2010 REPORT TO MEMBERS AND PENSIONERS

Strength in numbers

Solid investment returns lead to improved financial position

The Ontario Pension Board (OPB) had another solid investment year in 2010. Our conservative, capital preservation approach to investing enabled us to navigate market uncertainty and global economic challenges to generate a return of 9.4%.

That solid investment return – combined with recent contribution increases and lower-than-expected growth in public sector salaries and inflation – led to a modest improvement in the overall funding position of the Public Service Pension Plan (PSPP, or “the Plan”). While a December 31, 2010 funding valuation won’t be completed until later this year, we expect it to show that the Plan is approximately 94% funded – up from 93% at year-end 2009.

During 2010, OPB continued to make headway with a number of important business and service objectives. Specifically, we ramped up the delivery of our asset allocation strategy, added needed investment expertise, and trimmed pension administration expenses.

We also continued to elevate service levels – despite ongoing staffing and budget constraints. The introduction of additional web services in late 2009 brought new administrative efficiencies that allowed us to meet growing service demands, free up staff for more one-on-one client counseling, and move forward with new service initiatives. Our emphasis on service is paying off. The results of an industry survey released in 2010 ranked OPB’s service levels second among its peer group.

You will find details on these and other accomplishments in this report to members and pensioners. For even more detail, refer to the full 2010 Annual Report, available online at www.opb.ca. If you have any feedback on what you read, please send us an email at feedback@opb.ca or give us a call at 416.364.8558 (ask for the Communications department).

We encourage you to take a few minutes to read this report. It is, after all, about your pension, your future.

OPB
Your Pension. Our Promise.

Our promise to you

- Protect the long-term vitality of the Public Service Pension Plan.
- Invest the Plan’s assets to maximize returns within acceptable risk parameters.
- Keep contribution levels reasonably stable and affordable.
- Deliver superior, cost-effective service so that you realize the full value of your participation in the Plan.

Who we are

Ontario Pension Board ("OPB") is the administrator of the Public Service Pension Plan ("PSPP" or the "Plan") – a major defined benefit pension plan sponsored by the Government of Ontario. Our membership is made up of certain employees of the provincial government and its agencies, boards and commissions.

With more than $17 billion in assets, 42,379 members, 35,497 pensioners and 3,978 deferred members, the PSPP is one of Canada's largest pension plans. It is also one of the country's oldest pension plans, successfully delivering the pension promise since the early 1920s.

Who we serve

OPB serves:

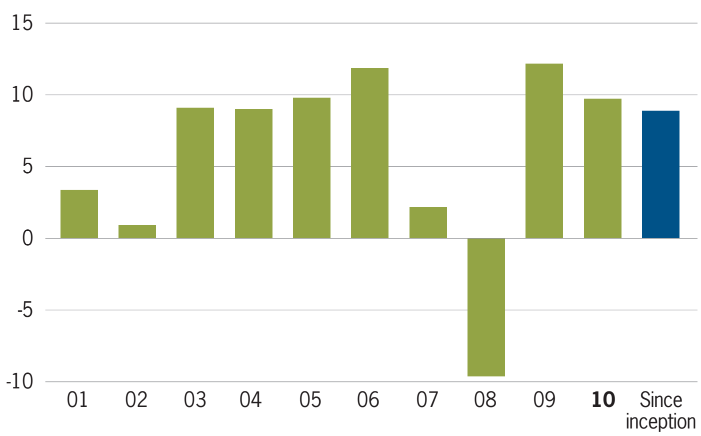
- PSPP members, pensioners and employers ("clients") and
- other key stakeholders (the Plan Sponsor, bargaining agents and the citizens of Ontario).

About your Plan

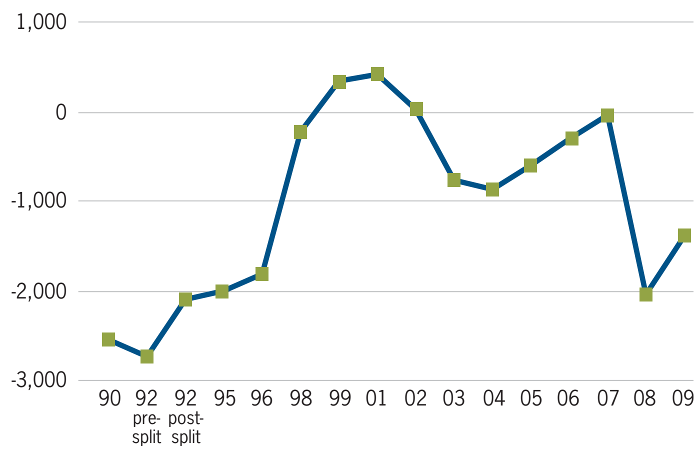
The PSPP is a defined benefit pension plan that is designed to provide financial security to its members. Retired members receive a pension benefit based on a pre-set (defined) formula. That formula takes into account each member's earnings history and years of service with the Plan. The pension promise is funded by investment returns, as well as contributions made to the Plan by both members and the employer.

Total returns

(% per annum)



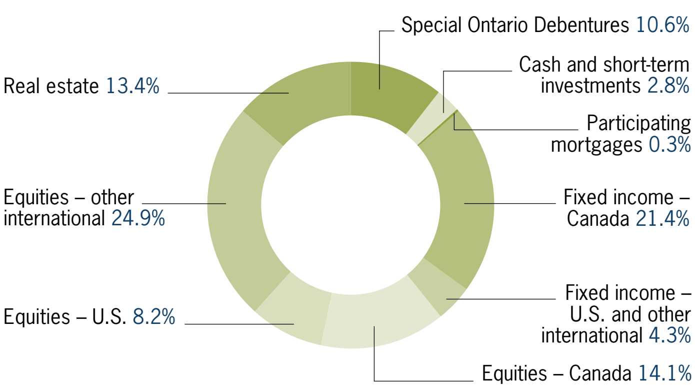
Funded status



The years shown on this graph represent the years where a funding valuation was completed. Funding valuations are not necessarily completed every year.

Asset mix

(as at December 31, 2010)



Service to members

	2010	2009	2008
Telephone calls	**27,677**	18,872	21,154
Buyback of service[1]	**3,366**	5,188	3,302
Online buyback cost quotes	**6,222**	n/a	n/a
Manual pension estimates[1]	**793**	1,965	1,402
Online pension estimates	**3,903**	n/a	n/a
Presentations	**170**	165	130

Service to pensioners

	2010	2009	2008
Telephone calls	**15,058**	17,411	21,096

[1] The drop from 2009 to 2010 is due to increased take up on the online estimate and buyback cost quote tools.

Message from the Chair

OPB continued to achieve success in 2010, despite global economic uncertainty and market instability. By focusing on our core values and strategic objectives, we were able to generate a healthy investment return, reduce our funding shortfall, keep expenses down, and provide more value-added services to clients and stakeholders.

M. Vincenza Sera, Chair

Protecting the Plan

As always, the continuing health of the PSPP remains our number one priority. That means ensuring we have the investment and funding strategies in place that we need to meet future pension obligations.

During 2010, we continued to build our in-house investment management capabilities. This initiative will help OPB enhance long-term investment returns while better managing risk.

Our ongoing work with the Plan Sponsor (the Ontario government) to formalize a Plan funding policy is another noteworthy example. Once finalized, this policy will provide clear-cut guidelines aimed at making sound long-term decisions about the contribution rates and benefits to be provided under the Plan, so that we can continue to keep the Plan in sound financial shape and ensure the PSPP has, over the long term, the funds it needs to meet future pension obligations. Our goal is to finalize and formalize that policy in 2011.

We are also committed to protecting the health of the Plan by helping to ensure the legislative environment in which we operate remains amenable to defined benefit pension plans, such as the PSPP. To that end, OPB continued to play an active role in pension reform in 2010 by making recommendations to proposed legislation aimed at updating Ontario's pension laws.

Holding the line on costs

Through 2010, financial management and accountability continued to sit top-of-mind for the Board. Responding to a difficult economic climate, the Ontario government set stringent cost-constraint expectations for government agencies, including OPB. We are pleased to report that our cost-constraint measures meet or exceed those expectations. For example, with the exception of promotional increases, we have maintained base compensation rates for senior executives at 2008 levels, where they will remain through 2011. We also held our staff complement to pre-2008 levels, despite ongoing service improvements and a build-up of in-house investment expertise. Most importantly, management's focus on financial management resulted in a decrease in overall 2010 operating expenses compared to 2009, despite the fact that our investment expenses have been increasing as we work to increase our capabilities in this area.

Two years ago, the Board decided to participate in the CEM Benchmarking Inc. Pension Administration and Investment surveys. These surveys are designed to provide information about how our pension administration and investment performance and cost levels compare with a peer group of other large pension plan administrators. Details about the benchmarking results are provided in the President's message. The Board is satisfied that the results validate that not only is OPB extremely competitive versus our peers, but also indicate OPB is making absolute progress year over year.

Moving forward

I would also like to extend the Board's appreciation to Patricia Li, whose term on the Board ended in late 2010. Patricia's dedication and insight contributed greatly to OPB's success. We welcome Shamira Madhany, who was appointed to the Board on December 8, 2010. Shamira is the Assistant Deputy Minister for Diversity & Accessible Public Service. She has extensive experience leading and managing complex change, and developing provincial policies, programs and services across a range of ministries. We look forward to working with Shamira.

The Board is proud of what Mark and his team accomplished in 2010. While we cannot control the financial markets, interest rates, or the global economy, by focusing on certain key priorities – such as investment strategy, risk management practices, and financial controls – we are keeping our pension promise.

M. Vincenza Sera, Chair

President's message

I am pleased to report that OPB leveraged its many strengths this year to successfully navigate challenging investment markets, protect the health of the PSPP, and deliver quality service to clients and stakeholders.

Mark J. Fuller, President and CEO

The financial health of the PSPP continued to improve during 2010 and remains sound. We expect the 2010 valuation, which will be completed mid-2011, to show that our funding ratio is approximately 94%, up from 93% last year.

Several factors contributed to this improvement. Chief among them was a solid 9.4% investment return in 2010, which exceeded the rate of return assumed in our valuations by 2.65% (before expenses). Another factor was the inflation increase that was applied to pensions in 2010. This increase was 1.4%, which was less than our assumption of 2.5%. A third factor was lower-than-expected salary growth in the public sector – due to restraint measures introduced by the Government in response to a challenging fiscal and economic environment. This salary restraint, combined with contribution rate increases implemented in 2009 and 2010, means that members are contributing to improving the Plan's funded status.

Carefully balanced strategies

After the meltdown of capital markets in 2008, we raised our expectation for "go forward" investment returns – and built this assumption into our PSPP valuations. Our assessment was that financial assets were underpriced and would recover over time, generating solid returns. Since then, markets have recovered very strongly. The Plan earned 11.9% in 2009 and 9.4% in 2010, for a compounded total return over the two-year period of 22.4%. In light of this strong bounce back, we have moderated our expectation for future returns and intend to reduce the investment return assumption used to value the PSPP by 0.40% – lowering it to 6.35% per year (or 3.85% after deducting assumed inflation of 2.5%). Without this increased conservatism for future returns, our funding ratio would have shown even greater improvement in 2010. However, we believe this assumption change is a prudent step that will help protect the long-term financial health of the PSPP by ensuring our assumption more closely matches actual returns.

It is worth noting that our funding ratio includes all investment losses and gains to the end of 2010. We do not use smoothing (a commonly followed pension valuation methodology that recognizes investment gains and losses over three to five years). Our approach fully recognizes all investment returns as they occur. This gives us a real-time view of the financial health of the PSPP and enables us to identify and respond to funding issues more quickly. We also believe this is the basis on which all funding and benefit decisions should be made in plans like ours.

We regard our current funding level as both solid and manageable. And, given the long-term negative impact that 2008 had on most other pension plans, we are proud of our relatively strong funding position – especially in light of the prudent assumptions and methodologies we use to value the PSPP.

Investing for success

Our objective is to generate the long-term investment results necessary to return the PSPP to fully funded status. Over the past three years, we have taken a number of steps to achieve that objective. We have:

- modestly increased our allocation to equities (and within our equity portfolio, have significantly increased our holdings in rapidly growing developing nations, where we believe economic growth will be stronger and investment returns higher);
- begun to build a private debt portfolio (which we believe will provide higher yields than the public bond market);
- enhanced the quality of our real estate portfolio by selling underperforming properties and purchasing higher-quality assets, such as our purchase of the Erin Mills Town Centre in late 2010;
- implemented new investment risk management and compliance tools and processes; and
- expanded the breadth and depth of our in-house investment team.

Our investment portfolio has been constructed deliberately to preserve capital in the face of declining financial markets. Avoiding deep losses is critical to long-term investment success and to maintaining contribution rate and benefit stability. For example, recovering from a loss of 20% requires a return of not 20%, but 25%. We required a return of 10.4% to recover from our 2008 loss of 9.4% – which was far easier than digging out from the double-digit losses experienced by many plans (the average pension plan lost 18% in 2008).

Managing for the long term

Protection against downside risk comes with a trade-off. In strong markets, like we saw in 2010, OPB's investment returns will tend to lag those of investors with higher-risk portfolios. But for a defined benefit pension plan like ours, it is long-term returns that count. OPB's average annual return over 2008, 2009 and 2010 was approximately 3.5%, making us one of the best performing institutional investors during that period.

That said, it's critical that we strike an appropriate balance between loss protection and generating returns. Where that balance lies for a defined benefit pension plan depends in part on the ratio of active contributors to pensioners. The higher the number of active contributing members relative to pensioners, the greater a plan's tolerance for risk. For the PSPP, that ratio has increased over the last 10 years. As a result, we can – and intend to – seek out incremental returns through a variety of investment strategies and tools, while at the same time continuing to step up our investment risk management.

To make that happen, we have built a highly capable investment team over the last few years. This year, I was delighted to appoint Jill Pepall as our Chief Investment Officer. Jill has headed up investments at two other major Canadian financial institutions and, in both cases, built a track record of excellent long-term investment performance. Jill and her team are capable of, and committed to, delivering the strong results needed to return the PSPP – over time – to a fully funded position.

Responsible financial management and accountability

OPB embraces accountability. One of the ways we hold ourselves to account is to benchmark our operating performance and cost effectiveness against other pension plan administrators. We track our overall annual expenses as a percentage of dollars under administration and compare this to other major public sector pension plan administrators. Based on data drawn from annual reports, OPB was one of the most cost-efficient public sector plan administrators in Ontario in 2009.

As our Chair noted in her letter, we also participate in the pension administration and investment benchmarking surveys conducted by CEM Benchmarking Inc. On the investment side, the 2009 survey results (released in 2010) showed that we outperformed the benchmark in terms of both returns and investment expense levels. On the pension administration side, our 2009 service score was up significantly from 2008 and was the second highest among our peer group. While our pension administration expenses per member were at the high end of our peer group, we are improving that metric. Since 2008, we have reduced our pension administration operating costs by over 17%, while at the same time improving our service levels and handling increased service demand. Going forward, we will remain focused on gradually improving our cost per member and further improving service levels.

Finally, I would like to recognize OPB's dedicated team of employees. In the face of strict cost-containment measures and a challenging economic climate, they have worked together to achieve more with less. Without their dedication and commitment, the PSPP would not be in the strong and healthy position it is today. I am also very grateful for the leadership, wise counsel and full engagement of our Board of Directors.

Mark J. Fuller, President and CEO

Straight talk with OPB's Chief Investment Officer

In December 2010, Jill Pepall was appointed Chief Investment Officer ("CIO") for OPB. In her new role, Jill is responsible for the management and direction of the $17 billion in investments held by the PSPP. With more than 25 years of investment experience, there is no doubt that she has the expertise to drive OPB's investment program to the next level.

Here, Jill responds to questions about our current investment climate and provides insight into how OPB's approach to investing is evolving to ensure our future success.

Jill Pepall, Chief Investment Officer

What investment challenges did OPB face in 2010?

The Plan faced three key investment challenges during 2010. The first was the uncertainty of financial markets; markets declined in early 2010, but picked up steam in the latter half of the year – reflecting a shift in investors' perception of general economic conditions. The second challenge was the occurrence of periodic bursts of market volatility resulting from rapid and unpredictable changes in investor confidence due to negative news flow. The third was the uncertainty of global recovery given the sovereign debt crises in Europe. Fortunately, OPB's focus on capital preservation enabled us to manage through these challenges.

How would you describe OPB's investment strategy?

OPB's strategic approach to investing is comparatively conservative. OPB's investment approach is shaped by the Plan's key objectives to provide security for the promised benefits, invest within an acceptable level of risk, and allow for relatively stable and reasonable contribution rates. We seek to achieve these goals by investing in global investment opportunities that generate good cash flow while avoiding unrewarded risk. If we drill down, there are three key components to our investment strategy:

a) An emphasis on capital preservation – It is easier to make money if one starts by not losing money. For example, if an investment loses 33% of its value, the investor has to generate 50% just to get back to his or her original capital.

b) A focus on fundamental research-based investing – In other words, we engage investment managers who conduct fundamental research on the companies; evaluating the strength of management, balance sheet and earnings/cash flow generating potential.

c) The management of absolute volatility – We aim to reduce absolute volatility by diversifying our investments across asset classes (e.g. fixed income vs. equities) and investment strategy styles (i.e. growth vs. value style).

What do you mean when you say OPB has a *comparatively conservative* approach to investing?

Compared to many other pension plans, our approach to investing is a bit more conservative as we place a greater emphasis on capital preservation, fundamental research and managed absolute volatility. In investing, there is a direct relationship between risk and reward – simply, the greater the potential for investment gains, the greater the risk for investment losses. We invest the assets in a risk-managed approach – only taking risks when we believe it will be well rewarded. For example, just prior to the 2008 credit crisis, the Plan had a higher allocation to cash; then, in early 2009, we invested a portion of the cash in dedicated higher-yielding corporate credit mandates because we saw an opportunity when the general fear in the market had significantly depressed valuation of corporate credits. Our measured risk-taking was well rewarded in the latter part of 2009 and 2010; the corporate credit mandates returned more than two-fold over our fixed income benchmarks. We believe this is the more prudent approach for long-term investing.

Overall, how did OPB's investments fare in 2010?

OPB had a solid year, generating a return of 9.4%. We expect our return of 9.4% for 2010 to be on the low side of the range for Canadian institutional investors, whereas in 2009 we were close to the average and in 2008 we were well ahead of the average. That is exactly what we would expect from a strategy that stresses capital preservation and strong returns over a long time horizon. Our returns over the three-year period are well above the Canadian institutional investor average.

How is OPB doing relative to other pension plans?

Generally, quite well. OPB was conservatively invested in 2008 when the markets crashed, so our investments preserved more of their value. We were able to take advantage of our initial conservative asset positioning to capitalize on investment opportunities – we had the flexibility to opportunistically shift money into higher-yielding, specialty mandates and to capitalize on the market rebound of 2009 and 2010.

In 2009, OPB began to broaden its investment strategy. What progress did you make in 2010?

We moved forward on several fronts. We achieved our strategic asset allocation target in global investments. We continued to deepen our private debt capabilities to evaluate investment opportunities. At the same time, we sold and bought several real estate properties as part of our strategic plan to upgrade the quality of our real estate portfolio. One of the properties we bought in 2010 was the Erin Mills Town Centre, a major retail shopping complex in Mississauga.

Does an expanded investment strategy mean increased investment risk?

The answer is both "Yes" and "No." If we view each investment separately then the absolute risk is higher, however, on an aggregate basis, the diversification benefits of investing across asset classes and styles improves the return potential for each unit of risk taken. Again, we invest in a risk-managed manner where we aim to improve the return/risk relationship with each investment decision that we make. On the other hand, if a pension plan does not take on sufficient market risk – with the aim of earning higher returns – it could face a different risk: the risk that it will not generate the returns it needs to meet its long-term pension obligations. This reinforces the conscious need to balance risks and rewards.

What steps is OPB taking to manage risk?

We have taken quite a few steps. For starters, we have taken a staged approach to increasing our holdings in global investments to help reduce the impact of market volatility. We have also maintained a higher short-term cash position – relative to our asset allocation targets – so we can capitalize on the upside of market volatility. In addition, we continue to hire the expertise we need to support our broadening investment capabilities to generate incremental returns over each unit of risk taken. For example, in 2010, we retained an external currency overlay manager to implement the Plan's currency hedging policy, which reduced short-term currency volatility associated with global investing.

What other hires have you made?

We hired an in-house private debt manager in 2010 and also transitioned one of our proven real estate consultants to a permanent in-house position. In 2011, we expect to broaden our public and private market teams. In addition, we expect to augment our tactical asset allocation expertise, recognizing that asset allocation decisions are the biggest driver of investment performance.

How do OPB's investment management costs compare to those of other plans of OPB's size?

Our investment costs are very competitive. In fact, based on the most recent CEM Benchmarking Inc. survey, our fees are significantly lower than the industry standard – due in part to the fact that we have negotiated favourable fees with the outside money managers retained to invest parts of the pension fund. While the Plan's investment fees did go up in 2010, this increase reflects our ongoing investment in global and specialty mandates, both of which tend to require higher fees, and the broadening of OPB's in-house expertise. We expect these changes to generate higher risk-adjusted returns over the long term.

Your Pension. Our Promise.

At OPB, we know that you – and more than 80,000 members and pensioners – are counting on your pension. Here's how we work to deliver on Our Promise…

- **Focus on funding** – Ensuring the Plan has the assets it needs to fulfill the pension promise is our number one priority. It's at the heart of everything we do – from managing expenses to developing investment strategies tailored to our long-term cash flow needs.
- **Strategic investment** – We take a strategic and comparatively conservative approach to investing – one that emphasizes capital preservation. In short, we look to generate solid long-term returns by investing in assets that provide steady growth, generate good cash flow, and avoid unrewarded risk. To learn more about our approach to investing, please read Straight talk with OPB's Chief Investment Officer.
- **Effective risk management** – For pension plans, risk comes in all shapes and sizes. Investment risk, currency risk, funding risk, assumption risk, liquidity risk…the list goes on. At OPB, we have the people, policies, procedures, and experience to effectively manage those risks.
- **Administrative efficiency** – We know the importance of running an efficient operation. We work hard to streamline pension administration processes and costs – without compromising quality or service. That means fast, effective service at a competitive cost.
- **Sound governance** – We're committed to good governance. Our first-class governance structure reflects industry best practices, our high professional standards, leadership excellence, and commitment to transparency.

Directory of key personnel

Officers

Mark J. Fuller
President and CEO

Jill Pepall
Chief Investment Officer

Peter Shena
Senior Vice-President, Pensions and Stakeholder Relations

Paul Edmonds
Senior Vice-President, Corporate Affairs, and General Counsel

Duncan D. Webb
Senior Vice-President, Finance

Glenn Hubert
Vice-President, Private Debt

Brian Whibbs
Vice-President, Real Estate

Anne Catherall
Vice-President, Corporate Services

Thomas Choi
Vice-President, IT Services and Enterprise Solutions

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