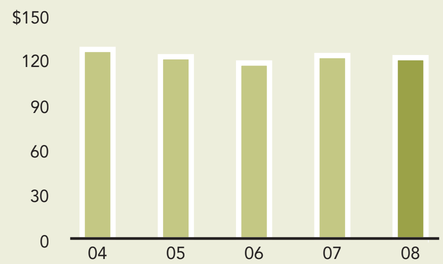
We placed first for service in our peer group and we tied for first internationally in the 2008 CEM Benchmarking survey, an independent evaluation of the costs and services of 58 major pension plans around the world.

High marks for service quality and cost

9 out of 10

Members continued to rate our services at the top of the scale. The Quality Service Index (QSI) measures members' satisfaction with our services. Our **9 out of 10** rating in 2008 is based on surveys with members conducted by a third party, using a scale of zero to 10.

Cost per member served
(for the year ended December 31)

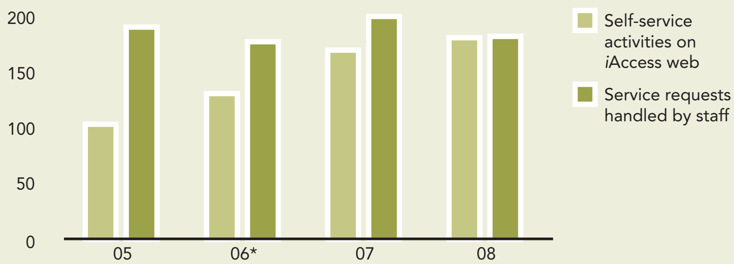


We challenge ourselves every year to improve service levels while managing costs. Our cost per member served was $122 in 2008, down slightly from $123 in 2007.

Service to include more customization, more counselling and more choice

As members continue to access pension services and information online, we have redefined our long-term service delivery strategy. We will continue using resources freed up by technology to tailor services to our members' individual needs.

Growing use of online services
(in thousands)



* Member requests lower due to work stoppage.

In 2008, we successfully communicated plan changes to members and experienced:

↑ **7%**
increase in visits to *i*Access web, our secure members-only website

↑ **13%**
increase in online pension applications, with 81% of teachers retiring online last June

↑ **71%**
increase in use of online T4As

↓ **5%**
decrease in telephone calls as more members opt for online self-service

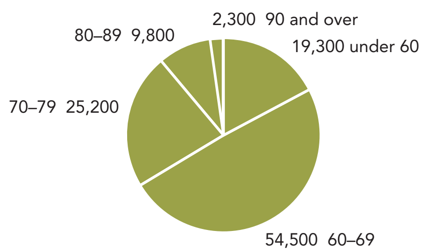
Overview

The Member Services division interacts with pensioners, working teachers, inactive members, school boards and other designated employers: our customers. To them, this team is the face of the Ontario Teachers' Pension Plan.

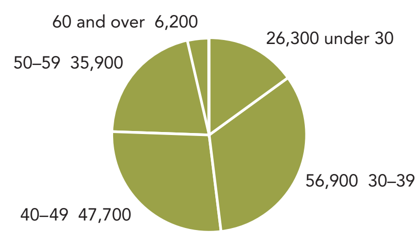
This team is also an information powerhouse, taking in and processing billions of dollars of contributions and millions of pieces of personal information every year while administering the timely payment of pensions to 111,000 retirees and survivors – one of Canada's largest payrolls.

With pensioners living longer, pensions are being paid over a longer period than before. The average age at retirement was 58 for new retirees in 2008, with an expected 30 years on pension and a survivor pension paid for an additional five years. This implies that half the teachers who retire each year will live at least into their late eighties. Currently there are approximately 9,800 pensioners in their eighties, 2,200 pensioners in their nineties, and 78 are age 100 or older.

PENSIONERS BY AGE
(as at December 31, 2008)



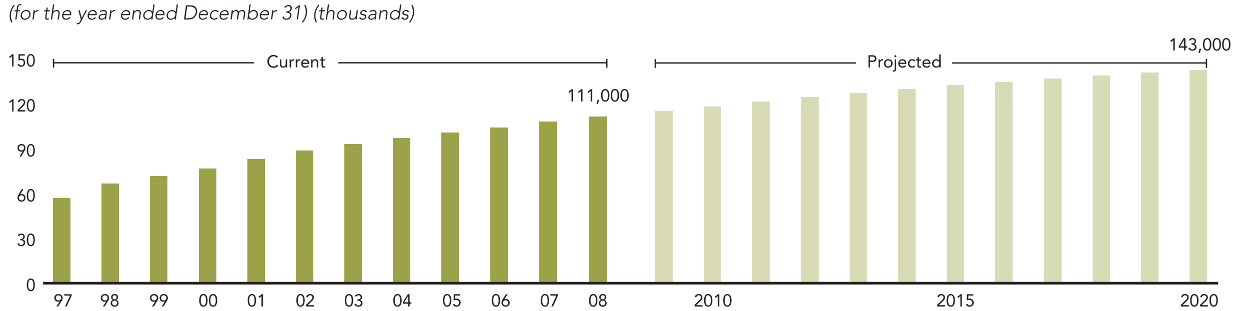
TEACHERS BY AGE
(as at December 31, 2008)



The average age for pensioners was 68 and for teachers was 42 at year end.

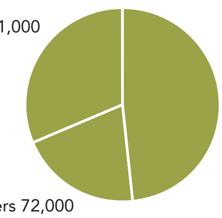
We expect 57,100 teachers to retire over the next 12 years. The number of pensioners will continue to grow, both in absolute terms and as a percentage of total plan membership. The ratio of active members to retirees could reach 1.2:1 in a decade.

NUMBER OF PENSIONERS
(for the year ended December 31) (thousands)



Plan membership totalled 356,000 at year end, including 173,000 working teachers, 111,000 retirees and survivors, and 72,000 inactive members. Last year, 9,400 teachers entered the profession or were re-hired during the year, and 4,700 new retirees began collecting retirement or disability pensions. The number of pensioners has grown every year since 1917, when a pension plan for Ontario teachers was created. The average pension for a teacher retiring at the 85 factor – age plus years of eligible service – was $42,000 in 2008.

MEMBER PROFILE
(as at December 31, 2008)



The total number of pensioners grew by 3,000 in 2008. Active members also increased by 3,000.

In 2008, we located 5,100 inactive members who taught briefly between 1950 and 2005 and moved without informing us so we could give them refunds or commuted value payments. There is no legal requirement to track down these people, and most pension plans don't, but we have decided that it is part of our commitment to excellent member service.

Teachers' deals with about 200 school boards and designated employers, whose administrative systems vary widely in practice and sophistication. In 2004, we began asking school board finance officers to certify that contributions and information delivered to us were correct both in terms of timely remittance and application of the plan's rules – just as a public company's CEO and CFO would certify its financial statements. This proved invaluable in getting administrators to focus on what, to them, is simply one payroll deduction.

We have changed our organizational structure so that each employer has a designated Teachers' contact – similar to the account representative model. This person gains detailed understanding of the employer's payroll system and practices, and serves as a conduit for feedback. This past year, we continued to focus on programs for employers, conducting six workshops and 24 employer visits compared to eight workshops and 13 employer visits in 2007. Teachers' employees hold these sessions throughout Ontario, helping employer personnel master the pension reporting requirements and online technology we provide. Employers – particularly those under staffing and funding constraints – appreciate this hands-on assistance, rather than a constant barrage of memos and information validation requests. This program, in combination with system enhancements, has increased online use and improved efficiency by reducing the time required to obtain accurate, up-to-date data.

Goals

Our overall objective is to provide outstanding personalized service to pension plan members, while managing our costs to the previous year's level plus inflation. Each year we set specific goals designed to move us further along that continuum of service. We gauge our success against an international peer group, and the service satisfaction ratings we receive from plan members. Details are available in the Performance section on page 48.

IN 2008, WE MEASURED OUR PERFORMANCE AGAINST FOUR MAJOR GOALS:

- Enhance member service through personalization
- Optimize business processes to reduce complexity and improve immediate service
- Improve internal controls and processes
- Enhance staff development

Managing for Value

The technology platform required to meet our four major goals has been substantially expanded and upgraded in recent years. Enhanced technology has increased the automation of routine transactions and requests. Members have enthusiastically embraced our secure website, and a rapidly growing number now answer their own questions and update personal information online. As a result, staff resources are now available to provide more value-added services.

In 2008, using resources freed up by enhanced technology, we launched an ambitious program to deepen the level of member service, tailoring it more to individual needs. We also identified the initial areas in which we will provide value-added counselling to individual members.

Counselling is a considerable leap forward in meeting a demand that members have long expressed. The benefits and rules of the Ontario Teachers' Pension Plan are complex and the decisions made by an individual have lifetime ramifications. Members often turn to us for help. Our current approach can be described as full disclosure. We simply cite and explain the applicable options under the plan, leaving it entirely to the member to weigh the alternatives and make his or her choice.

Over the next year, we plan to produce the materials and training programs that will enable pension benefit specialists to delve more deeply into a member's circumstances, discuss benefit options in more detail and do more to help the member make informed choices, taking into account his or her circumstances. The intent is to add value by offering greater access to the pension experience of our staff.

Key performance drivers

THE FOLLOWING FOUR KEY PERFORMANCE DRIVERS ENABLE MANAGEMENT TO IMPLEMENT THE STRATEGY:

Technology	Expertise	Service	Processes

As demonstrated in the previous narrative, three of our key performance drivers are technology, expertise and the desire to provide outstanding, value-added service. The fourth driver is efficient and effective processes.

This year we made permanent a process improvement team that was originally created for temporary use during a large-scale effort throughout Teachers' to review and document internal controls. This team is now a stand-alone group of three highly experienced Member Services staff who are examining every aspect of our business from the members' viewpoint. We are reviewing every interaction with members in an attempt to reduce processing time and effort, as well as anticipating and filling any real or potential cracks that are discovered.

In October, the plan sponsors changed re-employment rules that will produce efficiency gains in the future. Starting January 1, 2009, pensioners who teach more than 95 days in a school year will no longer have to make pension contributions. Before the change, we received such contributions from working pensioners and later refunded them with interest to all but a few members, a time-consuming and inefficient process.

All four drivers – technology, expertise, service and processes – are fuelled by a commitment to continuous improvement.

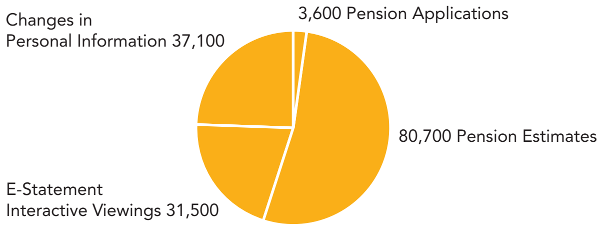
We invest in people. According to our research, we invest more in training, coaching and staff development than our peer organizations do. We enhanced the training program this year by offering each employee five days of instruction in a skill or subject that is not required for his or her current job, but might be of use in career development at Teachers'. For example, a pension benefit specialist from our contact centre might elect to be trained in managing and using spreadsheets. This is in addition to normal in-service training, and has become very popular among the staff.

Performance

GOAL	MANAGING FOR VALUE	PERFORMANCE
Enhance member service through personalization	Expand the pension benefits specialist role to provide in-depth counselling on certain subjects	Identified the specific issues on which properly trained Teachers' staff are able to provide one-on-one counselling
Optimize business processes to reduce complexity and improve immediate service	Working from the members' viewpoint, examine all processes in a linear fashion to reduce time and effort, and eliminate real or potential gaps	Established a permanent process review team comprised of highly experienced staff working as a stand-alone unit
	Increase employer use of online facility to reduce processing time and effort, and improve accuracy	Conducted more employer workshops/visits than in 2007 to increase web usage
	Enable members to update personal information and analyze their retirement situation online. Free up staff to improve/expand service elsewhere	Use of secure website increased markedly from prior year. Online retirement applications increased 13% from 2007
Improve internal controls and processes	Ensure a pension does not continue to be paid by direct deposit if the retiree dies and family or executors do not notify the plan	Obtained agreement, on a test basis, from Ontario government to access Ontario's death registry data, so pensions payments could be validated
Enhance staff development	Help staff qualify for career advancement opportunities at Teachers'	Offered five days of training annually in a skill or subject that is not required for the individual's current job, but would be relevant in other positions

We fulfilled 180,000 member requests, compared to 198,000 in 2007. Telephone inquiries fell by 5% from the previous year. Members' use of our secure *i*Access website continued to increase substantially. There were 179,000 web sessions – up 7% from the year before. Approximately 80% of retiring teachers retire in June, and in 2008, 81% of those retirement applications were submitted online. That was a 13% gain from 2007. In addition to saving in time and effort for data entry, validation and application processing, online retirement has substantially reduced the need for pension application kits that were expensive to update, produce and mail.

SELF-SERVICE ACTIVITIES ON *iAccess* web
(for the year ended December 31, 2008)



A growing number of members are using the services available on the secure member website to answer their own questions and update personal information.

Our overall initial accuracy rate for processing members' requests and transactions was 91.5% for 2008, compared with 94.3% for 2007.

Composite Quality Service Index (QSI)

We regularly ask clients to rate our services through a third-party survey. All Member Services employees – from new recruit to executive – receive a variable component of compensation based on the levels of satisfaction expressed in our Quality Service Index (QSI) measurements. Compensation also reflects the success achieved in meeting organizational goals that are set annually to drive continuous improvement.

As in recent years, our members gave us an "A" for service in 2008. The overall QSI score was 9.0 on a 10-point scale. We have maintained this high standing since 2005. As shown in the accompanying table, members rate us in terms of direct service and communications, with direct service representing 85% of the overall score.

The QSI score reflects the results of a member survey protocol that Teachers' developed in the early 1990s. Administered by a third party, the survey is continually reviewed and refined to remain current. For example, questions about e-mail handling and our secure website were added in 2006. During 2008, we launched a project to identify and examine the specific factors that influence the QSI score. This proved to be soul-searching because it challenged everything that we have taken for granted. The result was a list of several success factors. During 2009 staff will be trying to improve scores by focusing on these factors.

QUALITY SERVICE INDEX

(on a scale of 0 to 10)	***2008***	*2007*
Total QSI	**9.0**	9.0
Service QSI (85%)	**9.1**	9.0
Communications QSI (15%)	**8.8**	8.9

The Quality Service Index is a measurement of service satisfaction. Our 9.0 rating is based on surveys with members conducted by a third party using a scale of zero to 10.

Cost Effectiveness Measurement (CEM)

We measure our services against the leading pension plans worldwide by participating in surveys by CEM Benchmarking Inc., which conducts independent evaluations of the costs and services of 58 major pension plans. We consistently placed among the league leaders in recent years, and in 2008 won the highest ranking in our peer group and tied for first among all 58 international pension plans. Judged on several categories ranging from payment of pensions to quality of member statements and telephone call-wait times, we scored 89 on a 100 point scale, which is 15 points above our peer average (for similar plans) and 17 points above the overall average. CEM commented, "Ontario Teachers' has been cited as best practice in all of CEM's research projects. In our universe, you are the leading edge."

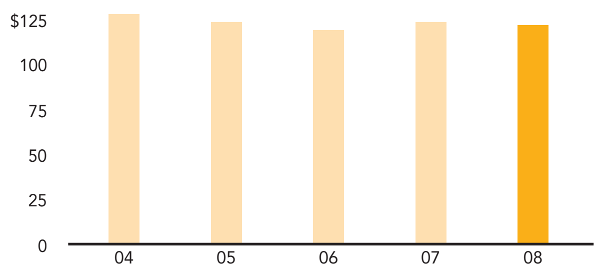
Other rankings

This year, Teachers' participated for the first time in the annual Contact Center World Awards. We placed second in Best Contact Center (for the category of "under 50 agents") and were one of five finalists for Best in Customer Service.

Expense management

The cost per member served in 2008 was $122 versus $123 in 2007.

COST PER MEMBER SERVED
(for the year ended December 31)



Our goal is to manage costs so that they grow no faster than inflation.

Our annual service cost is above the median of the pension plans in the CEM survey mentioned above. This is primarily because we provide full services directly to members. Services provided by many other plans in the study are wholly or partially administered by employers, thus reducing the cost of their plans.

Management intends to maintain the cost per member at the current level, adjusted for inflation. As increased use of technology creates operational savings, that money will be used to further improve our service.

Rosemarie McClean, MBA, ICD.D
Senior Vice-President, Member Services

Governance

As an investor, we believe good governance is good business because it helps companies deliver long-term shareholder value.

As a plan administrator, we measure ourselves by the same governance, internal control and enterprise risk management standards that reflect corporate best practices and high standards of stewardship.

The plan's governance structure assigns clear roles to the plan sponsors and to the independent board members who are appointed to oversee management's decisions and actions.

Governance

Governance is a system of checks and balances aimed at ensuring that an organization pursues its mission in a legal, responsible and effective manner. It assigns decision-making authority with accountability, ensures that those managing the organization are capable and fairly compensated, and that the interests of management are properly aligned with the interests of those they serve. Governance also ensures that the organization has identified and addressed the myriad of risks it might face.

Plan governance approach

We seek to employ the best practices of stewardship in every area of Teachers' plan governance. Teachers' is governed by nine board members. Four members are appointed by each of the plan's sponsors, the Ontario government and the Ontario Teachers' Federation (OTF). The two sponsors jointly appoint the board's chair.

The board members interact with the two sponsors through the Partners' Committee. This committee was established by the sponsors to make recommendations on benefit design, the contribution rates and the handling of a surplus or shortfall. Each sponsor appoints three people to this six-member committee. The plan's governance approach is discussed in more detail on our website. In 2008, the board members and plan sponsors also agreed to the creation of an ongoing mechanism through which the two sponsors may provide input and feedback to the board concerning the plan's funding status and the factors that may affect it.

Governance structure

Plan sponsors **Ontario Teachers' Pension Plan**

- The plan sponsors are responsible for ensuring the plan remains fully funded over the long term, sharing responsibility for surplus and shortfalls.
- They determine contribution rates and benefit levels.
- Each sponsor appoints four members to the plan's board for staggered two-year terms and they mutually select the board chair.

- Teachers' is an independent corporation, established by Ontario law.
- Board members are required to act independently of both the plan sponsors and the plan's managers to make decisions in the best interests of plan members and their beneficiaries.
- Management and staff administer the pension plan, invest the pension fund and pay members and their survivors the benefits promised to them.

Board members

All board members serve on the Investment Committee. Board and committee attendance was 91% for 2008. Individual attendance is reported below. For more information on board members and board committees, please see our website, www.otpp.com > Corporate Info > Board Members. Additional information on board members' affiliations on boards of public issuers is available on our website.

Eileen Mercier

Former Senior Vice-President and CFO of Abitibi-Price Inc.; Fellow of the Institute of Canadian Bankers
Chair of the Board

Appointed 2005
Attendance 100%

Jill Denham

Former Vice Chair, Retail Markets, Canadian Imperial Bank of Commerce
Member of the Governance and Human Resources & Compensation Committees*

Appointed 2006
Attendance 88%

Helen Kearns

President, Bell Kearns and Associates; Former President, Nasdaq Canada; Former director, Toronto Stock Exchange
*Member of the Benefits Adjudication,** Audit & Actuarial and Governance Committees*

Appointed 2005
Attendance 93%

Hugh Mackenzie

Principal, Hugh Mackenzie and Associates
Member of the Audit & Actuarial and Benefits Adjudication Committees*

Appointed 2007
Attendance 100%

Louis Martel

Managing Director and Chief Client Strategist, Greystone Managed Investments, Inc.
Member of the Audit & Actuarial and Governance Committees

Appointed 2007
Attendance 92%

Guy Matte

Former Executive Director of l'Association des enseignantes et des enseignants franco-ontariens
Member of the Governance, Audit & Actuarial and Human Resources & Compensation Committees*

Appointed 2002
Attendance 94%

Sharon Sallows

Partner, Ryegate Capital Corp.; Former executive, Bank of Montreal
Member of the Human Resources & Compensation and Governance Committees

Appointed 2007
Attendance 80%

William Swirsky

Fellow of the Institute of Chartered Accountants of Ontario; Former executive, Canadian Institute of Chartered Accountants
Member of the Audit & Actuarial and Human Resources & Compensation Committees*

Appointed 2007
Attendance 100%

Jean Turmel

President, Perseus Capital Inc.; Board member, TMX Group Inc.
Member of the Investment, Audit & Actuarial, and Human Resources & Compensation Committees*

Appointed 2007
Attendance 77%

* Committee Chair ** Committee Vice-Chair

Independent and qualified board members

Together, the board members have a wide range of professional experience required to oversee a plan as vast and complex as Teachers'. They have been drawn from the fields of business management, finance and investment management, actuarial science, economics, education and accounting. No member of management serves as a board member or on any of the board's committees.

The board members' mandate, committee structure and terms of reference are posted on the Teachers' website. The website also contains Teachers' three Codes of Business Conduct, one each for board members, investment personnel and member services personnel. Board member remuneration is discussed on pages 61 and 62 with management compensation.

Board responsibilities

The board members are responsible for overseeing the management of the pension plan. They have delegated day-to-day investment of the plan's assets to the Chief Executive Officer with the power to sub-delegate appropriately. Nevertheless, the board members remain responsible for overseeing and reviewing investment policies, risks and asset mix, benchmarks, performance and compensation. As well, they approve annual performance objectives for the investment portfolio and review all transactions that exceed the discretionary limits set for management. Their collective wisdom adds value as investment managers must crystallize and justify their thinking when seeking approval for strategic recommendations and significant investments from a group that is expert in financial matters, yet removed from the day-to-day clamour of the markets. The board members and plan management are fully responsible for investment decision-making. The plan's sponsors are not involved in investment decisions.

Board activities

Board members met 16 times in 2008 for board and Investment Committee meetings, 10 of which included sessions without management present. In addition, the Governance Committee met twice, the Human Resources and Compensation Committee met seven times, the Audit and Actuarial Committee met seven times, and the Benefits Adjudication Committee heard one member appeal and held two general meetings. There also were numerous briefing meetings.

Board member attendance at board and committee meetings is reported on page 53.

Effective oversight and controls

Management is responsible for establishing corporate strategy, objectives and an annual financial plan. Board members review progress against management's stated objectives. Board members confirm that management's strategies and decisions are in the best interests of all pension beneficiaries. They also help ensure that management can attract and retain the best available staff – the more senior the position, the more directly involved the board members are. It is also up to the board members to ensure that the organization's standards are respected, that its policies and procedures are appropriate and are complied with. Supporting these responsibilities is an internal audit function that reports directly to the Audit and Actuarial Committee. Two additional important risk management processes are Enterprise Risk Management and internal controls.

Enterprise Risk Management (ERM)

The pension plan is exposed to a number of risks. The intent of ERM is to ensure risks are managed as effectively as possible. We define risk broadly as any event that can adversely affect the achievement of the pension plan's objectives and may result in the potential for loss. ERM involves identifying and assessing the risks facing the organization and the risk mitigation strategies in place to address them. Teachers' enterprise risk management approach is built on four principles:

- ERM is an integrated enterprise-wide process that enables us to identify, assess, measure, manage and report risk concerns, events, exposures and potential opportunities in a cross-functional manner. ERM encompasses investment and non-investment risks as both are critical. For example, the organization must be able to assess the impact of management transition, employee turnover and implementation of key management information systems. For details on how we understand and manage investment risks, refer to note 2 of the consolidated financial statements.
- ERM is not only a process, but requires an appropriate risk culture. If ERM is not embedded in the culture, even the most sophisticated risk management programs will not be effective. It is up to management to cultivate this culture across the organization.
- Divisional heads must have the tools and authority to optimize the risk-reward equation. While there has been a tendency to focus on investment risk, all divisional heads must use their authority and tools effectively to manage the risks and rewards of their operations.
- Risk measurement and monitoring (much like performance measurement) must be independent of the business areas.

As Teachers' has grown, the need for a more structured ERM process has also grown. To implement the four principles, we formalized the ERM governance structure in 2008 with the establishment of an ERM Committee, composed of the heads of all divisions and corporate support departments and chaired by the CEO.

The ERM Committee aggregates the risks from all divisions and corporate support departments to provide a comprehensive understanding of the overall risks the organization faces. It provides the infrastructure that ensures all risks can be brought to the attention of the executive team promptly, and that they will be reviewed in the context of the whole organization. The process then flows logically in a closed loop, with risks being prioritized, action plans designed and deployed, resources allocated appropriately, and results measured and reported, ultimately to the board members.

Annually, the ERM Committee performs a thorough risk evaluation and reports top risks to the board members along with an explanation of how management mitigates these risks. Regular updates on the top risks and emerging risks are also reported to the board members through the year. The ERM Committee will continue to formalize and strengthen the ERM process in 2009 to ensure compliance with evolving best practices.

Disclosure controls and procedures and internal control over financial reporting

Teachers' has conducted a comprehensive internal control evaluation to document, assess and enhance the design of its internal controls. It did so using the Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We are not required by law to comply with Multilateral Instrument 52-109 of the Canadian Securities Administrators, but have chosen to meet the standards required by the Instrument as part of our emphasis on good governance.

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for Teachers'. We have designed disclosure controls and procedures to provide reasonable assurance that material information relating to the plan, including Teachers' consolidated subsidiaries, is made known to us.

We evaluated the effectiveness of Teachers' disclosure controls and procedures as of the end of the period covered by annual certification and the CEO and CFO have concluded, based on the evaluation, that the disclosure controls and procedures are effective.

We have also designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles (GAAP).

We have evaluated the effectiveness of Teachers' internal control and procedures over financial reporting as of the end of the period covered by the annual certification, and the CEO and CFO have concluded, based on the evaluation, that the internal controls and procedures are effective. No changes were made in Teachers' internal control over financial reporting during the year ended December 31, 2008, that materially affected, or are reasonably likely to materially affect, Teachers' internal control over financial reporting.

Protecting audit integrity

Teachers' and others who stress the value of effective corporate governance have expressed concern over the years about relationships in which the accounting firms that audit public companies also receive substantial payments from those companies for non-audit management consulting services. Such consulting fees can compromise the integrity of the audit function. Teachers' strives to minimize our own use of such consulting services from the plan's auditors and discloses the total amount paid. In 2008, fees paid to Deloitte & Touche LLP, the plan's auditors, totalled $4.1 million ($3.2 million in 2007), of which $3.7 million was for audit activities and $0.4 million for other, non-audit services.

Transparent reporting

Teachers' board members receive from management in-depth monthly reports and quarterly summaries of the financial and funding positions of the plan, performance results, risk levels, client satisfaction ratings, key Member Services statistics, compliance, as well as annual reviews of each department, internal controls and enterprise risk, and reports on all other significant events.

As well, we strive to keep stakeholders fully informed of the state of the plan:

- In addition to publishing this annual report, Teachers' provides regular newsletters to more than 284,000 members, updating them on key plan financial and other important information. Our website details plan governance practices and facts about our investment strategy and major portfolios, as well as service initiatives and news updates.
- Each April, Teachers' holds an annual meeting at which executives report on the state of the plan and invite questions. This meeting is open to all members of the plan and the sponsors. In 2009, it will take place in Toronto on Friday, April 3 at 5 p.m. The meeting is webcast for those who cannot attend in person and is archived for later viewing.
- Each August, the chair addresses the OTF Board of Governors. Teachers' executives meet regularly with representatives of both sponsors to discuss key issues.

Changeover to International Financial Reporting Standards (IFRSs) in 2011

In October 2008, the Accounting Standards Board of Canada confirmed that publicly accountable enterprises in Canada are to adopt IFRSs for fiscal years beginning on or after January 1, 2011. However, Canadian pension plans will continue to prepare their financial statements, after January 1, 2011, in accordance with Canadian Institute of Chartered Accountants (CICA) Section 4100, Pension Plans, and apply IFRSs only when the financial reporting guidance is not addressed by CICA Section 4100.

In 2008, we commenced an analysis to identify financial reporting guidance not addressed by CICA Section 4100, and differences between IFRSs and the Canadian GAAP that affect the plan's financial reporting. The analysis will continue in 2009 and expand to include assessment on the implications for the plan's accounting policies, accounting and data systems, internal control over financial reporting, disclosure controls and procedures, employee education and other business activities. In 2009, a detailed implementation plan will be prepared based on the results of the analysis. We are confident we will be able to meet requirements for financial reporting in 2011.

Compensation discussion and analysis

The goals of our compensation programs are to attract and retain high-caliber employees, motivate and reward top performance, encourage team work, align personal and organizational objectives and reward successful performance over the long term.

Each year, the Human Resources & Compensation Committee of the board reviews compensation policies, including incentive components linked to investment department and total fund performance. This review comprises research and recommendations from independent compensation consultants Towers Perrin.

Given the varied employment opportunities at Teachers', each position is compared against relevant job groups and incentive programs in like markets. Our overall objective is to be competitive with those organizations against which we compete directly for talent. Such organizations include other major Canadian pension funds, banks, insurance companies, investment counsels, private investment managers; for some positions we look at the general financial industry.

Teachers' compensation program has been developed on a foundation of "pay for performance." Our compensation structure is composed of base pay, short-term incentives, and long-term incentives. Base pay and incentive levels in each area of the business are based on the competitive labour market practices for specific jobs. Teachers' targets base salaries at the median of the market, with an opportunity, conditional on performance, to earn above-average total compensation (i.e., base pay plus short-term and long-term incentives combined) through incentive opportunities. Conversely, total compensation would decrease when overall performance declines. All full-time employees participate in one or more incentive programs. Incentive plan structures are designed to enhance and reward performance delivery against pre-set objectives, benchmarks, or both.

In 2008, named executive officers' incentive compensation decreased by 48%. Incentive compensation for investment managers declined by $27 million (including executive officers). This reflects the alignment of our compensation programs with the negative total fund performance in 2008.

Investment incentive compensation programs are measured on a four-year basis; accordingly, the impact of the 2008 below-benchmark performance is moderated by previous years' performance. However, the underperformance in 2008 will carry forward and negatively impact compensation through 2011.

2008 performance results:

Corporate performance

Each year, the executive team collaborates to establish corporate and divisional objectives for the fiscal year. All employees are aligned with individual objectives to support the corporate and/or divisional objectives. The corporate objectives always include a measure of the rate of return, dollars of value added (i.e., dollars earned above the benchmark), and member service quality in relation to expenses. Additional corporate objectives include significant strategic initiatives supported by management. Corporate and divisional objectives are assessed and a report card is prepared to determine the overall level of performance achieved. Due to the underperformance of the two investment corporate objectives and one other corporate objective, our score in 2008 was 1.0 out of 2.0 – the lowest corporate performance score for Teachers' since this measure was adopted in 1991.

CORPORATE OBJECTIVES

	Actual	*Goal*	*Status*
Rate of return			
Four-year vs. benchmark	3.25%	3.35%	✗
One-year vs. benchmark	-18.01%	-9.59%	
Service expenses and quality			
Ongoing member service costs *($ millions)*	$34.48[1]	$ 35.80	✓
Cost Per Member	$119.90[1]	$124.30	
Quality Service Index	9.03/10.0	8.98/10.0	
Dollars of value added above benchmarks (net of costs)			
Four-year *($ millions)*	-$152[2]	Meet benchmark	✗
One-year *($ millions)*	-$9,405[2]	Meet benchmark	
Other corporate objectives in 2008 include:			
Implementing components of our Investment Strategy 2020			✓
Enhancing our member experience through our Member Services strategy e=mc[3]			✓
Converting our FMC Portfolio Management System to SimCorp Dimension			✗

[1] Net of adjustments for processing inactive members and long-term incentive payments.

[2] Net of expenses.

Investment performance

At the beginning of each year, the board members approve the active risk allocation for the total fund and each investment department, which in turn establishes expected annual value added performance goals (i.e., dollars earned above the benchmark) for the year. The greater the risk allocation for a department, the greater the value added target to be achieved. Actual investment performance at the total fund and departmental levels (measured in dollars of value added after expenses) is compared against our annual target for adding value above the benchmark. This value added performance is measured over four annual performance periods and incentive payments are based on an average of the previous four years' performance factors.

In 2008, the total fund value added performance after expenses was -$9.4 billion, resulting in a performance factor of -18.76. This is the lowest annual total fund performance for Teachers' since inception. Because of the significant overperformance in 2005, 2006, and 2007, the 2008 total fund payout factors were positive. The negative performance in 2008 will be carried forward for the following three years. Departmental payout factors for the Short-term Incentive Plan ranged from zero to five, reflecting the performance of each asset group.

Compensation programs

Unionized employees (297 employees)

Compensation structures have been negotiated into the Collective Agreement. The current agreement runs from January 1, 2006 through December 31, 2009. All bargaining unit employees are eligible for short-term incentives based on the following three elements:

(1) corporate performance;

(2) individual performance; and

(3) cost control and quality service targets for those bargaining unit employees in the Member Services departments and total fund performance above the composite benchmark for those employees working in investment-support departments.

Management and professional employees:
Base salary (411 employees excluding students)
Base salaries for staff are intended to be market competitive, and are reviewed annually after the end of each fiscal year. Executive salaries are approved by the board members. In setting salaries, consideration is given to individual performance and salary range adjustments within our market comparators.

Short-term Incentive Plan

- *Member Services and Corporate (128 employees)*
  Rewards are based on the corporate performance score and achievement of individual objectives over the course of the year. Target incentive payments are set as a percentage of salary for delivering fully satisfactory performance against objectives and competencies. Based on performance, actual payments can range from zero to two times the target incentive amount.

- *Investment Support (102 employees)*
  Rewards are based on the corporate performance score, achievement of individual objectives and four-year total fund performance above a composite benchmark. Target incentive payments are set as a percentage of salary for delivering fully satisfactory performance against objectives and competencies. Based on performance, actual payments can range from zero to two and a half times the target incentive amount.

- *Investments (181 employees)*
  Rewards are based on the achievement of total fund and investment department performance, measured in dollars of value added above established benchmarks over four annual performance periods. Senior executives have an individual performance component that reflects achievement of annual objectives and leadership competencies.

  Target incentive payments are set as a percentage of salary for delivering benchmark performance. Based on actual total fund and departmental performance, actual incentive payments can range from zero to five times the target incentive amount. All employees receive the four-year performance of the total fund. Departmental performance will build to a four-year performance measure with participation in the plan. Hence new participants are measured on only one year's departmental performance.

Long-term Incentive Plan

- *Member Services and Corporate (15 employees)*
  This program is available to employees at the director level and above. Rewards are based on delivery of cost control relative to inflation and quality service results, both over three years. Target incentives are set as a percentage of salary at the start of the three-year cycle to which a multiplier, determined by actual performance, is applied. The actual incentive payment can range from zero to two times the target incentive amount.

- *Long-term Incentive Plan, Investments (132 employees)*
  This program is available to investment employees at the assistant portfolio manager level, and higher, and to corporate executives. A small number of select employees in investment support areas may receive discretionary grants each year. The program is based on four-year performance results to reward investment managers in a manner that matches our long-term goals and strategies.

  At the start of the four-year cycle, employees receive an initial dollar grant. These dollar grants are determined based on a percentage of the employee's salary plus the prior year's annual incentive payout. The initial dollar grant will increase or decrease in value over the four-year period based on two factors:

  (1) a combination of total fund and investment department performance, measured in dollars of value added after expenses above established benchmarks over four annual performance periods.

  (2) the compound absolute rate of return for the total fund over the four-year period.

Benefits

Teachers' provides a competitive benefit program which includes life insurance, disability, health and dental benefits, time-off policies, and an employee assistance program. Teachers' retirement benefit for employees is a defined benefit pension plan. (Further details on retirement plans can be found below.)

Looking forward

The market volatility experienced during 2008 stressed all established systems at Teachers' including the compensation system. During 2009, Teachers' will conduct a review of all compensation programs to ensure they continue to be aligned with the business strategies for Investments and Member Services, are market competitive, and drive the desired behavioural outcomes for our success.

Executive compensation

The compensation table represents disclosure of base salary, short- and long-term incentives and other compensation earned in 2008, 2007 and 2006 by the Chief Executive Officer, Chief Financial Officer and the three other most highly compensated executives, excluding subsidiary companies.

Name and Principal Position	*Year*	*Base Salary*	*Short-term Incentive Plan*	*Long-term Incentive Plan*	*Other Compensation*[2]	*Total Compensation*
Jim Leech President and CEO	2008	$441,923	$435,600[1]	$1,148,900	$10,365	$2,036,788
	2007	274,123	850,000	2,241,900	1,212	3,367,235
	2006	256,581	512,000	3,007,600	455	3,776,636
David McGraw SVP and CFO	2008	293,269	109,700	147,500	6,855	557,324
	2007	256,827	149,200	393,000	3,828	802,855
	2006	241,461	132,500	–	429	374,390
Bob Bertram[3] EVP, Investments	2008	425,723	662,400[1]	1,389,900	8,738	2,486,761
	2007	394,039	721,100	3,736,500	8,710	4,860,349
	2006	378,619	673,300	5,114,400	8,671	6,174,990
Neil Petroff[3] Group SVP, Investments	2008	310,906	568,100[1]	848,600	538	1,728,144
	2007	263,731	580,000	2,241,900	476	3,086,107
	2006	248,115	500,000	2,933,800	440	3,682,355
Wayne Kozun SVP, Public Equities	2008	247,769	487,600	533,200	430	1,268,999
	2007	202,132	371,700	993,800	365	1,567,997
	2006	190,700	338,400	1,084,700	338	1,614,138

[1] Annual incentive payments for Mr. Leech, Mr. Bertram, and Mr. Petroff have been deferred until 2011.

[2] Other compensation includes one or more of the following: group term life insurance, automobile allowance, unused vacation cashout.

[3] Mr. Bertram retired from his position as Executive Vice President, Investments, on December 31, 2008. Mr. Bertram was succeeded by Mr. Petroff, effective January 1, 2009.

There are no executive contracts or severance guarantees other than as required by law.

Retirement benefits

Executive employees of the Ontario Teachers' Pension Plan participate in the Public Service Pension Plan (PSPP) and the Public Service Supplementary Benefits Account (SBA). These plans combined provide indexed pension benefits equal to 2% of the executive's best five-year average annual base salary for each year of service, less a CPP integration formula. Benefits under these combined plans are capped by the base salary reached at the maximum pension contribution permitted under ITA regulations.

Executives earning 2008 annual salaries in excess of $200,315 also participate in a non-registered, unfunded Supplemental Employee Retirement Plan (SERP). This plan provides non-indexed retirement benefits equal to 2% of the executive's best three-year average annual salary for each year of service, less the initial annual pension to which the executive is entitled under the PSPP and SBA, combined.

- For executives at the Executive Vice-President level and above, average annual salary includes a percentage of annual incentive, building at 20% per year to 100%.
- For executives at the Senior Vice-President level, having attained the age of 55, average annual salary includes a percentage of annual incentive, building at 10% per year to 50%.
- For executives at the Vice-President level, having attained the age of 55, average annual salary includes a percentage of annual incentive, building at 5% per year to 25%.

The total liability for the SERP increased by a net amount of $3.5 million in 2008 for a total accrued SERP liability of $15.9 million as at December 31, 2008.

The table below outlines the estimated present value of total retirement benefits from all sources (PSPP, SBA and SERP) and estimated annual retirement benefits at age 65 for the Chief Executive Officer, Chief Financial Officer and the three other most highly compensated executives, excluding subsidiary companies.

Name and Principal Position	*Projected Years of Service at Age 65*	*Estimated Total Annual Pension Benefit at Age 65*	*Present Value of Total Pension at January 1, 2008*	*2008 Compensatory Annual Change in Pension Value*	*2008 Non-Compensatory Annual Change in Pension Value*	*Present Value of Total Pension at December 31, 2008*
Jim Leech, President and CEO	11	$252,000	$1,984,700	$273,200	$257,000	$2,514,900
David McGraw, SVP and CFO	17	$150,800	$ 288,700	$ 83,200	$ 34,000	$ 405,900
Bob Bertram EVP, Investments	19	$413,100	$5,175,100	$418,600	$572,000	$6,165,700
Neil Petroff Group SVP, Investments	32	$391,100	$1,554,100	$131,000	$101,400	$1,786,500
Wayne Kozun, SVP, Public Equities	36	$394,200	$1,030,000	$ 92,800	$ 54,000	$1,176,800

The values shown are estimated amounts based on assumptions and represent entitlements that may change over time. "Non-compensatory" changes are those changes that relate to interest rates, indexing and joint and survivor benefits.

Board and committee member remuneration

During 2008, the remuneration of the board members was reviewed to bring their compensation in line with other boards with similar responsibilities and changes were implemented in April. Each board member now receives an annual retainer of $12,000, plus $12,000 as a member of the Investment Committee. The board Chair receives an additional retainer of $100,000, and the Chairs of the Investment, Governance, Human Resources & Compensation, and Audit & Actuarial Committees receive additional retainers of $5,000 each.

Fees for committee and other eligible meetings are $1,200. Board meeting fees are combined with Investment Committee fees at $1,500 per day. The Chair of the Benefits Adjudication Committee receives an additional fee of $1,000 for each Benefits Adjudication meeting or hearing attended to a maximum of five per annum.

Board members are reimbursed for normal expenses for travel, meals and accommodation, as required.

Board Member	*Retainer and Chair Fee*	*Board Meetings*	*Committee Meetings*	*Meeting Fees*	*2008 Total Remuneration*
Eileen Mercier, Chair of the board	$111,500	11	24	$45,300	$156,800
Jill Denham, Chair, Human Resources & Compensation Committee	$ 28,750	10	21	$40,200	$ 68,950
Helen Kearns, Vice-Chair, Benefits Adjudication Committee	$ 24,000	11	21	$41,700	$ 65,700
Hugh Mackenzie, Chair, Benefits Adjudication Committee	$ 27,000	11	24	$45,300	$ 72,300
Louis Martel	$ 24,000	11	15	$34,500	$ 58,500
Guy Matte, Chair, Governance Committee	$ 28,750	11	23	$44,100	$ 72,850
Sharon Sallows	$ 24,000	10	16	$34,200	$ 58,200
William Swirsky, Chair, Audit & Actuarial Committee	$ 28,750	11	25	$46,500	$ 75,250
Jean Turmel, Chair, Investment Committee	$ 28,750	9	19	$36,300	$ 65,050

Legislation update

There were no legislative or regulatory changes in 2008 that materially affected the plan's governance. We expect that in 2009 the Ontario legislature will amend the Teachers' Pension Act to accommodate the agreement of the partners in 2008 concerning extra contributions from the government of Ontario and designated employers in the event that the plan sponsors invoke conditional inflation protection. These changes are discussed on page 15.

Regarding the administration of plan benefits, in addition to changing the Funding Management Policy, the sponsors changed the re-employment provisions effective January 1, 2009. Working pensioners who exceed the 95-day re-employment limit will no longer have to make pension contributions. Those who plan to return to work for more than one year may request pension recalculation for the additional service only if they notify the plan of their intention before returning to work, return to work in education for the first time after December 31, 2008, and work for the equivalent of at least one year. These rules apply to all pensioners, regardless of age.

The final report of the Ontario Expert Commission on Pensions, *A Fine Balance*, was released in November 2008 and recommends constructive reforms to outdated pension rules in Ontario.

We addressed three primary issues in our October 2007 submission to the expert commission, led by Harry Arthurs. Those issues were funding, investment rules and administration.

We are pleased with many of the recommendations in the *Arthurs Report*. For full details of our original submission, as well as our February 2009 response to the Ontario Finance Minister about the *Arthurs Report* and its conclusions, please visit the Submissions page of our website at www.otpp.com. Many of the Arthurs Report recommendations are presented as part of a balanced package of reforms, and we encourage the government to consider them together, rather than addressing them in pieces.

More generally, we have expressed concern that:

- some proposed funding measures for private sector pension plans will not do enough to encourage the additional funding that is really necessary from plan sponsors to enhance the security of benefits promised to plan members;
- the trend from defined benefit to defined contribution plans in the private sector shifts more risks onto employees, many of whom may outlive their savings; and
- the lack of occupational pension coverage is an issue that requires attention across Canada.

Investments over $100 million

(as at December 31, 2008)

Fixed income and short-term investments

Type ($ millions)	*Maturity*	*Coupon (%)*	*Fair Value*	*Cost*
Government of Canada bonds	2009–2041	2.75–9.75	$12,177	$11,116
Canadian corporate bonds	2009–2085	0.00–16.00	3,796	4,295
International corporate bonds	2007–2049	0.00–9.86	3,055	3,975
Securities purchased under agreements to resell	2009–2009	0.01–1.47	3,002	3,000
Canada treasury bills	2009–2009	0.00–0.00	1,815	1,796
Bank notes	2009–2009	0.00–5.43	540	538
Commercial paper	2009–2009	0.00–5.66	159	166
Securities sold under agreements to repurchase	2009–2009	0.12–2.35	(20,569)	(20,539)

Inflation-sensitive investments

Type ($ millions)	*Maturity*	*Coupon (%)*	*Fair Value*	*Cost*
United States treasury inflation protection	2010–2032	0.88–3.88	$7,482	$6,801
Real-return Canada bonds	2021–2041	2.00–4.25	7,341	6,656
Real-return provincial bonds	2013–2036	2.00–4.50	1,471	1,333
Real-return Canada corporate bonds	2016–2046	0.00–5.33	1,278	844
Index-linked mortgages	2022–2030	4.63–5.53	234	219
Real-return international bonds	2015–2045	0.50–6.00	143	113

Province of Ontario debentures

Maturity Date ($ millions)	*Coupon (%)*	*Fair Value*	*Cost*
2009–2012	10.11–11.40	$4,340	$3,868

Corporate shares/units over $100 million

(as at December 31, 2008) (millions)

Security Name	*Shares*	*Fair Value*
BCE Inc.	50.8	$1,295.2
OGX Petróleo e Gás Participações S.A.	3.9	1,095.6
Transurban Group	180.3	854.9
Deutsche Telekom AG	43.0	793.9
Northumbrian Water Group plc	138.8	592.5
Maple Leaf Foods Inc.*	53.7	549.9
Macquarie Infrastructure Group	285.5	444.7
Eni S.p.A.	15.0	432.2
Petro-Canada	16.0	431.6
Akzo Nobel N.V.	6.6	334.4
Multiplan Empreendimentos Imobiliários S.A.	51.3	334.2
Nippon Telegraph and Telephone Corporation	0.05	292.2
Continental AG	1.8	227.9
PNC Financial Services Group, Inc.	3.6	220.7
Mitsubishi UFJ Financial Group, Inc.	27.6	206.1
HSBC Holdings plc	16.6	198.9
UBS AG	11.4	197.0
Portugal Telecom, SGPS, SA	17.9	186.9
Nestlé SA	3.8	184.7
Intel Corporation	10.1	182.1
Cisco Systems, Inc.	8.9	179.6
Unilever N.V.	6.0	177.5

Security Name	*Shares*	*Fair Value*
Sanofi-Aventis	2.1	$164.4
Microsoft Corporation	6.8	162.9
Pfizer Inc.	7.0	153.1
Samsung Electronics Co., Ltd.	0.4	152.8
Safeway Inc.	4.9	144.6
Total SA	2.1	141.2
Manitoba Telecom Services Inc.	3.8	138.9
Macdonald, Dettwiler and Associates Ltd.	6.1	132.0
Hitachi, Ltd.	27.8	130.4
Novartis AG	2.1	130.0
3M Company	1.8	128.5
Hammerson plc	13.4	127.4
JPMorgan Chase & Co.	3.2	123.1
GlaxoSmithKline plc	5.3	122.4
Sumitomo Mitsui Financial Group, Inc.	0.02	120.3
Canon Inc.	3.1	118.4
Bayerische Motoren Werke AG	3.2	117.9
Royal Bank of Scotland Group, plc	131.7	115.5
NuVista Energy Ltd*	15.8	111.1
Siemens AG	1.2	109.9
Nokia Oyj	5.7	108.8
Johnson & Johnson Inc.	1.4	106.4
Lockheed Martin Corporation	1.0	105.9
France Telecom SA	3.0	102.0
Goldcorp Inc.	2.7	101.9

*Includes fair market value of warrants and subscription receipts

For equities greater than $50 million, please visit our website at: www.otpp.com.

Real estate investments over $100 million

(as at December 31, 2008)

Property	Total Square Footage (in thousands)	Effective % Ownership
Canadian regional shopping centres		
Champlain Place, Dieppe	812	100%
Chinook Centre, Calgary	1,195	100%
Erin Mills Town Centre, Mississauga	806	50%
Fairview Mall, Toronto	748	50%
Fairview Park Mall, Kitchener	748	100%
Fairview Pointe Claire, Montreal	1,027	50%
Georgian Mall, Barrie	626	100%
Hillcrest Mall, Richmond Hill	586	100%
Le Carrefour Laval, Montreal	1,321	100%
Les Galeries d'Anjou, Montreal	1,224	50%
Les Promenades St. Bruno, Montreal	1,137	100%
Lime Ridge Mall, Hamilton	814	100%
Market Mall, Calgary	972	50%
Markville Shopping Centre, Markham	1,016	100%
Masonville Place, London	687	100%
Pacific Centre, Vancouver	1,430	100%
Polo Park Mall, Winnipeg	1,233	100%
Regent Mall, Fredericton	490	100%
Richmond Centre, Richmond	493	100%
Rideau Centre, Ottawa	694	69%
Sherway Gardens, Toronto	984	100%
The Promenade, Toronto	704	100%
Toronto Eaton Centre, Toronto	1,722	100%

Property	Total Square Footage (in thousands)	Effective % Ownership
Canadian office properties		
Encor Place, Calgary	360	100%
Granville Square, Vancouver	407	100%
HSBC Building, Vancouver	395	100%
Pacific Centre Office Complex, Vancouver	1,550	100%
PricewaterhouseCoopers Place, Vancouver	241	100%
Shell Centre, Calgary	683	50%
Toronto-Dominion Centre Office Complex, Toronto	4,442	100%
Toronto Eaton Centre Office Complex, Toronto	1,896	100%
Waterfront Centre, Vancouver	410	100%
Yonge Corporate Centre, Toronto	674	100%
Canadian properties under development		
The Shops at Don Mills, Toronto	N/A	100%
RBC Centre, Toronto	N/A	100%
U.S. regional shopping centres		
Lakewood Mall, Lakewood, California	2,079	49%
Los Cerritos Center, Cerritos, California	1,282	49%
Stonewood Center, Downey, California	919	49%
Washington Square, Tigard, Oregon	1,327	49%
U.K. office properties		
Thomas More Square Estate, London	562	50%

Private companies and partnerships over $100 million

Aguas Nuevo Sur Maule, S.A
Alliance Laundry Systems, LLC
AOT Bedding Holding Corp.
Apollo Overseas Partners (Delaware 892) VI, L.P.
Aquilex Holdings, LLC
Ares Corporate Opportunities Fund II, L.P.
Ashmore Global Special Situations Fund 4 Limited Partnership
Ashmore Local Currency Debt Portfolio
Auriel Global Macro Fund
Avaya Inc.
BC European Capital VII
BC European Capital VIII
BDC Offshore Fund Ltd.
Bernstein Global Long/Short Equity Portfolio L.P.
Birmingham International Airport
Bridgewater Pure Alpha Fund II Ltd.
Bristol Airport (Bermuda) Limited
Canary Wharf Group plc
CCMP Capital Asia Ltd.
Crestline Offshore Opportunity Fund, Ltd.
CTVglobemedia Inc.
CVI Global Value Fund B L.P.
Donnet Participações S.A.
Drawbridge Global Macro Fund Ltd.
Education Management Corporation
Empresa de Servicios Sanitarios del Bio-Bio S.A.
Esval S.A.
Express Pipeline Ltd.
GCT Global Container Terminals Inc.
Glenstone Capital Inc.
GMO Mean Reversion Fund (Offshore) L.P.
GNC Corporation, Inc.
Gottex ABL Fund
Grupo Corporativo Ono, S.A.
Hancock Timber Resource Group
Hawker Capital Harrier Fund
Hudson Catastrophe Fund, Ltd.
Humber View Ltd.
IIG Trade Finance Partners Ltd.
IntelSat, Ltd.
InterGen N.V.
Kabel Deutschland GmbH
Maple Financial Group Inc.
Maple Leaf Sports & Entertainment Ltd.
MBK Partners, L.P.
Morgan Stanley Real Estate Special Situations Fund III, L.P.
Northern Star Generation LLC
OLE Media Management, L.P.
Orbis Sicav Global Equity Fund
Park Square Capital, LLC
Pershing Square International Ltd.
Pinnacle Natural Resources Offshore Ltd
Providence Equity Partners V L.P.
Providence Equity Partners VI L.P.
R3, Ltd
Resource Management Service Inc.
Scotia Gas Networks PLC
Silver Creek Low Vol Strategies, Ltd.
Silver Creek Low Vol Strategies II, Ltd.
Silver Creek Special Opportunities Fund Cayman III, L.P.
Sociedad Austral de Electricidad S.A.
Southern Cross Airports Corporation Holdings Inc.
The Hillman Companies, Inc.
Univision Communications Inc.
Yellow Pages Group Limited
York Street Capital Partners

Eleven-year review

($ billions)	***2008***	*2007*	*2006*	*2005*	*2004*	*2003*	*2002*	*2001*	*2000*	*1999*	*1998*
CHANGE IN NET ASSETS FOR THE YEAR ENDED DECEMBER 31											
Income											
Investment income	**$ (19.03)**	$ 4.68	$ 12.31	$ 14.09	$ 10.80	$11.42	$ (1.41)	$ (1.74)	$ 6.21	$10.12	$ 5.14
Contributions											
Members/transfers	**1.13**	1.06	0.83	0.79	0.75	0.71	0.68	0.64	0.62	0.63	0.61
Province of Ontario	**1.18**	1.08	0.82	0.78	0.75	0.72	0.70	0.68	0.66	0.66	0.65
Province of Ontario – special payments	**–**	–	–	–	–	–	–	–	–	0.13	0.49
Total income	**(16.72)**	6.82	13.96	15.66	12.30	12.85	(0.03)	(0.42)	7.49	11.54	6.89
Expenditures											
Benefits paid	**4.20**	4.02	3.82	3.62	3.43	3.20	3.08	3.08	2.54	2.28	2.10
Investment expenses	**0.15**	0.23	0.22	0.21	0.19	0.16	0.10	0.12	0.10	0.09	0.07
Member service expenses	**0.04**	0.04	0.03	0.03	0.03	0.03	0.03	0.04	0.03	0.03	0.03
Total expenditures	**4.39**	4.29	4.07	3.86	3.65	3.39	3.21	3.24	2.67	2.40	2.20
(Decrease)/increase in net assets	**$ (21.11)**	$ 2.53	$ 9.89	$ 11.80	$ 8.65	$ 9.46	$ (3.24)	$ (3.66)	$ 4.82	$ 9.14	$ 4.69
NET ASSETS AS AT DECEMBER 31											
Investments											
Fixed income	**$ 5.32**	$ 18.68	$ 21.44	$ 19.33	$ 13.91	$19.38	$ 13.96	$ 7.09	$ 13.32	$17.30	$11.48
Equities											
Canadian	**6.21**	13.73	16.39	19.26	16.80	15.19	13.43	17.06	17.74	19.89	17.61
Non-Canadian	**28.72**	36.31	32.42	25.78	23.09	19.13	18.19	24.28	23.14	21.76	24.02
Inflation-sensitive investments											
Commodities	**1.25**	3.02	2.32	2.65	2.13	1.89	1.48	1.09	2.10	1.09	0.40
Real estate	**16.16**	16.36	14.53	12.45	10.90	9.87	11.49	11.59	6.20	2.82	1.58
Infrastructure & timberland	**10.03**	8.84	6.78	4.77	2.99	1.90	0.97	0.03	–	–	–
Real-rate products	**17.41**	11.06	11.80	10.56	11.90	7.07	5.92	6.98	9.55	4.24	3.02
Net investments	**85.10**	108.00	105.68	94.80	81.72	74.43	65.44	68.12	72.05	67.10	58.11
Receivable from Province of Ontario	**2.19**	1.84	1.58	1.50	1.42	1.36	1.32	1.28	1.25	1.25	1.23
Other assets	**47.35**	48.19	35.47	20.90	23.17	11.30	23.45	24.26	13.15	7.04	5.39
Total assets	**134.64**	158.03	142.73	117.20	106.31	87.09	90.21	93.66	86.45	75.39	64.73
Liabilities	**(47.20)**	(49.48)	(36.72)	(21.07)	(21.98)	(11.41)	(24.00)	(24.20)	(13.33)	(7.08)	(5.56)
Net assets	**87.44**	108.55	106.01	96.13	84.33	75.68	66.21	69.46	73.12	68.31	59.17
Smoothing reserve	**19.52**	(3.63)	(11.16)	(7.44)	(1.54)	3.48	9.65	2.97	(4.34)	(8.32)	(4.79)
Actuarial value of net assets	**106.96**	104.92	94.85	88.69	82.79	79.16	75.86	72.43	68.78	59.99	54.38
Accrued pension benefits	**118.14**	115.46	110.50	110.53	96.73	83.12	73.67	65.43	58.56	52.11	48.64
(Deficit)/surplus	**$ (11.18)**	$ (10.54)	$ (15.65)	$ (21.84)	$ (13.94)	$ (3.96)	$ 2.19	$ 7.00	$ 10.22	$ 7.88	$ 5.74
PERFORMANCE (%) FOR THE YEAR ENDED DECEMBER 31											
Rate of return	**-18.0**	4.5	13.2	17.2	14.7	18.0	-2.0	-2.3	9.3	17.4	9.9
Benchmark	**-9.6**	2.3	9.4	12.7	10.6	13.5	-4.8	-5.3	5.3	17.6	11.9

Corporate directory

Ontario Teachers' Pension Plan

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Audit Services
Peter Maher, Vice-President

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Human Resources
Marcia Mendes-d'Abreu, Vice-President

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General Counsel and Secretary
Sandra J. Hardy, Executive Vice-President

Investments
Andrea Stephen, Executive Vice-President

Operations
Ron Wratschko, Executive Vice-President

Annual Meeting
April 3, 2009 at 5:00 p.m.
The Carlu
444 Yonge Street, 7th floor
Toronto

We welcome your comments and suggestions on this annual report.

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