2012 REPORT TO MEMBERS AND RETIRED MEMBERS

Protecting the long-term sustainability of the Plan

The *2012 Report to Members and Retired Members* is a summary of the many steps OPB took to deliver and protect the pension promise. This report outlines our many achievements and provides a snapshot of the financial status of your Public Service Pension Plan (PSPP) as of December 31, 2012.

Inside this report, you'll find:

- Client service and financial highlights from 2012 (pages 2–3).
- Messages from both the Chair of the Board, and OPB's President & CEO (pages 4–5).
- A one-page "scorecard" recapping our 2012 achievements (page 6).
- An interview with Jill Pepall, OPB's Chief Investment Officer (pages 7–8).
- Information on our governance structure (page 8).

For more information on our accomplishments and detailed financial pages, please view our full Annual Report on our website, **www.opb.ca**

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 base is made up of certain employees of the provincial government and its agencies, boards and commissions.

With approximately $19 billion in assets, 41,863 members, 35,616 retired members and 4,746 former 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.

Our promise

- Protect the long-term vitality of the 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 to clients and stakeholders so that they can realize the full value of their participation in the Plan.

OPB

Your Pension. Our Promise.

Who we serve

OPB serves:

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

About your Plan

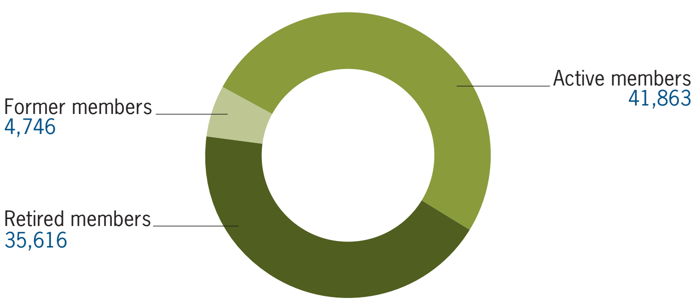
The PSPP is a defined benefit pension plan designed to enhance the financial security of its members. Retired members receive a pension benefit based on a pre-set (defined) formula. That formula takes into account each member's earnings history and years of service with the Plan. To fund the pension promise, both members and employers make matching contributions to the Plan.

Client service highlights

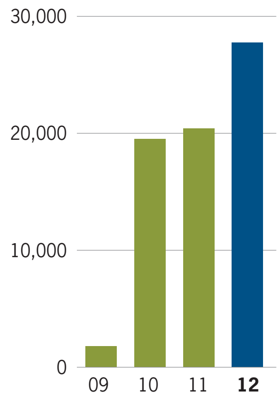
At OPB, we're committed to providing our clients with outstanding service, while holding the line on expenses. It's a commitment that has earned us a reputation for service excellence, worldwide. In 2012, CEM Benchmarking, a global leader in pension administration benchmarking, ranked OPB third in the world for client service. During 2012, we continued to build on that success by:

- putting in place the infrastructure for a new "client care centre" to be launched in early 2013;
- increasing awareness and use of our industry-leading e-services; and
- building out our internal service expertise so that we can provide members with personalized, decision-making support.

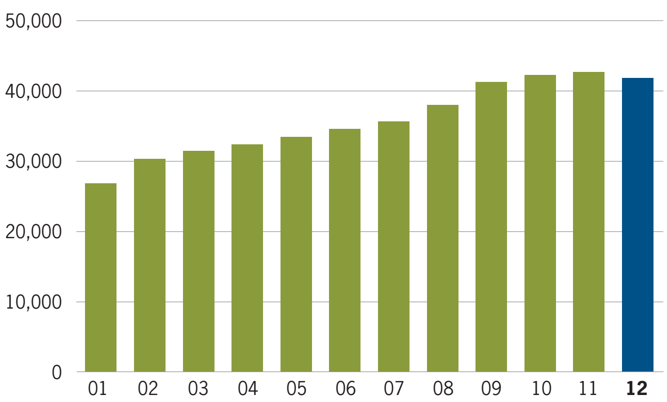
Client profile



Website visits – E-services logins



Growth in membership



Client interactions

	2012	2011
Applications for retirement online	2,573	N/A
Buyback cost estimates completed online	2,210	1,928
Beneficiary designations updated online	1,693	426
Address changes completed online	610	318
Presentations to members	165	165
Number of members using retirement planner	8,502	N/A

Investment & funding highlights

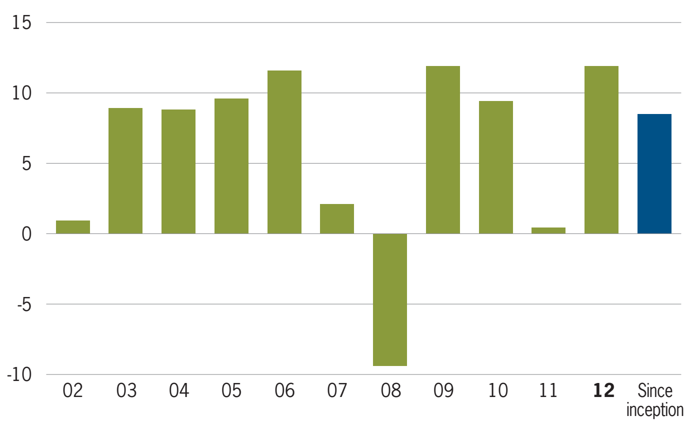
OPB generated strong returns and improved the funded status of the Plan in 2012 – thanks in part to a sound investment strategy and a high-performing investment team. We also made significant headway with the implementation of our strategic asset allocation (a strategy that rebalances the investment fund on an ongoing basis to maintain long-term asset mix targets).

In addition, we:

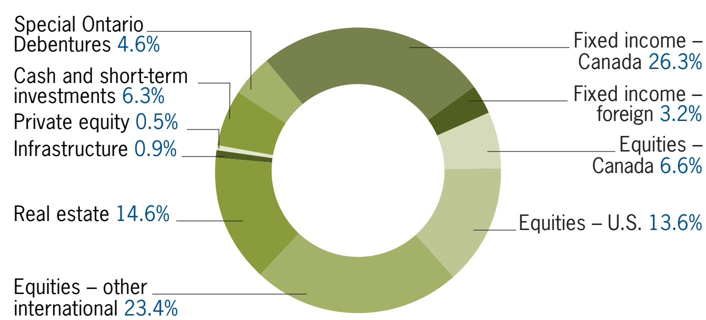
- issued our first bond offering;
- expanded our private market holdings (including real estate, private equity, and infrastructure);
- added new specialty mandates (allocating funds to specific market segments within existing portfolios); and
- moved forward with tactical asset allocation (a strategy that adjusts the Plan's asset mix to take advantage of short-term market fluctuations).

The Plan's year-over-year return as of December 31, 2012 was 11.9%. This means the Plan's long-term annual rate of return since inception now stands at 8.5%. Our next valuation is expected to show the Plan is just over 93% funded on a going-concern basis, up from around 90% at year-end 2011.

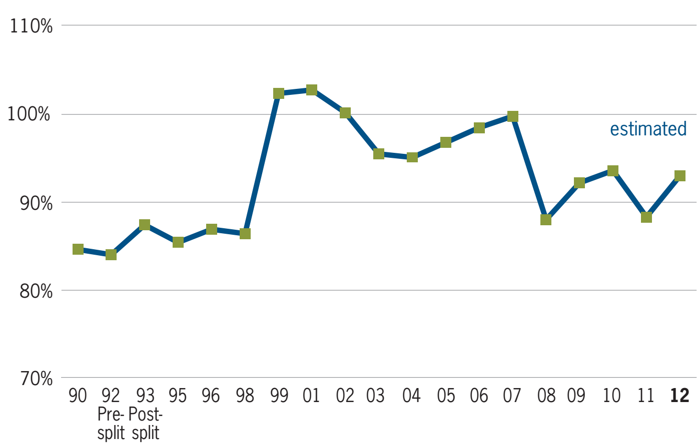
Total returns
% per annum



Asset mix
as at December 31, 2012

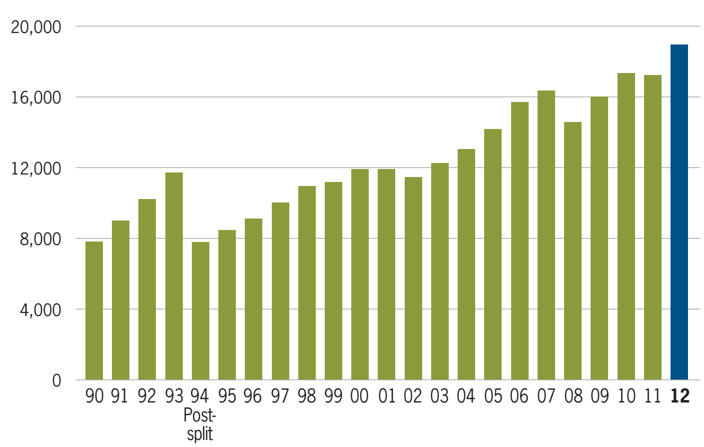


Funded status



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

Net assets
$ in millions



Message from the Chair

2012 was an outstanding year for OPB. We generated strong investment returns, materially improved the funded status of the Plan, and were ranked third internationally for service excellence – while maintaining an all-in cost structure that is significantly below our peers.

As part of our strategy to enhance long-term returns and manage investment risk, OPB has been transitioning to a new strategic asset allocation over the last few years and investing heavily in our investment team. During 2012, this strategy allowed us to successfully navigate ongoing market challenges, upgrade the quality of our real estate portfolio, complete our first direct investment in infrastructure, and continue to invest in private equity. Two particularly important achievements: OPB teamed up with a consortium in a takeover bid for Primaris REIT, which, when completed, will solidify our position as one of the premier owners of enclosed regional shopping centres across Canada, and we completed a highly successful bond offering which saw an independent bond rating agency rate our paper AAA.

During 2012, we also worked to protect the long-term interests of our stakeholders and Plan beneficiaries in the face of a shifting pension landscape. In the spring of 2012, the Government of Ontario announced its interest in pooling the assets of some public sector and broader public sector pension plans to achieve cost efficiencies and enhance investment returns. OPB believes, done properly, consolidation has the potential to generate enhanced investment returns for the PSPP. We are open to participating in consolidation so long as we are confident that it is achieved in a way that will benefit the financial status of the Plan and is in the best interests of Plan beneficiaries and stakeholders.

Service excellence

While preserving the long-term financial sustainability of the pension plan continues to be our primary focus, it is not our only priority. We are also committed to continuous service improvement. That's why, in 2012, we laid the groundwork for a new client care centre that will be launched in early 2013. A passion for service excellence has established OPB as an international leader. According to CEM Benchmarking Inc., a leading pension administration benchmarking firm, we now rank third in the world among pension plans they monitor in terms of administration service levels.

Managing risk

Over the years, OPB has adopted a disciplined approach to ensuring our risk management practices meet the needs of the risk profile of the organization. While our risk management initiatives are a point of strength, there is one risk that is of particular concern: there are significantly higher compensation levels at other public sector pension plans, as well as private sector wealth management firms. This makes it difficult to attract senior, high-quality investment professionals to OPB. It is essential that we continue to build our capacity to invest effectively, and that we are able to attract the best people to support that effort. This is in the best interests of all our stakeholders. We believe that compensation adjustments will be required in the future if we are to continue to attract and, importantly, retain qualified professionals and fulfill our fiduciary duty.

Governance excellence

Governance excellence also remained a priority. To ensure we continue to reflect industry best practices for leadership, OPB's Board of Directors adopted the use of individual director performance feedback surveys. These surveys serve as a proactive tool designed to raise the performance bar for individual directors.

In 2012, Board appointment terms for both Lisa Hillstrom and Lynn Clark came to an end. On behalf of the Board, I thank them for their many contributions and years of dedicated service. We are very pleased to welcome our newest member, Karl Walsh, who joined the Board this year. Karl is the Chief Administrative Officer for the Ontario Provincial Police Association, where he has held senior leadership positions since 2005. We believe Karl's expertise in pensions, stakeholder relations and public policy will greatly enhance our discussions around the boardroom table.

In light of our many achievements in 2012, I would like to thank my fellow Board members, OPB's management team, and all employees for their hard work and commitment to success.

M. Vincenza Sera, Chair

Message from the President & CEO

Coming out of 2012, the financial status of the Plan is strong. While we will not know the precise funded status until we complete the annual valuation in mid-2013, we expect the going-concern funded ratio to be just over 93%, with all of our assets at market value.

Mark J. Fuller, President & CEO

Our excellent investment performance, at 11.9%, was the main, but not the only, driver of this improvement. Also contributing significantly were the compensation restraint measures of the Government, which resulted in salaries increasing at a rate lower than we assume in valuing the Plan's liabilities. Lower than assumed salary increases have a direct effect on the cost of providing benefits. From the beginning of 2010 through the end of 2012, salary restraint will have resulted in the Plan's pension liability being $300 million to $400 million lower than it otherwise would have been. In its 2012 budget, the Government of Ontario signaled that salary restraint will continue, to some degree, for some time.

The last five years have been very challenging for defined benefit pension plans. Sustainability and affordability have become watchwords of the moment for the industry. During 2012, we continued with our proactive program to protect the sustainability and affordability of the PSPP. We commenced a long-term funding study. This is a study conducted by OPB together with the Plan's external actuary. It tests the appropriateness of the assumptions we use to value the Plan (e.g., salary and mortality assumptions), the adequacy of the current contribution rates, and the affordability of the benefits. Since Plan demographics, as well as the economic environment that the Plan operates in, change over time, we conduct these studies every five years. The last study was completed in 2008 and resulted in OPB recommending to the Plan Sponsor (the Government of Ontario) an increase in member and matching employer contributions. The current study will be completed during 2013.

In order to better reflect the current realities of the economy and the capital markets (particularly very low rates of interest and inflation), we have decided to change certain assumptions used in the valuation of the Plan. The assumed annual rate of investment return has been lowered from 6.35% to 5.95%. I assure you that the fact that we have lowered our investment return assumption to 5.95% does not mean that we are only aiming to generate that return. Indeed, our expectation is that our investment strategy will produce higher average annual returns over the long term. We also decreased our annual inflation assumption from 2.5% to 2.1% and, therefore, maintained our "real" (that is, after deducting inflation) assumption at 3.85%. The impact of these changes is reflected in the expected funding ratio figure referred to above.

Over the last several years, OPB has adopted a new investment strategy and invested in building a high-quality investment team. We made further additions to the team during 2012. That this investment in talent has been successful and paid off is demonstrated not only by our investment return for the year, but also in a number of breakthrough achievements such as a successful inaugural bond issue, participation in the bid for Primaris Real Estate Investment Trust, our infrastructure investment in two gas-fired power plants in the United Kingdom and being awarded a licence to invest in China A-Shares. These were possible only as a result of the investment we have made in talent on our investment team.

Effective cost management

I firmly believe that efficiency is a critical feature to success in any retirement system. We have all heard the phrase "the magic of compound interest". We also need to have due regard to the "tyranny of compound expenses". Our expense ratio (our expenses per dollar of assets, determined in accordance with industry practices) of 0.495%, which includes investment and pension administration expenses, is one of the lowest expense ratios among major public sector pension plan administrators, even much larger ones that would be expected to have greater economies of scale. It compares to mutual fund expense ratios of between 2% and 3%, which include only investment management services. While investment expenses are rising, we expect that the higher expenses will be more than offset by higher rates of investment return.

Delivering excellent service

In 2012, we continued to improve our pension administration client service while slightly decreasing our pension administration expenses from 2011 levels. I am extremely proud of our global ranking in the CEM Benchmarking Inc. survey. We have dramatically improved our service response times and enhanced the quality of the service we provide. We now offer more personalized service around key pension decisions and extensive education to our Plan members, employers and bargaining agents about the Plan. I am even more proud that we have improved our ranking and service offerings over the last few years while decreasing our annual pension administration expenses by more than 15% since 2008. The Government of Ontario has set an objective of greater efficiency in the delivery of public services. OPB has delivered on that expectation. This is a credit to the fine team of people we have assembled here at OPB, who have delivered more with less. It also demonstrates a strong return on the investment in technology that we have made over the last several years.

As we enter 2013, the world economy and capital markets remain challenging and the environment for pension plans difficult. That said, I am confident that OPB is strongly positioned to continue to manage the sustainability of the Plan well, as we have over the last five years.

Mark J. Fuller, President & CEO

Scorecard

WHAT WE DID	WHY WE DID IT AND WHAT IT MEANS
Funding	
Conducted a funding basis valuation	A funding basis valuation is used to ensure there are sufficient assets in the Plan to meet pension obligations. The results of this valuation resulted in the decision to lower the discount rate and inflation rate assumptions used to value the Plan.
Lowered the assumptions for the annual rate of investment return and annual rate of inflation	To reflect the current realities of the economy and capital markets – particularly very low interest rates and inflation – the assumed annual rate of investment return has been lowered from 6.35% to 5.95%, and the assumed annual rate of inflation has been lowered from 2.5% to 2.1%.
Investment	
Achieved an investment return of 11.9%	Strong investment returns contributed to a significant year-over-year improvement in the funded status of the Plan. We expect the valuation as of December 31, 2012, to show the Plan was just over 93% funded.
Moved forward with the implementation of our new strategic asset allocation (SAA)	The new SAA, which is being implemented over a five-year period, will help OPB better manage risk and meet long-term funding objectives. It puts more emphasis on private investments, such as real estate and infrastructure.
Hired a senior Investment Manager to implement and lead our tactical asset allocation strategy	The TAA strategy will enable us to quickly adjust the percentage of assets held in various investment portfolios, allowing us to take advantage of short-term changes in the market and to generate value-added returns.
Increased our use of derivative overlays	The use of derivative overlays enables OPB to respond more quickly to changing market conditions and to reduce trading costs.
Expanded our private market holdings	Investing in private markets helps to enhance returns in volatile markets by providing a larger component of their return from cash flow. It also provides a hedge against inflation.
Began investing in private equity and infrastructure	Private equity investments (such as private companies) and infrastructure (such as power plants) tend to be less susceptible to market volatility than public market assets (such as stocks).
Expanded our list of specialty mandates	Specialty mandates provide a way to add value through “smart risk”.
Service Excellence	
Continued to develop internal service expertise	Developing internal service expertise ensures OPB staff have the expertise required to help clients review their pension options and make informed decisions.
Laid the groundwork for a new client care centre	A “care centre” will be launched in early 2013. The centre will provide callers with “on-the-spot” answers to questions or redirect them to a trained specialist qualified to assist them in the decision-making process.
Raised awareness and usage of our “suite” of online services	E-services enable members to quickly and conveniently carry out key transactions, such as updating their address, changing their beneficiary, getting a pension estimate, and initiating the retirement process.
Advocacy	
Continued to take steps to protect the DB pension model	OPB believes DB plans are the superior model for offering retirement security and adequacy. With that in mind, we work to protect the Plan and the pension environment by ensuring the voice of defined benefit (DB) pension plans is heard by key decision-makers.
Provided a submission on asset consolidation	In the wake of an announcement by the Government of Ontario that it is looking at pooling the assets of smaller public sector pension plans, OPB made a proactive submission acknowledging the merits of the idea and outlining OPB’s minimum requirements for participation.
Financial Management	
Continued to make cost constraint a priority	We limited CEO compensation, deferred some non-critical strategic initiatives, leveraged efficiencies gained through online services, and automated internal processes.
Risk Management	
Enhanced our investment risk management systems	We updated our risk monitoring, data management, performance attribution and investment modelling systems to ensure we have the “middle/back-office” tools needed to manage risk effectively.
Governance	
Implemented a Governance Improvement Action Plan	The plan strengthens OPB’s governance structure by incorporating recommendations stemming from a third-party evaluation of Board performance conducted in 2011.

Straight talk: Jill Pepall, CIO

Since stepping into the position of Chief Investment Officer (CIO) at OPB just over two years ago, Jill Pepall has overseen some significant changes in our investment division. In this interview, Jill talks about those changes, the successes and the challenges, and why the Plan is now better positioned for the future.

Jill Pepall, Chief Investment Officer

(The following is an abridged version of the full interview that appears in the 2012 OPB Annual Report. To read the full interview, access the full Annual Report in the "What's new" section of our website at **www.opb.ca**)

OPB generated a strong 11.9% investment return in 2012. What factors contributed to this success?

There were a number of factors. For starters, in public markets, our managers in all the major asset classes outperformed their benchmarks. Asset mix was also a contributor. We held an overweight position in the strong U.S. equity market and an underweight position in the weaker Canadian equity and fixed income markets. We also had significant exposure to emerging markets, which performed well. An increased and successful focus on private markets – particularly real estate – also played an important role. In addition, our increased allocation to specialty mandates added to returns. For example, within fixed income, our specialty credit mandates significantly outperformed the rest of the fixed income asset class – which contributed to our 2012 investment performance.

What investment challenges did OPB face in 2012?

The Plan did face some challenges in 2012. In particular, market volatility continued to be a challenge, fuelled by the ongoing debt crisis in Europe and fiscal uncertainty in the U.S. At the same time, the outlook for global recovery was sensitive to China's efforts to stimulate its economy. In addition, interest rates continued to hover at historic lows, which resulted in continued upward pressure on pension liabilities and a challenging environment for finding yield across all asset classes.

What strategies are in place to manage/mitigate ongoing market volatility?

We have a number of strategies and tools in place to navigate through this volatility. For example, we have increased our exposure to real estate and infrastructure, which typically generate a larger component of their return from relatively stable cash flows. We have also chosen to work with public market investment managers who place greater emphasis on capital preservation. In addition, we have increased our use of derivative overlays to create overweight or underweight positions that take advantage of short-term market movement. On the operations side, we are upgrading our data management, analytic and performance management systems to better track investments and help us identify and avoid unnecessary risk.

What steps did you take to move forward with the strategic asset allocation (SAA) approved by the Board in late 2011?

We actively searched for opportunities to increase our exposure to alternative investments. By year-end, we were tracking ahead of schedule in terms of reaching our target allocation for real estate, infrastructure and private equity. How quickly we build up the private markets portfolio will depend on the quality of investment opportunities available. Our priority is to identify good investments with strong return potential.

In the past, OPB has talked about increasing its exposure to private market investments. Was that accomplished in 2012?

Yes. OPB increased exposure to real estate and infrastructure and made its first private equity investments in 2012. We also participated in a bid for Primaris Real Estate Investment Trust.

Our real estate portfolio continued to be a source of strength for the Plan – delivering solid returns, reliable cash flow, and a hedge against inflation. In 2012, we concluded a three-year plan to upgrade or sell properties that no longer meet our requirements. Having established a strong core of Canadian properties, we are taking a more opportunistic focus globally with an emphasis on capital growth.

OPB issued bonds for the first time in 2012. What does this mean for the Plan?

The bond offering is significant for two reasons: it gives us an opportunity to enhance investment returns and it provides a hedge against future rises in interest rates. The bond offering provided OPB with access to low-cost financing. This money has been reinvested in high-quality real estate that generates a cash flow greater than the amount needed to cover the interest payments on the bonds. In short, it has enabled OPB to enhance returns in a cost-effective manner. Prior to the bond offering, the OPB bond issue received an AAA credit rating from Standard & Poor's. This is the highest rating that can be assigned to a bond issue by a credit rating agency. This rating and the fact that the offering was oversubscribed are clear endorsements of OPB and its management.

Interest rates are at historic lows. How does this impact the plan and what is OPB doing about it?

Low interest rates affect both the asset and liability sides of the pension funding equation. On the liability side, lower interest rates increase estimated pension liabilities. This is because interest rates are used to calculate the present value of future pensions; the lower the interest rate, the higher the present value. From an asset perspective, low interest rates mean lower returns from interest-bearing investments, such as bonds and mortgages. To mitigate the effects of low interest rates on our fixed income returns, we have decreased our exposure to fixed income assets and increased our exposure to higher-returning alternative investments, such as real estate and infrastructure. The OPB bond offering issued at historically low interest rates increases our real estate returns.

Straight talk: Jill Pepall, CIO (continued from page 7)

What is the investment outlook for 2013?

Economic growth in the developed world, although improving, is expected to remain sub-par. Governments are still focused on reducing high debt levels and maintaining a low interest rate environment to try and stimulate the economy. Emerging economies are expected to perform better as they are not burdened by the high debt levels of the developed world. Equity markets will remain volatile. On the one hand, they will benefit from improving economic growth and corporate earnings, but will also be subject to instability surrounding the European political situation, as well as U.S. fiscal issues. OPB is well positioned to manage through these uncertainties. And, more importantly, we have the strategies and expertise needed to generate value-added results in today's challenging investment climate.

We value your feedback! Let us know your thoughts on this condensed version of the report. Email us at **feedback@opb.ca.**

Effective governance

OPB is governed by a nine-member Board of Directors. The Board holds ultimate responsibility for the Plan. That said, the Board has delegated responsibility for the day-to-day operations of the Plan – including administration and asset management – to OPB's management team. It has also delegated specific responsibilities to five committees of the Board, including a Governance & Conduct Committee, Investment Committee, Audit Committee, Pension Committee, and Human Resources Committee.

Board members are directly accountable to the Plan's beneficiaries (members and retired members), the Government of Ontario (the Plan Sponsor), and the Financial Services Commission of Ontario (the government agency that oversees registered pension plans in Ontario).

The Board is committed to governance best practices and continues to make improvements to stay at the forefront. For example, in 2012, the Board implemented a Governance Improvement Action Plan. This action plan incorporates recommendations stemming from a third-party review conducted in 2011.

Good governance – it's about trust, transparency and delivering value-added benefit to our clients and stakeholders.

Directory of key personnel

Mark J. Fuller
President & CEO

Jill Pepall
Executive Vice-President & CIO

Peter Shena
Senior Vice-President,
Pensions & Stakeholder Relations

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

Duncan D. Webb
Senior Vice-President,
Finance & Technology

Anne Catherall
Vice-President, People
& Corporate Services

Thomas Choi
Vice-President, IT Services
& Enterprise Solutions

Glenn Hubert
Vice-President, Private Debt

Tanya Lai
Vice-President, Public Markets

Sean Macaulay
Vice-President, Private Markets

Brian Whibbs
Managing Director, Real Estate

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OPB
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