



# Statement of Investment Policies and Procedures for Ontario Teachers' Pension Plan (“SIPP”)

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Investing to make a mark

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# Section 1 – Purpose

## 1.1 Description of the Ontario Teachers' Pension Plan

The Ontario Teachers' Pension Plan (the "Plan") is governed by the Teachers' Pension Act as amended (the "TPA"). It is a contributory, defined benefit pension plan co-sponsored by the Ontario government (the "Province") and the Plan members, who are represented by Ontario Teachers' Federation ("OTF"). The Province and OTF will be referred to as the "Partners".

The terms of the Plan are set out in the plan document, Schedule 1 to the TPA, as amended from time to time.

Active members of the Plan are persons employed in education as defined in the Plan. Most persons who are employed in education on a full-time or part-time basis are required to become active members of the Plan and to contribute to the pension fund (the "Fund")<sup>1</sup>.

## 1.2 Description of the Ontario Teachers' Pension Plan Board

The Plan is administered and the Fund is managed by the Ontario Teachers' Pension Plan Board ("Ontario Teachers"). Under the TPA, Ontario Teachers' is constituted as a corporation without share capital to which the Corporations Act does not apply. The Partners appoint a maximum of eleven individuals to serve as board members of Ontario Teachers' (the "board").

## 1.3 Purpose of the SIPP

The board has prepared this statement of investment policies and procedures (the "SIPP")<sup>2</sup> to address the manner in which the Fund shall be invested. Investments shall be selected and held in accordance with the criteria and limitations set forth herein and in accordance with all relevant legislation.

<sup>1</sup>The Plan covers all people employed in education as described in Part II of Schedule I to the TPA.

<sup>2</sup>In accordance with section 78 of regulation 909 promulgated under the Pension Benefits Act (Ontario) ("Regulation 909").

# Section 2 – Fund Governance

## 2.1 Responsibilities of the Board

The board is responsible for the overall management of the Fund. In fulfilling its responsibilities, the board may delegate certain duties and responsibilities to committees of the board (“Committees”) and to the President and Chief Executive Officer with the power to sub-delegate. The board shall supervise the President and Chief Executive Officer, the Chief Investment Officer, Asset Allocation, and the Chief Investment Officer, Public and Private Investments (collectively, “Management”) and establish or require to be established by Management, written investment policies and procedures including this SIPP. The board, its delegates and the sub-delegates shall exercise the degree of care, diligence and skill in the investment of the Fund that a person of ordinary prudence would exercise in dealing with the property of others. In doing so, they shall use all relevant knowledge and skill that they possess or, by reason of their profession, business or calling ought to possess.

## 2.2 Management’s Responsibilities

Management shall be responsible for the day-to-day operations of the Fund, including adherence to Ontario Teachers’ policies and guidelines and supervision of employees and agents.

## 2.3 Custodian’s Responsibilities

The Custodians appointed by Ontario Teachers’ shall perform the duties required of the Custodians pursuant to written agreements entered into from time to time with Ontario Teachers’ and any applicable regulation<sup>3</sup>.

## 2.4 Code of Conduct

Board members, Committee members, and all Ontario Teachers’ employees shall adhere to Ontario Teachers’ Code of Conduct.

## 2.5 Sustainable Investing

The consideration of sustainability-related risks and opportunities that may have an impact on the financial performance of the Fund is consistent with Ontario Teachers’ objective to meet the pension liabilities of the Plan over the short and long-term horizons, based on current Plan provisions.

Alongside financial, economic, and other factors, Ontario Teachers’ may weigh relevant sustainability-related factors on the value of the Fund over both short and long-term horizons. Ontario Teachers’ recognizes that there may be jurisdictions, markets, sectors or companies where the associated risks, including risks posed by sustainability-related factors may outweigh the benefits to the Fund.

<sup>3</sup> See section 78 of Regulation 909 and section 6(2) of the Pension Benefits Standards Regulations.

# Section 3 – Plan Overview and Investment Implications

## 3.1 Nature of the Plan

The Plan is a defined benefit pension plan covering almost all certified teachers employed in education in Ontario and it is registered under the Pension Benefits Act (Ontario) and the Income Tax Act (Canada). Participation in the Plan is mandatory.

## 3.2 Pension Entitlement

A member may start receiving a pension any time after reaching age 50, or earlier if the member has become disabled.

## 3.3 Pension Formula and Indexation

The annual pension payable to a member is equal to 2% of the member's highest 5-year average salary multiplied by the number of years of credited service. At age 65, or earlier if a pensioner is in receipt of a Canada Pension Plan disability pension, the pension is reduced by 0.45% of the member's highest 5-year average salary (or of the 5-year average Year's Maximum Pensionable Earnings, if lower) multiplied by the number of years of credited service during which the member contributed to the Canada Pension Plan. The pension is reduced if the member retires before their age and qualifying service total 85 or before age 65 if earlier.

Annual pensions are also reduced to provide a survivor pension of 55% or greater. The reduction varies depending on the percentage chosen and the ages of the member and spouse. No reduction is made to the pension for a 50% survivor pension. Members without a spouse are provided a 10-year guarantee of benefits without reduction.

Pension benefits are adjusted each year for inflation, subject to an upper limit of 8% and a lower limit of 0% in any one year with any excess above or below those limits carried forward. In accordance with the terms of the Plan, the annual adjustment is made each January and is determined as the ratio of the 12-month average of the Consumer Price Index ("CPI") ending the most recent September over the 12-month average of CPI ending the prior September (the "CPI ratio").

For pension credit earned up to December 31, 2009, inflation protection is 100% of the CPI ratio. Pension credit earned after December 31, 2009, is subject to conditional inflation protection. For pension credit earned between January 1, 2010, and December 31, 2013, the minimum inflation protection level is set at 50% of the CPI ratio. There is no minimum level of inflation protection for pension credit earned after 2013. Inflation protection levels stated in the most recent funding valuation filing remain in effect until a subsequent filing updates the amount. Inflation protection of up to 100% for pension credit earned after 2009 can be restored on a go-forward basis, depending on the Plan's funded status.

## 3.4 Funding

The actuarial valuation for funding purposes of the Plan, which must be filed with the regulatory authorities at a minimum of every three years,

- a) determines the sufficiency of scheduled contributions to fund the Plan;
- b) determines the actuarial gain or loss arising since the last valuation;
- c) determines the surplus or deficit;
- d) specifies the rate and duration of any additional contributions required to eliminate a deficit, if any; and
- e) determines the sufficiency of funds available to provide various levels of inflation protection that will apply for pension credit earned after December 31, 2009. The Partners rely upon this information when setting inflation protection levels.

Current contribution rates are as follows:

Active members who are required to contribute to the Canada Pension Plan contribute 10.4% of earnings up to the Year's Maximum Pensionable Earnings ("YMPE") plus 12.0% of earnings over the YMPE. Active members who are not required to contribute to the Canada Pension Plan contribute at the higher rate on all earnings.

Member contributions to the registered pension plan ("RPP") are capped at a dollar figure with contributions in excess of the cap being diverted to the Retirement Compensation Arrangement ("RCA"). This cap is subject to annual revision by the Plan's actuary by analyzing the amounts necessary to fund RCA benefits.

The Province and designated employers match member contributions. In addition, when CIP is invoked, the Province and designated employers make additional contributions equal to the difference between the inflation adjustments that were paid and the inflation adjustments that would have been paid had CIP not been invoked ("foregone inflation") for the first 50% of foregone inflation.

## 3.5 Plan Changes

The Partners' Agreement specifies that actuarial gains in the Plan are available to enhance plan benefits, reduce contribution rates, raise pensions prospectively to the level that would have been paid had CIP not been invoked, or held as a contingency reserve, all as determined by OTF and the Province.

## 3.6 Solvency

The values of the Plan's assets and liabilities on a solvency basis are related to values calculated as though the Plan were wound up and settled on the valuation date and excludes the value of future cost-of-living adjustments. The Plan performs a solvency valuation each year; however, the Plan is not required to fund any solvency deficiencies that may arise.

## 3.7 Plan Maturity

Important indicators of the maturity of the Plan include the ratio of active members to pensioners and the plan's annual net cash flows (contributions into the plan less benefit payments out of the plan). As the active-to-pensioner ratio decreases, it indicates that increasing contribution rates would have a limited ability to make up a funding deficiency. The ability to use contribution rates to keep the plan fully funded has decreased over the past 20 years, however the introduction of conditional inflation protection (CIP) on service earned after 2009 provides another lever to address a funding deficiency. CIP allows flexibility in the amount of inflation increase provided to pensioners for benefits earned after 2009. The increase level is a decision of the Partners, conditional on the Plan's funded status. Pension credit that members earned before 2010 remains fully indexed to inflation. As CIP applies to more pension beneficiaries, it will be able to absorb a greater loss, making it a more effective risk management tool. Ontario Teachers' has developed tools to analyze policy alternatives and thereby help OTF and the Province to reach decisions regarding contribution and benefit levels. These decisions influence Ontario Teachers' investment and risk management policies.

## 3.8 Long-Term Rate of Return Goal

The Plan is required to deliver benefits to the members during their retirement years. To meet these obligations, and based on the current contribution rates of members, the Province and designated employers, the Plan needs to earn a rate of return that supports the long-term sustainability of the Plan.

# Section 4 – Investment Parameters

## 4.1 Investments and Investment Strategies

Ontario Teachers' participates in the following:

### Equity

Equities generally reduce funding risk in the long term because of higher expected returns than other asset categories but increase funding risk in the short-term because of higher volatility than other asset categories.

### Fixed Income

Fixed Income investments generally reduce funding risk over the long term because of their interest rate hedging properties but increase funding risk because of lower expected returns.

### Inflation Sensitive

Inflation sensitive investments generally reduce funding risk in the long term because of their hedging properties against unexpected inflation; however, they generally increase funding risk in the short term because of higher volatility than other asset categories.

## **Real Assets**

Included in this category are assets that are expected to have similar economic characteristics to the Plan's liabilities. These assets generally reduce funding risk over the long-term.

## **Credit**

Credit generally reduces funding risk in the long term by providing diversification benefits as well as a hybrid of interest rate hedging and growth properties. These assets generally increase funding risk in the short term because of higher volatility than some other asset categories.

## **Absolute Return Strategies**

Absolute Return Strategies generally reduce funding risk in the long term by providing an expanded investment opportunity set and diversification benefits, but increase funding risk in the short-term because of the potential for high volatility of returns.

## **4.2 Diversification**

Ontario Teachers' follows an approach of asset diversification. The purpose of such diversification is to have different segments of the Fund exposed to different investment risks to achieve an averaging of risks and returns in a fashion that reduces the likelihood of an overall decline in Fund value and increases the opportunity for gains over the entire portfolio.

Diversification of the Fund's portfolio is maintained in order to:

- 1) reduce the Fund's annual total return variability;
- 2) reduce market and credit exposure to any single issuer and to any single component of the capital markets;
- 3) reduce exposure to unexpected inflation;
- 4) enhance the long-term risk-adjusted return potential of the Fund; and
- 5) reduce funding risk.

## **4.3 Liquidity**

The Fund is managed with a view of providing sufficient liquidity to enable the Plan to meet all of its future obligations as they become payable. Investments are selected with consideration given to their effect on liquidity risk within the context of the investment portfolio as well as the income to be derived.

## **4.4 Asset Mix**

In determining the asset mix of the Fund, Ontario Teachers' considers the following factors:

- 1) Ontario Teachers' desire to maintain stable contribution rates and benefit levels for the members and the Province;
- 2) demographics of Plan membership and the expected pattern for employment of teachers in Ontario;
- 3) the correlations between the Plan's assets and liabilities;

- 4) Ontario Teachers' goal of achieving, at a minimum, a rate of return that supports the long-term sustainability of the Plan;
- 5) the characteristics of its categories of investments; and
- 6) adequate liquidity needed to fund current cash flow needs.

The asset mix is shown in the table below.

### Asset Mix \*

Exposure	Minimum	Mid-Point	Maximum
Equities	30%	37%	45%
Fixed Income	0%	34%	67%
Inflation Sensitive	15%	20%	25%
Real Assets	24%	29%	35%
Credit	10%	15%	20%
Absolute Return Strategies	4%	9%	14%
Funding for Investments**	-106%	-44%	10%
		100%	

\* Overlay strategies are employed from time to time to support risk management.

\*\* The Funding for Investments asset class is comprised of liquidity reserves and funding for investments in other asset classes.

\*\*\* For any period of time in which there is an inconsistency between this asset mix table and the Board Investment Policy (referred to in subsection 5.6 – Risk Appetite and Investment Policy), the Board Investment Policy shall prevail.

## Section 5 – Risk Management Tools

### 5.1 Asset/Liability Studies

The Plan's primary long-term risk is an inability to meet expected benefits payable to retired members with current contribution rates and indexation levels. To manage this long-term risk, Ontario Teachers' shall conduct asset/liability studies. These studies lead to the recommendation and adoption of an asset mix that aims to fund the liabilities and reduce the risk of adverse consequences to the Plan from decreases in the Plan's funding position.

### 5.2 Asset Mix

The long-term performance of the Fund is primarily determined by the long-term asset mix. The approach of broad diversification across various asset classes within the asset mix is an important risk management and control tool.

## 5.3 Benchmarks

In order to evaluate the performance of the Fund, Ontario Teachers' shall measure the performance of the investment program relative to the long-term rate of return goal. Benchmarks are used to assess the active management performance of the portfolio managers of Ontario Teachers'. In measuring active management, benchmarks normally represent the return of market indices from each of the asset classes or CPI + benchmarks.

## 5.4 Risk Metrics

Ontario Teachers' uses risk measures with a long historical window to calculate potential losses based upon volatility of returns implicit in the asset mix and the Fund's holdings. The long-term risk measures support Ontario Teachers' ability to control risk within the Fund, including market, issuer credit, and liquidity risks.

Ontario Teachers' also uses a risk measure with a short-term window to calculate potential losses resulting from a failure of its counterparties in derivatives, repurchase and prime brokerage agreements to meet their obligations to the Plan, or resulting from a decline in the value of the collateral exchanged with those counterparties. The short-term risk measure supports Ontario Teachers' ability to control counterparty credit risk.

## 5.5 Derivatives and Repurchase Agreements

Ontario Teachers' uses swaps, forwards, futures and options, which shall include without limitation equity, commodity, interest rate, inflation, currency, credit and other derivatives ("derivatives") and repurchase agreements to aid in the management of the Fund's asset-mix and other investment objectives of Ontario Teachers'. As such, derivatives and repurchase agreements may be used to synthetically replace any Ontario Teachers' approved activity that would traditionally be accomplished with any asset class.

## 5.6 Risk Appetite and Investment Policy

To apply risk management to investments in a consistent manner, the board establishes:

- Enterprise Risk Appetite Statement – The board articulates its risk tolerance to Management in its Enterprise Risk Appetite Statement. This forms the basis from which Management formalizes risk tolerances for identified risks. The board reviews and approves this Enterprise Risk Appetite Statement at least annually.
- Investment Policy – The Board Investment Policy is applicable to the Fund and aggregate asset classes. It addresses the risks that are relevant and material at the Total Fund level. The board reviews this policy at least annually. The execution of this mandate is the responsibility of the Chief Investment Officer, Asset Allocation and Chief Investment Officer, Public and Private Investments and is overseen by the President and Chief Executive Officer.
- Portfolio Governance & Oversight Policy – The Portfolio Governance & Oversight Policy is applicable to the Fund as a whole and to each asset class. It provides Ontario Teachers' framework for governing performance targets, performance measurement and investment-related compensation. The board reviews and approves this policy at least biennially.

# Section 6 – Related Party Transactions

The aggregate value of transactions with a related party (as defined in the Federal Investment Regulations) shall not exceed 3% of the fair value of the Fund's net investments.

# Section 7 – Lending of Cash and Securities

## 7.1 Permitted Circumstances

Ontario Teachers' may lend the cash and securities of the Fund as a means of generating incremental income or cash for investment or otherwise supporting an investment strategy.

Such loans shall be in writing. When Ontario Teachers' lends securities of the fund, the document shall provide for Ontario Teachers' right to terminate the loan and to recall the loaned securities.

## 7.2 Use of Agents

Management may delegate to a lending agent the authority to select borrowers, negotiate terms and rates and invest cash or securities collateral under written procedures which specify securities available for loan, pre-approved borrowers, loan terms, and instruments for the investment of collateral as well as administrative, risk management and reporting arrangements.

## 7.3 Collateral and Margin Requirements

When Ontario Teachers' lends securities of the Fund as a means of generating incremental income or cash for investment, the following rules shall apply. Ontario Teachers' or its lending agent shall receive from the borrower collateral equal to no less than 100% of the fair value of the securities loaned at the time of the transaction. The amount of collateral margin taken shall reflect best practices in local markets. Both loaned and collateral securities must be marked to market daily to account for increases in the fair value of the securities loaned or decreases in the fair value of the collateral. Shortfalls in the amount of collateral must be rectified by the following business day unless otherwise agreed to in writing. The collateral obtained to secure a loan of securities or any securities purchased with such collateral must be either cash or high quality, readily marketable securities acceptable as a direct investment under Ontario Teachers' investment policies. Title to all collateral must be clear.

# Section 8 – Short Selling of Securities

## 8.1 Permitted Circumstances

Ontario Teachers' may short sell securities, by way of borrowing securities or otherwise, to enhance the return or reduce the risk of the Fund.

Such short sales shall provide for Ontario Teachers' right to terminate the transaction and to recover Ontario Teachers' collateral.

When engaging in short sale transactions Management shall give consideration to the related risks.

## 8.2 Collateral and Margin Requirements

When Ontario Teachers' enters a short sale transaction the credit quality of the prime broker or lender, and (where relevant) the parent company of the prime broker or lender, shall be identified and monitored throughout the transaction. Ontario Teachers' will provide the amount and type of collateral consistent with market requirements.

Collateral shall be required to be held by the prime broker or lender in a manner designed to safeguard it, to the extent possible, from the interests of other creditors of the prime broker or lender. The agreement must provide for the collateral or equivalent collateral to be returned to Ontario Teachers' promptly upon the termination of the short sale transaction and after Ontario Teachers' has satisfied its obligation. The short sale securities (loaned securities) and the collateral shall be marked to market daily so that exposures of Ontario Teachers' may be monitored.

# Section 9 – Pledging and Borrowing Assets

## 9.1 Permitted Pledging

Ontario Teachers' may pledge, charge or otherwise grant a security interest in assets or post margin as required to effect transactions in derivatives and repurchase agreements, to secure a permitted borrowing or guarantee, or to effect a short sale.

## 9.2 Permitted Borrowing

Ontario Teachers' may borrow provided such borrowing is permitted in accordance with applicable law.

Ontario Teachers' may also guarantee the obligations of, or the performance of obligations by, entities in which Ontario Teachers' has a direct or indirect equity interest. The liability of Ontario Teachers' under any such guarantee shall not exceed a percentage of the obligations guaranteed which is equal to Ontario Teachers' direct or indirect percentage equity interest in the guaranteed entity, unless a higher percentage is approved by the Chief Investment Officer, Public and Private Investments or a delegate.

When engaging in permitted pledging, guarantees, or borrowing Management shall give consideration to the related risks.

# Section 10 – Voting Rights

## 10.1 Value of Voting Rights

Ontario Teachers' shall exercise voting rights in the manner that most enhances the long-term value of the Plan's investments.

## 10.2 Proxy-Voting Guidelines

Ontario Teachers' shall establish proxy-voting guidelines and review them at least annually.

## 10.3 Reports of Voting

The President and Chief Executive Officer or his delegate shall report to the board annually on the voting of proxies.

# Section 11 - Valuation of Investment Assets and Liabilities

The Fund's investment assets and liabilities shall be valued by using fair values or as otherwise may be required by law.

## 11.1 Frequency of Valuation

The frequency of valuation shall be dependent upon the nature of the investment asset or liability. To the extent possible, fair values shall be obtained or valuations prepared on a daily basis. However, for certain investments, for example, private instruments and real estate, valuations shall be prepared or reviewed on at least a semi-annual basis.

## 11.2 Fair Value

Where ascertainable, the fair values of Ontario Teachers' investment assets and liabilities shall be based on quoted prices (unadjusted) in active markets, or other relevant observable inputs.

## 11.3 Where Observable Inputs are Not Available

Where observable inputs are not available for an investment asset or liability, a suitable method of valuation shall be used including the use of: discounted cash flows, earnings multiples, appraisals, prevailing market rates for instruments with similar characteristics or other pricing models as appropriate. External appraisers may be used to provide independent valuations or verify the reasonableness of internal valuations.

## **Section 12 – The Effect of Expenses on Performance**

Ontario Teachers' shall give consideration to the impact of administrative expenses, external management fees and performance fees when establishing the asset mix. The board receives reports on the performance of the Fund both before and after expenses throughout the year. Management shall be responsible for ensuring expected returns on invested assets are monitored against budgeted expenditures.

## **Section 13 – Compensation of Managers**

Employees may be eligible for incentives based on portfolio and Fund performance and the achievement of corporate objectives. External managers are eligible for incentives based on portfolio performance.

## **Section 14 – Delivery to Actuary**

A copy of this SIPP and any amendment shall be delivered to Ontario Teachers' actuary within 60 days after this SIPP is amended.

## **Section 15 – Statement Review**

The board shall review the SIPP at least annually<sup>4</sup>.

<sup>4</sup> See subsection 7.2(1) to the Pension Benefits Standards Regulations, 1985.



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