OPTrust

OPSEU Pension Trust

Fiducie du régime de retraite du SEFPO

# For you. About you.

2006 ANNUAL REPORT

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2006 highlights

# OPSEU Pension Trust

With assets under management of $13.1 billion, the OPSEU Pension Trust (OPTrust) manages one of Canada's largest pension funds and administers the OPSEU Pension Plan, a defined benefit plan with more than 77,000 members and pensioners.

**IN 2006, OPTRUST:**

- ACHIEVED AN INVESTMENT RETURN OF 13.4%, EXCEEDING BOTH THE LONG-TERM FUNDING TARGET AND MARKET BENCHMARKS
- CONTINUED TO DIVERSIFY OUR INVESTMENT PORTFOLIO TO REDUCE VOLATILITY AND RISK
- USED FUNDS SET ASIDE FROM THE GAINS OF EARLIER YEARS TO MAINTAIN MEMBER AND EMPLOYER CONTRIBUTION RATES AT NORMAL LEVELS

Since OPTrust's launch in 1995, we have worked to provide service and security to the members and retirees of the OPSEU Pension Plan. Our mandate reflects three key objectives:

- GENERATING A LONG-TERM RATE OF RETURN ON INVESTMENTS THAT SUPPORTS OUR PENSION PROMISE
- DELIVERING THE FINEST SERVICE AND COMMUNICATIONS TO OUR MEMBERS AND PENSIONERS
- ENSURING MEMBERS AND PENSIONERS HAVE A REAL VOICE IN THE PLAN, THROUGH JOINT TRUSTEESHIP

At a glance

# 2006 Highlights

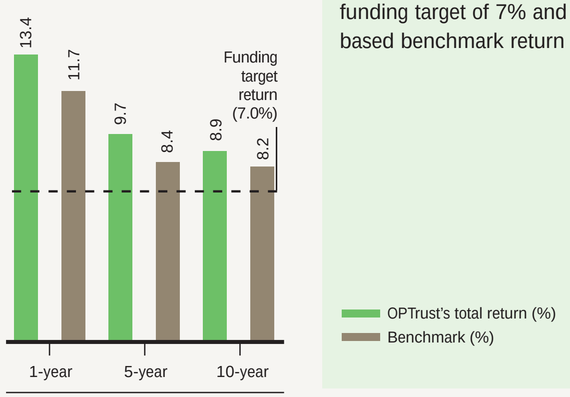
## FINANCIAL HIGHLIGHTS

| At December 31 ($ millions) | 2006 | 2005 (Financial statement valuation) | 2005 (Interim actuarial valuation) |
|---|---|---|---|
| Current cost of future pensions | **$ 10,460** | $ 9,944 | $ 10,913 |
| Actuarial smoothing adjustment | **1,341** | 899 | 973 |
| Rate stabilization funds | **427** | 446 | 446 |
| Unallocated surplus/(deficit) | **911** | 526 | (517) |
| Net assets available for benefits | **$ 13,139** | $ 11,815 | $ 11,815 |

## MEMBERSHIP SNAPSHOT

| At December 31 | 2006 | 2005 |
|---|---|---|
| **Active members** | **46,208** | 44,568 |
| **Former members with entitlements in the Plan** | **608** | 1,240 |
| **Pensioners** | | |
| Current | **22,058** | 21,439 |
| Deferred | **8,703** | 8,422 |
| **Total members and pensioners** | **77,577** | 75,669 |
| Number of new members enrolled | **4,373** | 3,400 |
| Number of members terminating or retiring | **3,365** | 3,168 |
| **Change in total membership** | **1,008** | 232 |

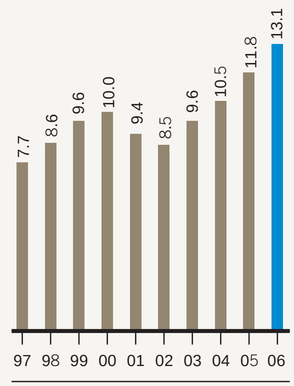
## INVESTMENT PERFORMANCE




Strong investment returns of 13.4% in 2006 exceeded both our long-term funding target of 7% and our market-based benchmark return of 11.7%.

## NET ASSETS AVAILABLE FOR BENEFITS

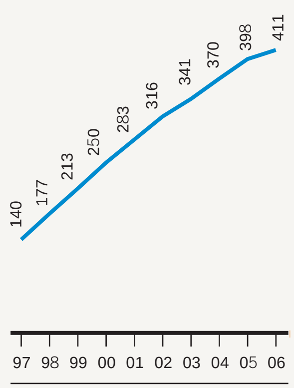
At December 31 ($ billion)




The Plan's net assets increased to $13.1 billion in 2006, driven by investment earnings of $1.5 billion.

## GROWTH IN PENSION PAYROLL

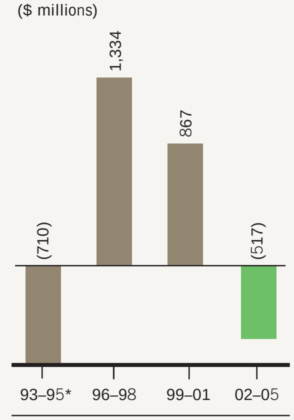
($ millions)




OPTrust's pension payroll continued to grow as increasing numbers of people reached retirement age and retiree pensions rose to offset the impact of inflation.

## ACTUARIAL FUNDING GAINS AND LOSSES

($ millions)




An interim actuarial valuation carried out at the end of 2005 indicated a total funding deficit of $517 million, reflecting investment losses from 2001 and 2002.

* includes balance of initial unfunded liability as at Dec. 31, 1995

Message

# Message from the Chair and Vice-Chair

**2006 HIGHLIGHTS**

- > THE PLAN'S FINANCIAL POSITION CONTINUED TO STRENGTHEN
- > INVESTMENT RETURNS EXCEEDED THE FUNDING REQUIREMENT FOR THE FOURTH CONSECUTIVE YEAR
- > DIVERSIFICATION INTO REAL ESTATE AND PRIVATE MARKETS CONTINUED
- > ASSET/LIABILITY STUDY COMPLETED AND FUNDING POLICY DEVELOPED FOR SPONSOR CONSIDERATION

We're pleased to report that OPTrust ended 2006 in excellent financial shape. Investment gains exceeded our funding requirement for the fourth year in a row and the investment losses from earlier in the decade are now behind us.

Those investment losses have created a funding deficit of $517 million, according to our most recent interim actuarial valuation, which was completed for the end of 2005. Offsetting that funding deficit, however, the Plan had $1.3 billion in deferred investment gains at the end of 2006.

As a result, if the Plan meets its targeted investment results in 2007, the actuarial valuation that we will file with pension regulators for the three-year period ending December 31, 2007, should indicate that our existing deficit has been eliminated and an actuarial gain has emerged.

What is particularly gratifying about this projected change in the Plan's funded status is that it has been achieved without the need for increases in member or employer contribution rates above their normal levels. It has also been accomplished without reducing benefits.

The strong financial status of OPTrust is a testament to the prudent financial path that has been followed by management, Trustees and sponsors since the Plan's inception in 1995. The current Board and management are committed to maintaining this tradition of prudence. We are committed to ensuring the security of the benefits that form the core of our pension promise to members and pensioners.

One of the major ongoing challenges we face in keeping our pension promise is the significant volatility that is inherent in investing in public markets for stocks and bonds. Investing in public markets has been necessary to ensure that the assets in the Plan grow enough to support pension payments that may last 30 years or more, indexed for inflation. However, investing in stocks and bonds brings with it the certainty that, in some years, losses will occur.

To help mitigate the impact of investment volatility, OPTrust recognizes investment gains and losses from any one year in equal increments over a period of five years. Even with this smoothing effect, however, the volatility of public markets could eventually require such measures as changes to contribution rates, which we have seen with other pension plans.

**Jordan Berger**
Chair

**Tony Ross**
Vice-Chair

## Portfolio Diversification

That is why the Board of Trustees has, in recent years, authorized a significant diversification of the Plan's assets away from public bonds and stocks – first into real estate and more recently into private markets investments. Over the past three years, real estate investments have grown to more than 5% of the total assets, worth more than $700 million at the end of 2006. These investments will ultimately make up about 10% of our portfolio.

In 2005, the Trustees approved an allocation to private markets investments, including target allocations to both private equity and infrastructure. These allocations will be implemented gradually, over a period of years. During 2006, activities centered on building the organizational capability to acquire and manage private equity and infrastructure investments. Toward the end of the year, OPTrust made its first private markets investment of $228 million in a European regulated utility.

Given the importance of matching the long-term, indexed liabilities of the Plan with an appropriate mix of assets, the Board authorized an in-depth, asset-liability study that was completed in 2006. The study, which was carried out by an external consulting firm, confirmed that our existing asset mix – with the changes we are already making by investing in real estate and private markets – represents an appropriate match for the liabilities of the Plan.

Another major undertaking during the year was the development of a funding policy for the Plan. The new policy confirms in writing the best practices that were already being undertaken in areas such as funding objectives, procedures for monitoring and reporting the financial health of the plan, and recommended principles for the use of any future surpluses. The draft policy was provided to the sponsors for their consideration in early 2007.

Once again in 2006, stabilization funds were used to cover payments on the unfunded liability that resulted from investment losses in 2001 and 2002. Those stabilization funds were set aside by the sponsors from part of the gains that arose from strong investment returns in the mid-to-late 1990s. Without the use of stabilization funds, members and employers would have been required to pay additional contributions above normal levels to cover the funding deficit. Stabilization funds will be used again in 2007 to avoid a contribution rate increase.

## Service Excellence

OPTrust is committed to providing excellent service that meets the evolving needs of members and pensioners.

One important element of the evolution in recent years has been the development of a website that provides continuous access to a growing body of pension-related information. As well, the addition of interactive capabilities has enabled members and pensioners to perform routine functions such as changes to beneficiary and address information, thus allowing the Plan's highly trained staff to devote additional time to dealing with more complex pension questions.

During 2006, the OPTrust public website was further upgraded to enable members and pensioners to customize their view of the web pages, so they can receive information that is most relevant to them.

In order to track service quality, we conduct quarterly surveys of a random sample of people who have had recent service dealings with the Plan. In 2006, the Plan achieved a service rating of 8.3, compared with 8.5 the previous year.

## Governance Highlights

The strength of OPTrust's governance structure starts at the top with the committed and active involvement of the Board of Trustees. Through our direct involvement in the development of policies on funding, asset mix, investment structure and performance monitoring, Trustees build a thorough understanding of a range of governance issues.

The existence of clear-cut policies, in turn, creates a framework of clarity, understanding and accountability that enables management to make well-informed decisions and proactively manage risks and volatility.

Another important contributor to the discharge of the Board's governance responsibilities is the existence of effective control systems. The Board has delegated the authority for the oversight of internal control procedures to the Audit Committee, which determines the effectiveness of these procedures and monitors compliance with OPTrust's policies. The Audit Committee requires management to implement and maintain appropriate systems of internal controls and meets with OPTrust's external auditors and audit partner to oversee the effectiveness of these systems.

To help us meet our fiduciary obligations regarding pension governance, the Board completed a pension governance audit in 2006. David Beatty, a strategy professor at the Rotman School of Management at the University of Toronto and managing director of the Canadian Coalition of Good Governance (an organization that OPTrust supports) was invited to assist in the audit.

As part of the audit, Trustees developed a governance self-assessment survey that covered a range of matters such as roles and structure, decision-making, culture, relations with management and strategic planning. Responses to the survey resulted in a number of changes, including an increase in the number of Trustee appointments to the Audit and Governance and Compensation committees from four to six Trustees, as well as various other enhancements to the monitoring processes within OPTrust.

During 2006, the Trustees began a review of the Statement of Investment Policies and Procedures to identify potential enhancements that can be made to emphasize the role of environmental, social and corporate governance considerations in investment decisions made by OPTrust and our external managers.

The Board encourages senior management to bring managers into board meetings from time to time to provide additional insight into the items being discussed. These managers also benefit from their exposure to the Board. While management develops the corporate strategy, the role of the Board is to review, question, and approve the strategic plan.

## Board Changes

At year end, Deb Stark stepped down both as chair and as a trustee of the OPTrust Board. We know we speak on behalf of the entire Board, as well as the senior management of the Plan, in extending to Deb our sincerest thanks and best wishes for the future. In her tenure with the Board – and particularly as chair – Deb dealt conscientiously with a range of important issues to members and pensioners. Her wise counsel and considerate nature will be missed by all.

Protecting the pension promise and respecting our fiduciary commitments to Plan members and retirees is both a major responsibility and a significant personal commitment for members of the Board and OPTrust staff. We are grateful to our fellow Trustees and to our professional staff for their care and dedication to the interests of more than 77,000 members and pensioners.

Chair

Vice-Chair

# A very good thing

Emily Bartlett works in the Ministry of Health and Long-Term Care's central laboratory in Toronto, helping to prevent the spread of disease by identifying potentially dangerous pathogens like the SARS virus. She's been a member of the OPSEU Pension Plan for about a decade and is looking forward to retirement in the next few years to travel and spend more time with her children and grandchildren.

"I've kept in touch with colleagues who've retired and they are very happy that they can count on the stability and good financial cushion provided by their OPTrust pension. And I personally think it's a very good thing that we have some control over our pensions through OPSEU's participation in the Plan."

Services

# Membership Services

**2006 HIGHLIGHTS**

- > WEBSITE FUNCTIONALITY ENHANCED
- > EMPHASIS ON PROACTIVE SERVICES INCREASED
- > PUBLICATION SURVEY UNDERWAY

One of OPTrust's key objectives is to provide excellent service and communications to its pensioners and members – the men and women who have spent or will spend their working lives serving the people of Ontario.

To achieve that goal, the Plan has developed a highly trained staff, created an interactive website with growing functionality, and produces a full range of informative publications, including this annual report and an abridged version specifically for members.

During recent years, OPTrust has devoted considerable effort to improving the timeliness of service to members and pensioners. In 2006, the number of cases overdue for more than 30 days was 3.7%, well below the target level of 10% of total cases. This is quite an aggressive target because about one in five cases is delayed for reasons beyond the control of OPTrust – for example, waiting for information from other pension plans or employers.

## Proactive Target Set

With service backlogs eliminated, the emphasis has now shifted to creating enhanced proactive initiatives. The Plan will further enhance efforts to inform members and pensioners on matters or issues of importance to them.

This is particularly vital in the pension field because many options – such as buying back credits lost during a leave – are only available for a specified period. If they are not exercised within that period they will be lost forever.

OPTrust has established a target that 10% of all service transactions during any given year should be proactive initiatives. During 2006, about 10,400 transactions – or 14% of the total – were proactive undertakings.

In addition to those initiatives, OPTrust continued a program begun the previous year to send detailed pension estimates annually to all Plan members 55 years of age or older. The detailed estimates provide information on the amount of pension that members would be eligible to receive for each year up to the age of 65. Previously, estimates were made available only on request. The purpose of the detailed annual estimates is to provide members with specific information that will assist them in the retirement planning process.

During 2006, OPTrust also contacted all unclassified employees who have the option of joining the Plan to inform them about the benefits of membership.

## Website Enhancements

During recent years, based on research with members and pensioners, OPTrust has steadily increased the functionality and information content of its public website, as well as developing a secure, password-protected section of the site called *Online Services*.

Enhancements to the public website in 2006 included:

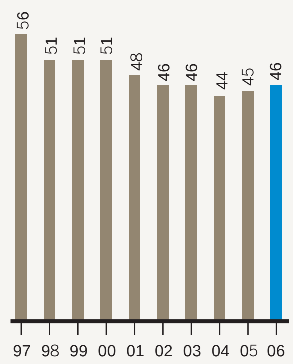
> The addition of a feature that enables members and pensioners to customize, and save for subsequent visits, the way website information is presented to them, based on their membership category.

> A new section of the homepage entitled “Hot Topics” provides questions and answers on newsworthy issues that are generating a large volume of phone calls or correspondence. The information can be easily accessed by visitors to the website, who can then perform a quick evaluation that indicates whether or not the information was helpful in answering their questions.

Also during the year, a usability study was conducted on the *Online Services* section of the site. Selected members and pensioners were asked to perform various tasks by a usability expert, who recorded their responses and comments. Changes to *Online Services* based on this feedback have now begun and will be completed during 2007.

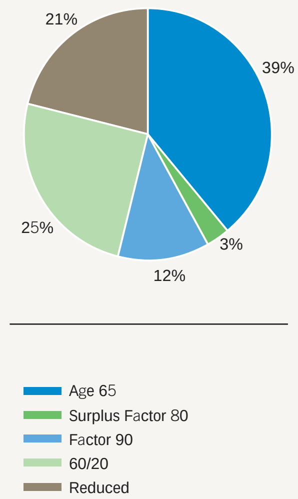
## OPTrust's ACTIVE MEMBERSHIP

At December 31 (thousands)




Active membership grew by nearly 4% in 2006 as the following members were added: certain court employees whose membership became mandatory; a group of correctional officers who rejoined the Plan; and employees with optional membership in the Plan who were proactively informed by OPTrust that they were eligible to join.

## 2006 RETIREMENT SNAPSHOT




**Age 65:** The normal retirement age under the OPSEU Pension Plan
**Surplus Factor 80:** For members who are laid off prior to January 1, 2009, and whose age and years of service total 80
**Factor 90:** Age plus years of credit total at least 90
**60/20:** Age 60 or older plus at least 20 years of credit
**Reduced:** Available starting at age 55 to vested members who do not qualify for an unreduced pension
**Note:** Chart does not include deferred, disability or survivor pensions

## MEMBERSHIP SERVICES
CONT'D

During 2006, the number of people registered to use *Online Services* grew substantially to 14,300, up from about 9,200 in 2005. This section of the site allows registered users to perform a wide range of tasks, including:

> Buying back leave of absence pension credits online

> Viewing online monthly updates to Pension Information Change Statements, including the current deposit amount

> Checking and updating personal and beneficiary information

> Viewing and printing T4A slips well in advance of mailing

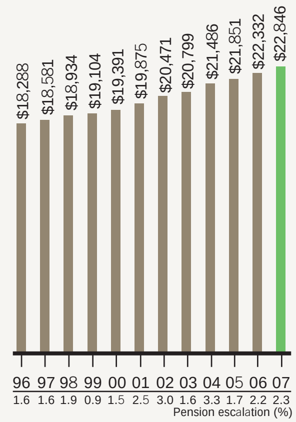
> Viewing and printing an Annual Pension Statement, and

> Asking questions, exchanging information and receiving answers in a special message area that is more secure than normal e-mail.

As more routine transactions are carried out by members and pensioners themselves through *Online Services*, the Plan's trained service representatives are able to devote more time to providing assistance with more complex pension situations. This is important because many pension decisions, once made, are irrevocable.

Also as a result of the increased number of "self-serve" transactions carried out by members and pensioners, the total number of transactions processed by staff during the year decreased slightly to 58,300 from about 60,000 in 2005.

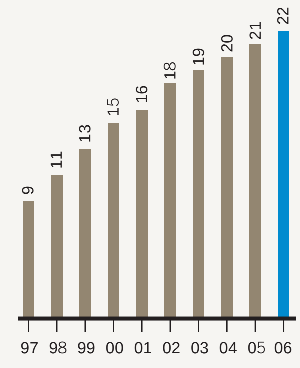
### INFLATION PROTECTION FOR PENSIONERS




OPTrust pensions are adjusted annually for inflation. A pensioner who received a typical annual pension of $18,000 in 1995 will receive $22,846 in 2007.

### OPTrust's CURRENT PENSIONERS

At December 31 (thousands)




The number of OPTrust pensioners continued to grow in 2006, supported both by demographic trends and the availability of flexible retirement options.

## Survey Results

Since 2001, OPTrust has been surveying members and pensioners on a quarterly basis to measure the level of satisfaction with the services provided.

During 2006, more than 7,800 surveys were distributed to a random sample of members and pensioners who had contacted the Plan with a variety of pension-related requests. About 14% of those contacted responded to the survey, enough to provide a valid sample of opinion. The results showed that overall satisfaction with our service was 8.3 out of 10, down slightly from 8.5 in 2005.

Despite the increased use of the website, the dominant method of contacting OPTrust for most members and pensioners continues to be by telephone. During 2006, more than 47,200 phone calls were received from members and pensioners, with an average response time of 11 seconds. More than 98% of those who call us get to talk to a “real person” rather than hearing a recorded message. We are proud of this level of personal service.

## Member and Pensioner Population

The number of OPTrust current pensioners continued to grow, reaching 22,058 at the end of 2006, compared with 21,439 at the end of the previous year. Of the Plan’s new pensioners during the year, about 80% retired with an unreduced pension under one of the Plan’s early retirement options.

The number of active members in the Plan grew by about 4% to 46,208 in 2006, from 44,568 at the end of the previous year. Major additions included the following: certain court employees whose membership became mandatory; a group of correctional officers who rejoined the Plan; and employees with optional membership in the Plan who were proactively informed by OPTrust that they were eligible to join.

## Inflation Protection

The OPTrust Pension Plan is indexed for inflation, providing an important measure of purchasing-power protection for current and future pensioners. On January 1, 2006, payments to pensioners were increased by 2.2% to reflect changes in the Consumer Price Index. On January 1, 2007, indexing resulted in a further 2.3% increase in pension payments for the coming year.

Since the Plan’s inception in 1995, the typical pension paid has increased from $18,000 to a total of $22,846 as a result of the inflation protection contained in the pension promise to members.

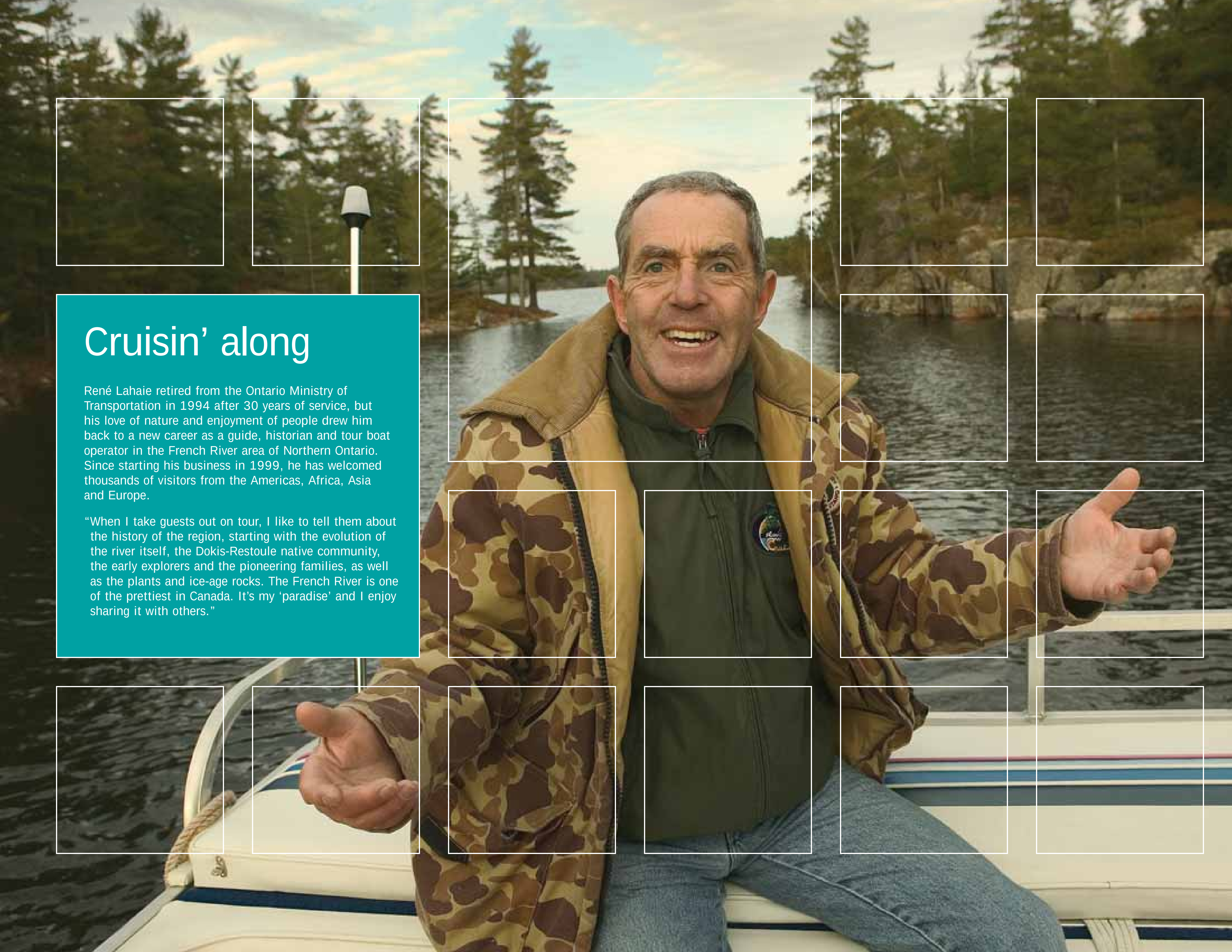
# Member statistics

**Membership statistics**

| (at December 31) | **2006** | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|---|---|---|---|---|
| Active members | **46,208** | 44,568 | 44,243 | 45,836 | 46,361 | 48,221 | 50,993 | 51,363 | 51,491 | 56,177 |
| Female/male ratio | **60:40** | 60:40 | 59:41 | 59:41 | 58:42 | 59:41 | 58:42 | 56:44 | 55:45 | 54:46 |
| Average age | **44.9** | 44.7 | 44.4 | 44.3 | 44.2 | 44.0 | 44.0 | 44.0 | 43.9 | 43.7 |
| Average salary | **$51,896** | $50,627 | $49,085 | $46,922 | $45,232 | $43,055 | $42,017 | $42,112 | $40,646 | $40,232 |
| Average years of credit in the Plan | **11.6** | 11.6 | 11.5 | 11.3 | 11.4 | 11.6 | 12.0 | 12.2 | 12.4 | 12.3 |
| Number of new members enrolled | **4,373** | 3,400 | 3,917 | 3,935 | 3,120 | 4,237 | 3,640 | 3,882 | 2,854 | 1,737 |
| Number of members terminated or retiring | **3,365** | 3,168 | 9,358 | 3,605 | 4,598 | 5,971 | 4,440 | 3,740 | 4,474 | 6,284 |
| Former members with entitlements in the Plan* | **608** | 1,240 | 1,333 | 5,181 | 4,326 | 3,944 | 2,906 | 3,336 | 3,066 | – |
| Net change in total members | **1,008** | 232 | (5,441) | 330 | (1,478) | (1,734) | (800) | 142 | (1,620) | (4,547) |
| Deferred pensioners** | **8,703** | 8,422 | 7,973 | 4,610 | 4,252 | 3,206 | 1,929 | 1,116 | 597 | 412 |
| Current pensioners | **22,058** | 21,439 | 20,246 | 18,977 | 17,713 | 16,282 | 14,711 | 12,971 | 11,024 | 9,001 |
| Average age | **65.3** | 64.5 | 63.9 | 63.4 | 62.6 | 64.0 | 63.0 | 62.0 | 60.0 | 60.0 |
| Average annual pension | **$18,697** | $18,642 | $18,616 | $18,430 | $18,434 | $17,963 | $17,734 | $17,615 | $17,370 | $17,390 |
| Current pensioners by type of pension | | | | | | | | | | |
| Normal and early unreduced | **17,638** | 17,318 | 16,653 | 16,180 | 15,199 | 14,079 | 12,747 | 11,286 | 9,569 | 7,839 |
| Reduced | **2,656** | 2,528 | 2,168 | 1,466 | 1,376 | 1,274 | 1,163 | 1,021 | 908 | 734 |
| Eligible survivors | **1,691** | 1,541 | 1,378 | 1,289 | 1,107 | 911 | 792 | 656 | 540 | 423 |
| Disability | **73** | 52 | 47 | 42 | 31 | 18 | 9 | 8 | 8 | 5 |
| Total members and pensioners | **77,577** | 75,669 | 73,795 | 74,604 | 72,652 | 71,653 | 70,539 | 68,786 | 66,178 | 65,590 |

* "Former members with entitlements in the Plan" includes members whose termination or divestment was unprocessed at year-end.

** "Deferred pensioners" includes members whose termination or divestment has been processed and who continue to have assets in the Plan.



# Cruisin' along

René Lahaie retired from the Ontario Ministry of Transportation in 1994 after 30 years of service, but his love of nature and enjoyment of people drew him back to a new career as a guide, historian and tour boat operator in the French River area of Northern Ontario. Since starting his business in 1999, he has welcomed thousands of visitors from the Americas, Africa, Asia and Europe.

"When I take guests out on tour, I like to tell them about the history of the region, starting with the evolution of the river itself, the Dokis-Restoule native community, the early explorers and the pioneering families, as well as the plants and ice-age rocks. The French River is one of the prettiest in Canada. It's my 'paradise' and I enjoy sharing it with others."

# Investment Performance

## 2006 HIGHLIGHTS

- > OVERALL INVESTMENT RETURNS OF 13.4% EXCEEDED THE LONG-TERM FUNDING TARGET OF 7% AND THE BENCHMARK RETURN OF 11.7%
- > GLOBAL EQUITIES RETURNED 23.8% VERSUS BENCHMARK PERFORMANCE OF 21.1%
- > CANADIAN EQUITIES RETURNED 18.6% VERSUS 17.0% FOR THE BENCHMARK
- > FIXED INCOME INVESTMENTS RETURNED 2.2% VERSUS BENCHMARK PERFORMANCE OF 2.1%
- > ACTIVE MANAGEMENT STRATEGIES ADDED $120 MILLION IN VALUE

During its first 12 years of operation, the OPSEU Pension Plan has achieved an average rate of return of 10.6% on its investments, exceeding the 12-year weighted return of 9.6% on its composite benchmark by a significant margin.

The Plan's overall investment return in 2006 was 13.4%, compared with 15.6% in 2005. The weighted return on its composite benchmark was 11.7% in 2006. This performance translated into investment income of $1.5 billion in 2006, compared with $1.6 billion the previous year.

## 2006 Investment Overview

In 2006, returns from Canadian and global equity markets continued to be very positive. The strong performance of the Canadian equity market was led by the materials and information technology sectors. The S&P/TSX Composite Index returned 17.3% during the year, compared with 24.1% in 2005.

Markets in the United States improved considerably from the previous year, although they didn't match the performance of Canadian or global markets. In 2006, the S&P 500 Index returned 15.8% in U.S.-dollar terms (15.4% in Canadian dollars), compared with 4.9% in 2005.

Returns from the Canadian bond market were lower than the previous year. The SC Universe Bond Index had a total return of 4.1% in 2006, down from 6.5% in 2005.

*Global Equities*

Global equities, which include stocks from the United States, Europe, Asia and other developed and emerging markets, make up the largest component of the Plan's current investment portfolio. The return on this group of investments was 23.8% during the year, compared with 16.7% in 2005. By comparison, our weighted global equity benchmark returned 21.1% in 2006.

In 2006, the active management structure employed for most of our global equity investments added net value of $72.8 million, with five out of eight actively managed global equity portfolios outperforming their benchmarks.

Since inception, our global equity portfolio has generated an average annual return of 10.2%, versus 9.6% for our combined foreign equity benchmark.

*Canadian Equities*

Canadian equities, which constitute the third-largest component of the Plan's portfolio, returned 18.6% in 2006, compared with 22.1% the previous year.

The return on our weighted benchmark index was 17.0% in 2006. The 1.6% outperformance was mainly attributable to strong stock selection in some of the Plan's actively managed portfolios.

*Fixed Income*

Canadian fixed income investments such as bonds and debentures, which constitute the second-largest component of the Plan's portfolio, returned 2.2% in 2006, compared with 9.7% the previous year. This compared with a return of 2.1% on the Plan's fixed-income benchmark, which includes real return bonds.

With their lower risk profile, fixed income investments are expected to return less than equities over the long term. However, they tend to provide greater certainty of returns than stocks, pay predictable income and are an important source of diversification for the overall portfolio.

Within the fixed-income portfolio, real return bonds had the only negative result during the year, with a loss of 3.2%, compared with a loss of 2.9% on the benchmark. Reductions in the price of real return bonds were caused by higher real interest rates (nominal interest rates minus the rate of inflation) and changing perceptions about future inflation.

*Currency*

Given the size of the Plan's foreign equity holdings, which represent about one-third of our total assets, changes in the value of the Canadian dollar versus other currencies can have a significant impact on the portfolio. To counter this we have implemented a strategic currency hedging program that is aimed at reducing the volatility of returns from foreign equity markets.

During 2006, key European currencies such as the Euro and British pound appreciated significantly against the Canadian dollar. In the absence of hedging, this appreciation would have increased our returns from investments based in those currencies. With hedging, returns were lower than they would otherwise have been, resulting in a loss from European currency hedging.

This loss was partly offset by gains from the hedging program resulting from the appreciation of the Canadian dollar versus its U.S. counterpart and the Japanese Yen. However, the aggregate result from the Plan's strategic currency hedging program was a loss of $47.5 million in 2006.

A separate program for currency management at OPTrust allows our currency manager to make short-term tactical allocations to major global currencies. This program resulted in a gain of $5.5 million.

The net result of currency management activities for public markets at OPTrust during 2006 was a loss of $42 million.

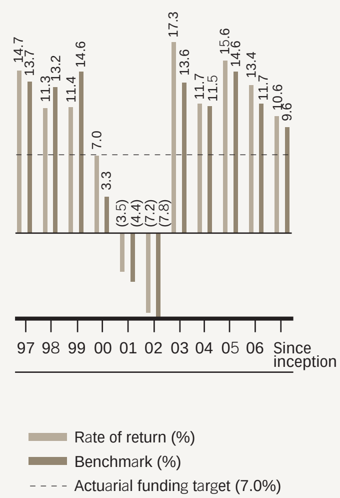
*Real Estate*

In 2006, OPTrust's real estate portfolio received further funding for new investments, bringing the Plan's total allocation to 5.5% of assets, up from 4.2% at the end of 2005.

The real estate portfolio posted returns of 12.5% during the first three quarters of 2006, compared with 14.7% for the full year of 2005. During 2006, the Plan adopted the policy of delaying performance reporting on real estate by one calendar quarter to ensure greater reporting accuracy. Performance results from real estate for 2006 include only the first nine months of the year. Performance figures in subsequent years will include the 12-month period from one September 30th to another.

RETURNS VS. BENCHMARKS

1997 – 2006




OPTrust's investment portfolio has outperformed the Plan's market-based benchmark for the past seven years and returns continue to exceed the long-term return target by a significant margin.

The prorated return on our real estate benchmark was 4.5% in 2006. The benchmark return target – 4% plus the rate of inflation – was prorated over the first nine months of the year to match the new reporting period for real estate assets and consisted of three-quarters of the return target of 4% (3%), plus three-quarters of the inflation rate in 2006 (1.5%).

The outperformance in 2006 was driven by strong capital appreciation in several of our real estate investment funds, as well as solid income returns from the entire portfolio.

## Investment Strategy Evolution

During 2006, the implementation of changes to the OPTrust investment portfolio continued.

The significant changes made in 2006 were:

> A reduction in the weighting of public equities

> Continued funding of the real estate portfolio

> Initial funding of private market investments in infrastructure.

*Real Estate*

Net investments in real estate rose to $716 million by the end of the year, from $491 million in 2005. This represented 5.5% of total Plan assets.

During the next several years, we plan to increase real estate investments to about 10% of Plan assets, at which time the total portfolio will be well in excess of $1 billion.

There are three main reasons for the decision to allocate a higher percentage of our investment portfolio to real estate:

> First, there is a low correlation between the performance of real estate and the performance of stock and bond markets, where most of the Plan's other assets are invested. Investments in real estate can therefore be expected to respond differently to economic circumstances than stocks or bonds. This diversification of assets provides more stable overall returns from the Plan's portfolio.

> Second, real estate tends to perform well during periods of expected inflation. It therefore provides an excellent match with our pension obligations, which also increase with inflation.

> And finally, real estate generates a steady stream of income that can be used to make ongoing pension payments.

*2006 Real Estate Investments*

OPTrust's strategy for the real estate portfolio is to hold a variety of investments that provide diversity by property type, geographical location, manager and investment style.

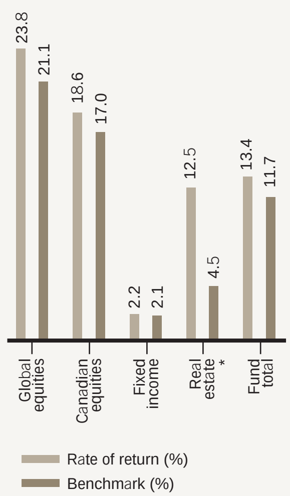
The Canadian portfolio consists of office, retail, industrial and multi-family properties that are owned by the Plan. In this regard, the five investment managers engaged by OPTrust to assist in the acquisition of directly held Canadian properties made the following investments representing over $84 million during the year:

> A retail shopping centre in Windsor, Ontario

> Industrial properties in British Columbia, Alberta, Saskatchewan and Ontario

> Apartment buildings in Ontario and Quebec.

2006 RETURNS VS. BENCHMARKS




Above-benchmark performances on all asset classes, led by robust returns on global equities, produced another year of strong investment results.

* For the first nine months of 2006

In addition, the Canadian portfolio also includes investments in pooled real estate funds. During the year, OPTrust committed $90 million to three domestic pooled real estate funds.

OPTrust believes that international real estate investments may help the real estate portfolio outperform its benchmark through enhancing portfolio returns and diversification. OPTrust advanced its investment strategy in international markets during 2006 by committing more than $130 million to three international pooled real estate funds.

*Private Markets*

The Plan's private markets initiative entails sourcing, structuring, acquiring and managing a target allocation of infrastructure and private equity investments.

Infrastructure investments include regulated assets like water, gas and electric utilities, transportation assets such as toll roads and airports, and long-term contracted assets like power-generating plants.

Private equity encompasses a wide range of investments, including mezzanine financing (a debt-like structure often used to fund the expansion of existing companies) and leveraged buyouts (a transaction used to purchase a relatively mature company, financed to a large degree by debt repaid through the cash flow of the acquired firm).

Highlights for the Private Markets Group in 2006 were building the organizational capability to carry out the approved investment strategy, as well as the funding of an initial $228 million infrastructure investment in a European regulated utility.

The private markets initiative is a long-term strategy approved by the Board of Trustees in 2005. The strategy is expected to be implemented over a period of years and will result in a diversified portfolio of infrastructure and private equity investments.

The expected benefits to the Plan from investing in private equity and infrastructure investments are:

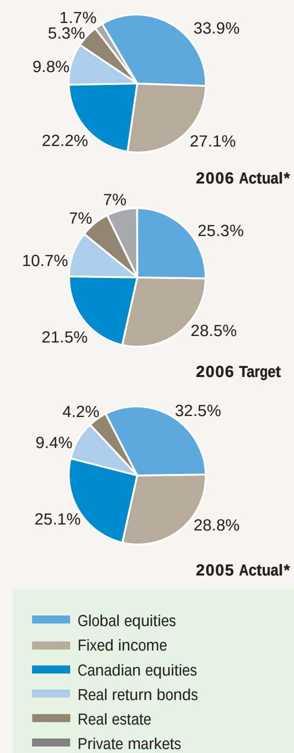
> Higher risk-adjusted returns from private equity assets, compared with public equities, which is expected to result from the direct involvement of the Plan's investment managers in structuring deals and in the ongoing management of the assets

> Improved diversification and lower expected volatility of Plan returns, resulting from the fact that private markets and public stock and bond markets do not necessarily move in the same direction at the same time

> Better matching of the Plan's indexed liabilities with the inflation sensitivity of infrastructure assets, due to the regulatory and contractual frameworks supporting the assets.

OPTrust's ASSET MIX*

(percent)



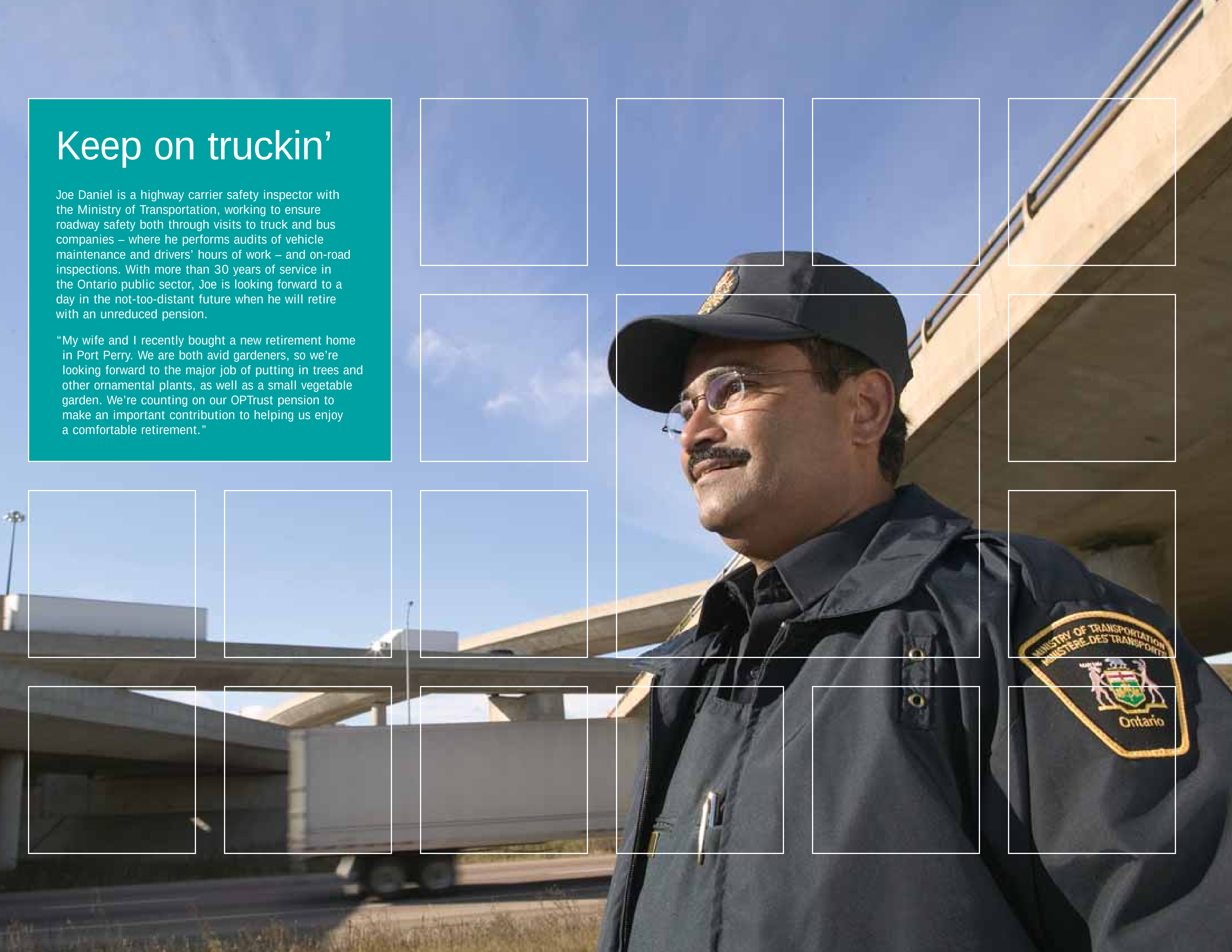

Investments in real estate and private markets increased to 7% of total assets in 2006, while the proportion of Canadian equity and fixed income investments decreased.

* Categories include temporary cash balances.

# Keep on truckin’

Joe Daniel is a highway carrier safety inspector with the Ministry of Transportation, working to ensure roadway safety both through visits to truck and bus companies – where he performs audits of vehicle maintenance and drivers’ hours of work – and on-road inspections. With more than 30 years of service in the Ontario public sector, Joe is looking forward to a day in the not-too-distant future when he will retire with an unreduced pension.

“My wife and I recently bought a new retirement home in Port Perry. We are both avid gardeners, so we’re looking forward to the major job of putting in trees and other ornamental plants, as well as a small vegetable garden. We’re counting on our OPTrust pension to make an important contribution to helping us enjoy a comfortable retirement.”



Funding

# Pension Funding

## 2006 HIGHLIGHTS

> AN INTERIM FUNDING VALUATION CARRIED OUT DURING THE YEAR INDICATED A DEFICIT OF $517 MILLION AT THE END OF 2005, COMPARED WITH A DEFICIT OF $428 MILLION AT THE END OF 2004

> STABILIZATION FUNDS WERE AGAIN USED IN 2006 TO MAINTAIN CONTRIBUTIONS AT NORMAL RATES

> THE PLAN'S FINANCIAL POSITION CONTINUES TO STRENGTHEN AS A RESULT OF ROBUST INVESTMENT RESULTS

One of the fundamental goals of OPTrust is to manage the contributions made by employers and members to ensure that funds are available to pay pension benefits as promised.

In order to confirm its ability to fund benefits, OPTrust – along with all other registered plans in Ontario – is required to complete a funding valuation that is filed with provincial regulatory authorities at least once every three years.

An actuarial funding valuation presents financial information about a pension plan in a manner prescribed by regulatory authorities. It is used to determine if there are losses that may affect contribution rates, or gains that can be distributed as benefit improvements or to reduce contributions at the discretion of the sponsors. Actuarial funding valuations are therefore an essential element in the overall management of a pension plan.

OPTrust's most recent filed funding valuation – for the one-year period ended December 31, 2004 – indicated an actuarial loss of $183 million for the period. That loss, when combined with the loss of $245 million remaining from the valuation filed the previous year, brought the total funding deficit to $428 million at the end of 2004.

## Interim Valuation Completed

During years when OPTrust does not complete a funding valuation for filing purposes, the Plan carries out an interim valuation. The purpose of these interim valuations is to ensure that the Trustees have access to up-to-date information on a variety of factors affecting the Plan's funding situation and that current decisions are based on accurate information.

Interim valuations employ the same methodology used to complete a filed valuation (see page 23 for an explanation of the methodology). However, the interim valuation is not based on as rigorous an examination of underlying data sources affecting the financial health of the Plan as a filed valuation. A filed valuation must also be certified by the Plan's independent actuaries: an interim valuation is not.

**Sources of gain and losses – 2005 funding valuation**
($ millions)

| | |
|---|---|
| Investment loss (primarily the amortization of investment losses from prior years) | (112) |
| Other economic experience gains | 122 |
| Demographic experience losses | (63) |
| Other losses | (54) |
| Total | (107) |

The interim valuation for 2005 was based on revised assumptions about inflation, investment returns and salary escalation that were modified as a result of a major study conducted in 2005 and approved by the Plan's Board of Trustees.

The valuation indicated a funding deficit of $517 million at the end of 2005, compared with $428 million at the same time the preceding year. The main reason for the change was the continued amortization of investment losses experienced by the Plan in 2001 and 2002.

## Stabilization Funds Being Used

Since OPSEU and the Government of Ontario jointly sponsor the OPSEU Pension Plan, both members and employers are equally responsible for making up any funding deficits (as well as sharing in the benefits of funding gains). A funding deficit would therefore normally trigger an immediate increase in member and employer contribution rates.

However, part of the funding gains that resulted from the strong investment performance of the Plan in the mid-to-late 1990s were set aside by both OPSEU and the Government of Ontario to create stabilization funds that could help offset any future funding deficits. These stabilization funds earn interest at the funding valuation interest rate.

In 2004, 2005 and 2006, both sponsors allocated $62 million each to reduce the funding losses identified in the two most recent filed funding valuations.

Allocations from stabilization funds will continue in 2007, which will avoid the need for any immediate increase in member or employer contribution rates.

At the end of 2006, the total amount in the members' stabilization fund was $161 million, compared with $174 million the previous year. The balance of the employer stabilization fund was $266 million, compared with $272 million the previous year.

The reason for the reduction in both cases was that the amounts used to meet the funding deficiency were larger than the interest earned on the stabilization funds.

## Financial Position Strengthens Further

The interim funding valuation completed for the end of 2005 showed deferred gains of $973 million. These gains resulted from strong investment returns between 2003 and 2005 and will be increased further by the Plan's investment performance in 2006. This large balance of deferred gains will continue to influence our financial position as it is recognized between now and 2010.

These deferred gains will help offset the impact of any downturns in stock or bond markets or any adjustments to assumptions resulting from changes in future conditions.

As well, members and employers still have the security of significant stabilization fund reserves to help offset future demands on contribution rates.

## Actuarial Assumptions Modified

The assumptions that a pension plan makes about factors such as inflation, investment returns, interest rates, salary increases and longevity can have a major impact on the current funding required by the Plan. In order to provide a measure of safety for keeping the pension promise, OPTrust uses assumptions that reflect a judicious assessment of current conditions, and reviews them regularly to ensure they continue to be appropriate.

Sensitivity analyses are also carried out to test the impact of potential changes to assumptions. As well, a margin of conservatism is included in assumptions about the inflation-adjusted rate of investment return on the Plan's assets.

In 2005, all of the Plan's significant economic and demographic assumptions were reviewed and the Board of Trustees approved the following changes:

> The assumed inflation rate was reduced to 3.0% from the previous rate of 3.5%

> Effective January 2006, the assumed long-term rate of return on the Plan's assets was reduced to 7.0% from 7.5%

> The assumed rate of increase in base pensionable earnings was reduced to 3.75%.

| | 2005 interim valuation | 2004 valuation |
|---|---|---|
| Investment return | 7.00% | 7.50% |
| Inflation rate | 3.00% | 3.50% |
| Salary escalation | 3.75%[2] | 4.50%[1] |

[1] 4.25% after two years, plus an amount for promotion, based on a long-term scale.
[2] Plus an amount for promotion, based on a long-term scale.

Risk

# Risk Management

**2006 HIGHLIGHTS**

> PRIVATE MARKET INVESTMENTS INITIATED
> EXPOSURE TO PUBLIC EQUITY MARKETS REDUCED
> FUNDING POLICY DEVELOPED

The primary responsibility of the OPSEU Pension Trust is to ensure that the pension entitlements earned by members during their working years are fully paid during their retirement years. A number of known risk factors could impair our ability to meet that commitment, so an important element of the Plan's overall activities is to ensure that those risks are effectively managed.

The risks fall into three main categories:

> Liability risk – arises if estimates of future pension obligations are too low. This could occur if future salary increases are higher than forecast, if inflation is greater than expected or if life expectancy improves significantly because of medical breakthroughs, among other factors.

> Investment risk – arises if average future returns on a pension plan's investment portfolio are lower than the long-term returns assumed in the overall funding plan.

> Operational risk – could arise from a lack of proper safeguards and controls that lead to higher expenses or asset losses.

## Managing Liability Risk

Liability management entails ensuring that estimates of the cost of future pensions are based on the best possible information, so that contribution rates and investment targets can be set at realistic levels to fund future pension entitlements.

Liability management strategies include:

> Establishing reserves such as stabilization funds that can be used to fund temporary shortfalls that would otherwise require member contribution rates to rise above normal levels

> Establishing asset-smoothing techniques that reduce the impact of investment volatility on a plan's funded position, and

> Adjusting the timing of actuarial valuations to better manage the impact of investment losses and gains.

In 2006, OPTrust developed a funding policy that formalizes our use of these strategies and also establishes or codifies funding objectives, procedures for monitoring and reporting the financial health of the plan, and recommended principles for the use of any future surpluses. The policy was submitted to the sponsors for their consideration and comment early in 2007.

## Managing Investment Risk

Approximately 93% of the Plan's total risk can be attributed to investments in public equities, even though they represent 56% of total assets. With this in mind, a long-term investment strategy is being implemented over several years with the objective of reducing both the Plan's reliance on the performance of public equity markets and the volatility of returns.

*Diversification*

An important milestone in asset diversification achieved in 2006 was an initial investment in the private markets asset category of infrastructure. Private market investments are targeted to grow during the next several years to 25% of total Plan assets. Infrastructure, similar to real estate, is considered to be an ideal investment for a pension plan with indexed liabilities because of its long-term inflation-hedging characteristics, which are a good match for the Plan's inflation-linked liabilities.

RISK MANAGEMENT CONT'D

*Rebalancing*

Rebalancing is a way of ensuring that the Plan's asset mix remains within the policy ranges that have been established for each portfolio. The need for rebalancing arises because different asset classes grow at different rates of return, over different periods of time.

For this reason, OPTrust has established a rebalancing policy to keep the Plan's asset mix within a specific percentage range above or below the target allocations for each asset class. The policy also provides for dynamic and flexible rebalancing of the investment portfolio, which allows us to consider short-term market conditions, as well as ensuring that the costs of rebalancing do not offset the expected benefits. A final consideration in the rebalancing policy is to ensure that there is always sufficient cash available to pay pension benefits and the operating expenses of the Plan as required.

## Active Risk Budgeting

The objective of active management for certain investment portfolios is to achieve returns that are higher than their index benchmark. However, the use of active management introduces the risk that the overall risk/return performance of a portfolio or an asset class will be less than the index alternative.

The goal of our risk budgeting process is to ensure that we manage the deployment of active management strategies appropriately both to achieve higher risk-adjusted returns and to manage the levels of risk taken by the Plan's active investment managers within specified limits.

## Currency Risk

Making foreign investments increases the diversification of the Plan, but it also introduces currency risk. Over the long term, fluctuations in foreign currencies are not expected to either add value to or subtract value from returns.

However, in the short term, changes in the value of the Canadian dollar versus other currencies can have a sizeable impact on investment returns. To manage currency risk, since 1998 the Plan, through external managers, has employed various products and strategies to manage or hedge our exposure to foreign currency.

Our policy consists of a passive strategy to hedge 50% of the currency exposure of our public foreign equity portfolios, with the exception of investments in emerging markets. We hedge 100% of the currency exposure from our foreign real estate and private market investments.

## Other Investment Risks

OPTrust's Board of Trustees recognizes that there can be certain reputational risks associated with investments. To help mitigate this risk, the Board has established a risk oversight committee to review potential investments.

Additional information on the Plan's approach to managing other investment risks is contained in Note 4 to the financial statements on page 37.

## Operational Risk

At OPTrust, we manage operational risk through a process that focuses on establishing clear objectives, identifying the risks related to those objectives and establishing processes to manage those risks.

OPTrust has put in place a program, which includes regular reporting to the Audit Committee, to systematically review areas of risk in our administrative operations, address potential concerns and incorporate best practices for managing risks on an ongoing basis.

In 2006, we completed a study of operational risks for activities related to plan administration and real estate, as well as updating our assessments for human resources and information technology.

*Changes to assumptions made by a pension plan can have a major impact on its funding requirements. The following table shows the impact of a 0.5% change in certain assumptions on the Plan's accrued pension benefits:*

**Sensitivity analysis of actuarial assumption changes** [1]

| ($ millions) | **+0.5%** | **-0.5%** |
|---|---|---|
| Assumed rate of inflation [2] | (47) | 50 |
| Assumed actuarial rate of return on plan assets | (649) | 727 |
| Assumed rate of pensionable earnings increases | 161 | (150) |

1 Assumes all other assumptions remain unchanged.
2 Assumes that real return rates and earnings remain unchanged.

# Financial Statement Overview

## 2006 HIGHLIGHTS

- NET ASSETS AVAILABLE FOR BENEFITS ROSE $1,324 MILLION TO $13,139 MILLION BY YEAR END
- DEFERRED INVESTMENT GAINS STOOD AT $1.3 BILLION AT YEAR END AND WILL BE RECOGNIZED DURING THE NEXT FIVE YEARS

The financial position of the OPSEU Pension Plan is presented following two different methods:

1. An actuarial funding valuation presents the financial information as required by regulatory authorities. Its purpose is to determine whether the Plan's assets, together with investment earnings and contributions expected to be made in the future in respect of current members, are sufficient to fund the members' promised benefits at retirement. (This is known as the *aggregate method*.) It identifies any gains and losses that have occurred since the previous funding valuation and establishes the overall contribution requirements until the next valuation. The actuarial funding valuation includes margins of conservatism in the setting of economic assumptions. Regulations require an actuarial funding valuation to be filed with provincial authorities at least once every three years. The most recent filing by OPTrust was in 2005, for the one-year period ended December 31, 2004.

2. A financial statement valuation, which must be completed annually (unlike the actuarial valuation), is prepared in accordance with Canadian generally accepted accounting principles and provides members, pensioners and other stakeholders with a snapshot of our financial position on December 31st of a particular year. The financial statement valuation is prepared using "best estimate" assumptions and does not incorporate margins of conservatism.

In a financial statement valuation, the determination of future benefits payable is based solely on the pension credits that existing members have built up at the date of the valuation (not a projection of their future service credits). Similarly, the assets available to make those payments are the ones currently in the plan, and do not include the present value of expected future contributions. (This is known as the *projected unit credit* method, *prorated on service*.)

### Comparison

Because an actuarial funding valuation assesses the ability of a plan to keep its pension promise over a very long period of time, the assumptions used are more conservative than the assumptions used for developing a financial statement valuation.

The results of the differences between the two approaches are highlighted in the table on the next page, which features results from an interim funding valuation carried out for the year ending December 31, 2005, and compares them with the financial statement valuation for the same year.

As indicated in the table below, the financial statement valuation shows an unallocated surplus of $526 million, whereas the funding valuation shows an actuarial loss, or deficit, of $517 million. The main reasons for the difference of $1,043 million are as follows:

> The largest factor is the difference in methodologies used to calculate the funding and financial statement valuations, as described in the preceding section.

> The second major factor is the lower real rate of return assumption (which excludes the effects of inflation) of 4% used for the funding valuation. This compares with the real return assumption of 4.25% used in the financial statement valuation and reflects a margin of conservatism embedded in the funding valuation.

## Review of 2006 Financial Statements

The following review of key elements of the financial statements provides an explanation of some of the important measures of the continuing health and soundness of the Plan.

## Net Assets Available for Benefits

In 2006, the Plan's net assets available for benefits rose by $1,324 million, to $13.1 billion at year-end. The increase resulted from net investment income of $1,537 million. Partly offsetting that income was benefit payments that exceeded contributions by $194 million during the year, and operating expenses of $19 million.

Net assets include the Plan's investments as well as contributions receivable, fixed assets and other accrued income. These amounts are offset by liabilities that are in the process of being settled at year-end, as well as investment-related liabilities.

## Accrued Pension Benefits

Accrued pension benefits are determined by calculating future benefits payable for service prior to the valuation date, which are then discounted back to the current date using the financial statement rate-of-return assumption of 7.25%.

At year-end 2006, accrued pension benefits were valued at $10,460 million, up $516 million from $9,944 million in 2005. This change reflects normal growth in the Plan's accrued benefits. This growth includes income required on previously earned benefits and benefits earned during 2006, offset by payments to pensioners and terminating members.

## Actuarial Asset Value Adjustment ("Smoothing")

Actuarial smoothing is an accepted technique in the pension industry used to reduce the impact of short-term fluctuations in investment results. The underlying rationale is that while the overall return on assets may fluctuate considerably from year to year, the long term average is expected to reflect the assumed rate of return on assets.

**Differences in financial statement and funding valuations**

| As at December 31, 2005 | Financial | Funding | Difference |
|---|---|---|---|
| Net assets | 11,815 | 11,815 | – |
| Actuarial asset value adjustment | (899) | (973) | 74 |
| Present value of future contributions | – | 2,988 | (2,988) |
| Accrued pension benefits related to prior service | (9,785) | (10,166) | 381 |
| Provision for pension benefits related to future service | – | (3,559) | 3,559 |
| Provision for administrative expenses | (159) | (176) | 17 |
| Rate stabilization funds | (446) | (446) | – |
| Less allocation to enhanced benefits | – | – | – |
| Financial statement unallocated surplus/ (Funding valuation actuarial deficit) | $ 526 | $ (517) | $ 1,043 |

Smoothing therefore "irons out" the short-term peaks and valleys in investment returns to provide a more stable view of results over a period of years.

At OPTrust, our smoothing methodology compares our actual return in any given year with the target rate of return we need to make over the long term to keep the pension promise. Any amounts above or below that target are considered gains or losses subject to smoothing. One-fifth of the gain or loss is recognized in the results of the current year, while the balance is recognized in four equal installments during each of the next four years.

At the end of 2006, the Plan's actuarial value adjustment was a deferred gain of $1,341 million, compared with a deferred gain of $899 million the previous year. The main reason for the change was the deferral of gains from 2006.

## Surplus

The Plan's financial statement surplus was $1,338 million at year-end, compared with $972 million at the end of 2005.

The total surplus includes contribution rate stabilization funds established by the sponsors using a part of the actuarial gains identified in the 2001 funding valuation. During 2006, $24 million from each of the members' and employers' stabilization funds was used to make up the difference between the actual contributions made and the contributions needed to pay this year's share of the funding shortfall identified in the previous actuarial funding valuation.

At year-end 2006, the balance of the member stabilization fund stood at $161 million, compared with $174 million at the same time in 2005, as payments made during the year exceeded income on that fund. The balance of the employer stabilization fund was $266 million at the end of 2006, compared with $272 million at the same point in 2005.

## Changes in Net Assets

Investment income and contributions are the primary sources used to fund payments to pensioners, other payments to or on behalf of terminating members, and operating expenses. Changes in net assets available to the fund are recognized when the inflows from investments and contributions are greater or less than the outflows from payments during the period.

*Investment Income*

Net investment income was $1,537 million in 2006, compared with $1,564 million the previous year.

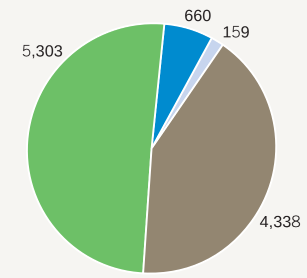
Investment expenses were higher than in 2005. Since investment fees are directly related to the size of the portfolio, some of the increase in fees resulted from the higher asset base. Higher investment management fees also resulted from the increased portion of actively managed assets in the foreign and domestic equity and real estate portfolios.

*Contributions*

Pension contributions from members and employers totalled $322 million in 2006, compared with $306 million in 2005. The main reason for the change was an increase in the number of contributing members.

### ACCRUED PENSION BENEFITS

At December 31, 2006 ($ millions)




Active members
Current pensioners
Divested members and deferred pensioners
Provision for administrative expenses
**Total: $10,460**

At the end of 2006, active members accounted for 41% of the Plan's accrued benefits, while pensioners accounted for 51%. The remaining 8% of the accrued liability represents the value of deferred pensions and a provision for administrative expenses.

**FINANCIAL STATEMENT OVERVIEW**
CONT'D

The remaining inflows were attributable to transfers from other pension plans, which accounted for $13 million in 2006, compared with $17 million in 2005.

Total contributions to the Plan were $335 million in 2006, compared with $323 million the previous year.

*Pension Payments*

OPTrust's pensioner population continued to grow in 2006, reaching 22,058 retirees at year-end. Pension payments increased by 3.3% to $411 million, compared with $398 million in 2005.

OPTrust pensions are adjusted annually for inflation. In January 2006, retirees received a pension increase of 2.2% (compared to 1.7% in 2005) under the Plan's inflation protection provision. The increase for 2007 is 2.3%.

*Terminations and Transfers to Other Plans*

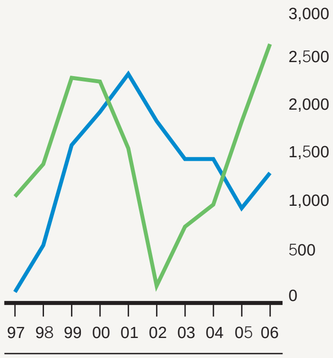
Termination payments and transfers to other plans were $118 million in 2006, compared with $126 million in 2005.

## Administrative Expenses

Administrative expenses were $19 million in 2006, down $3 million from $22 million the previous year. The reduction was primarily the result of lower costs for salaries and benefits and for system development.

FINANCIAL STATEMENT SURPLUS AND SMOOTHING

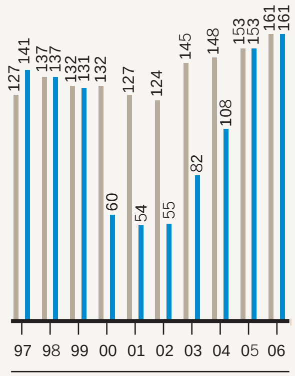
At December 31 ($ millions)




The Plan's financial statement surplus after smoothing rose to $1,338 million at the end of 2006, up from $972 million at the same time in 2005.

REGULAR CONTRIBUTIONS

($ millions)




Contribution rates for members remained at normal levels for the second consecutive year, after five years of reductions that saved the average member about $7,700. Employer contributions remained at normal levels throughout this period.

# Getting it right

Kam Chuhan is a coordinator in the OPTrust Data Management Group, where he has worked for the past seven years helping to make certain that the information contained in members' files is accurate and up to date. This year he will be taking part in a series of proactive visits that OPTrust is carrying out with employers to ensure that the data they provide is complete.

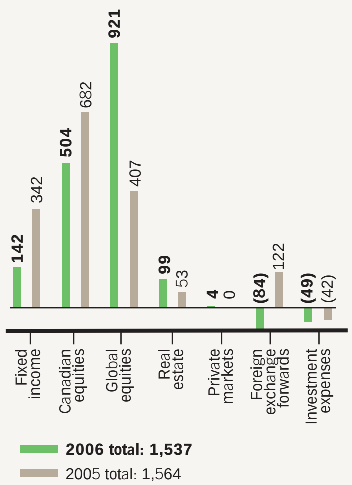
"We want to make sure that when it comes time for members to retire, it will be a smooth process for them. We want them to be able to enjoy their benefits without having to deal with any issues or delays that might result from missing data."

**FINANCIAL STATEMENT OVERVIEW**

CONT'D

## NET INVESTMENT INCOME

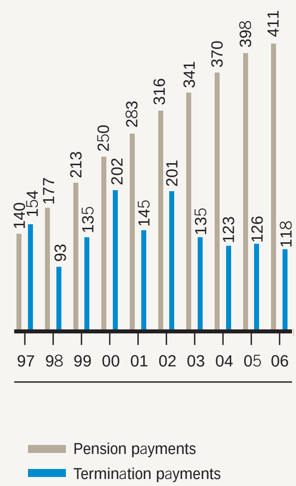
($ millions)




2006 investment income reflected a strong performance by global and Canadian equity markets, as well as a growing contribution from real estate.

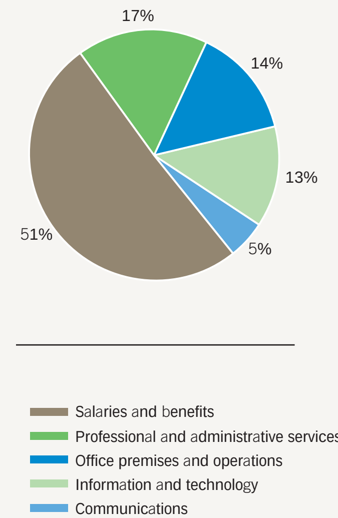
## BENEFIT PAYMENTS

($ millions)




Pension payments continued to rise, reflecting both rapid growth in the number of OPTrust retirees and inflation-related increases in their pensions.

## 2006 ADMINISTRATIVE EXPENSES




Administrative expenses fell by more than 15% to $19 million in 2006, primarily because of lower costs for salaries and benefits and for system development.

Financials

# Financial Statements

## Auditors' Report

To the Trustees of the OPSEU Pension Plan Trust Fund, Administrator of the OPSEU Pension Plan

We have audited the consolidated statement of net assets available for benefits, accrued pension benefits, actuarial asset value adjustment and surplus of the Ontario Public Service Employees Union Pension Plan (the Plan) as at December 31, 2006 and December 31, 2005 and the consolidated statements of changes in net assets available for benefits, changes in accrued pension benefits and changes in surplus for the years then ended. These financial statements are the responsibility of the Plan's administrator. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Plan's administrator as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the net assets available for benefits, accrued pension benefits, actuarial asset value adjustment and surplus of the Plan as at December 31, 2006 and December 31, 2005, and the changes in its net assets available for benefits, accrued pension benefits and surplus for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Toronto, Canada

February 28, 2007

PRICEWATERHOUSECOOPERS

## Actuaries' Certificate

We performed an actuarial valuation of the Ontario Public Service Employees Union Pension Plan (the OPSEU Pension Plan) for funding purposes as of December 31, 2004, as stated in Note 9 of these consolidated financial statements. For the purposes of that valuation as stated in our valuation report dated September 15, 2005, we hereby certify that, in our opinion, the assumptions are, in aggregate, appropriate, the methods employed are appropriate, and the data are sufficient and reliable. The valuation was prepared, and our opinion given, in accordance with accepted actuarial practice.

As further stated in Note 6 of these consolidated financial statements, we have prepared an actuarial valuation of the OPSEU Pension Plan accrued pension benefits for financial statement purposes as at December 31, 2006 in accordance with the Canadian Institute of Chartered Accountants Handbook Section 4100. The valuation was based on an extrapolation of the valuation as at December 31, 2004 and the accrued pension benefits determined using membership data from December 31, 2004, the projected unit credit cost method prorated on service and management's best estimate assumptions for consolidated financial statement purposes as set out in Note 6. In our opinion, the assumptions are, in aggregate, appropriate and the methods employed are appropriate for the purposes of the financial statement valuation.

In our opinion, the December 31, 2006 actuarial valuation for financial statement purposes was prepared in accordance with accepted actuarial practice.

H. Clare Pitcher
Fellow, Society of Actuaries
Fellow, Canadian Institute of Actuaries

Charlene Moriarty
Fellow, Society of Actuaries
Fellow, Canadian Institute of Actuaries

February 28, 2007

buckconsultants
an ACS company

# Management responsibility for financial reporting

The management of the OPSEU Pension Trust (OPTrust) is responsible for the integrity and objectivity of the financial information presented in this annual report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and comply with the financial reporting requirements of the *Pension Benefits Act* of Ontario. The consolidated financial statements include amounts that must out of necessity be based on the best estimates and judgment of management with appropriate consideration as to materiality. Financial information presented throughout this annual report is consistent with the consolidated financial statements.

Management has recognized the importance of OPTrust maintaining and reinforcing a high standard of conduct in all of its actions, including the preparation and publication of statements fairly presenting the financial condition of the OPSEU Pension Plan. Systems of internal control and supporting procedures are maintained to provide assurance that transactions are properly authorized, assets are safeguarded against unauthorized use or disposition and proper records maintained. The system is augmented by the careful selection and training of qualified staff, the establishment of organizational structures providing for a well-defined division of responsibilities, and the communication of policies and guidelines of business conduct throughout OPTrust.

The Board of Trustees has the ultimate responsibility for the consolidated financial statements presented to Plan members. An Audit Committee, consisting of Trustees appointed by each of the Government and OPSEU, reviews the consolidated financial statements in detail with management and the external auditors before such statements are recommended to the Board for approval. The Audit Committee meets on a regular basis with management and with the external auditors to review the scope of the audit and discuss auditor findings and to satisfy themselves that their responsibilities have been adequately discharged.

PricewaterhouseCoopers LLP, the external auditors, have conducted an independent examination of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and have expressed their opinion upon completion of such examination in their report to the Board of Trustees. The auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings as to the integrity of the Plan's financial reporting and the adequacy of the system of internal controls.

Heather Gavin
Heather Gavin
Chief Administrative Officer and Plan Manager

Charlie Eigl
Charlie Eigl
Vice-President, Finance

## Consolidated Statement of Net Assets Available for Benefits, Accrued Pension Benefits, Actuarial Asset Value Adjustment and Surplus

| As at December 31 ($ millions) | | 2006 | | 2005 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Investments (Note 5) | **$** | **15,990** | $ | 11,901 |
| Contributions receivable | | | | |
| Employers | | **22** | | 25 |
| Members | | **12** | | 12 |
| Property and equipment, net | | **4** | | 5 |
| | | **16,028** | | 11,943 |
| **LIABILITIES** | | | | |
| Accounts payable and accrued charges | | **(25)** | | (17) |
| Investment-related liabilities (Note 5) | | **(2,864)** | | (111) |
| | | **(2,889)** | | (128) |
| **NET ASSETS AVAILABLE FOR BENEFITS** | **$** | **13,139** | $ | 11,815 |
| **ACCRUED PENSION BENEFITS** (Note 6) | | | | |
| Active members | **$** | **4,338** | $ | 4,403 |
| Pensioners | | **5,303** | | 4,740 |
| Deferred and divested members | | **660** | | 642 |
| Provision for administrative expenses | | **159** | | 159 |
| | | **10,460** | | 9,944 |
| **ACTUARIAL ASSET VALUE ADJUSTMENT** (Note 7) | | **1,341** | | 899 |
| **SURPLUS** (Note 8) | | | | |
| Member rate stabilization fund | | **161** | | 174 |
| Employer rate stabilization fund | | **266** | | 272 |
| Unallocated surplus | | **911** | | 526 |
| | | **1,338** | | 972 |
| **ACCRUED PENSION BENEFITS, ACTUARIAL ASSET VALUE ADJUSTMENT AND SURPLUS** | **$** | **13,139** | $ | 11,815 |

The accompanying notes to the consolidated financial statements are an integral part of this statement.

On behalf of the Board of Trustees

Jordan Berger
Chair

Tony Ross
Vice-Chair

## Consolidated Statement of Changes in Net Assets Available for Benefits

| For the years ended December 31 ($ millions) | | 2006 | | 2005 |
|---|---|---|---|---|
| **NET ASSETS AVAILABLE FOR BENEFITS, BEGINNING OF YEAR** | **$** | **11,815** | $ | 10,474 |
| Net investment income (Note 10) | | **1,537** | | 1,564 |
| Contributions (Note 11) | | **335** | | 323 |
| Benefit payments (Note 12) | | **(529)** | | (524) |
| Administrative expenses (Note 13) | | **(19)** | | (22) |
| **NET INCREASE IN ASSETS AVAILABLE FOR BENEFITS** | | **1,324** | | 1,341 |
| **NET ASSETS AVAILABLE FOR BENEFITS, END OF YEAR** | **$** | **13,139** | $ | 11,815 |

## Consolidated Statement of Changes in Accrued Pension Benefits

| For the years ended December 31 ($ millions) | | 2006 | | 2005 |
|---|---|---|---|---|
| **ACCRUED PENSION BENEFITS, BEGINNING OF YEAR** | **$** | **9,944** | $ | 9,525 |
| **INCREASE IN ACCRUED PENSION BENEFITS** | | | | |
| Income required on accrued pension benefits | | **725** | | 694 |
| Benefits accrued | | **331** | | 324 |
| Benefit improvements | | **–** | | 84 |
| | | **1,056** | | 1,102 |
| **DECREASE IN ACCRUED PENSION BENEFITS** | | | | |
| Benefits payments | | **529** | | 524 |
| Experience gains | | **–** | | 93 |
| Changes in actuarial assumptions | | **–** | | 56 |
| Administrative expenses recognized | | **11** | | 10 |
| | | **540** | | 683 |
| **NET INCREASE IN ACCRUED PENSION BENEFITS** | | **516** | | 419 |
| **ACCRUED PENSION BENEFITS, END OF YEAR** | **$** | **10,460** | $ | 9,944 |

The accompanying notes to the consolidated financial statements are an integral part of this statement.

# Consolidated Statement of Changes in Surplus

| For the years ended December 31 ($ millions) | | 2006 | | 2005 |
|---|---|---|---|---|
| **UNALLOCATED SURPLUS, BEGINNING OF YEAR** | **$** | **526** | $ | 446 |
| **EXPERIENCE GAINS/(LOSSES) RELATED TO FINANCING PENSION BENEFITS** | | | | |
| Net investment income | | **1,537** | | 1,564 |
| Change in actuarial asset value adjustment | | **(442)** | | (929) |
| Income required on accrued pension benefits | | **(725)** | | (694) |
| | | **370** | | (59) |
| **OTHER EXPERIENCE GAINS/(LOSSES)** | | | | |
| Contributions net of benefits accrued | | **4** | | (1) |
| Administrative expenses | | **(8)** | | (12) |
| Demographic assumptions | | **–** | | 93 |
| | | **(4)** | | 80 |
| **OTHER CHANGES IN UNALLOCATED SURPLUS** | | | | |
| Changes in actuarial assumptions | | **–** | | 56 |
| Benefit improvements | | **–** | | (84) |
| Net transfer from rate stabilization funds | | **19** | | 87 |
| | | **19** | | 59 |
| **NET INCREASE IN UNALLOCATED SURPLUS** | | **385** | | 80 |
| **UNALLOCATED SURPLUS, END OF YEAR** | **$** | **911** | $ | 526 |
| **MEMBER RATE STABILIZATION FUND, BEGINNING OF YEAR** | **$** | **174** | $ | 185 |
| Interest earned on funds | | **11** | | 13 |
| Use of funds for funding deficiency | | **(24)** | | (24) |
| | | **(13)** | | (11) |
| **MEMBER RATE STABILIZATION FUND, END OF YEAR** | **$** | **161** | $ | 174 |
| **EMPLOYER RATE STABILIZATION FUND, BEGINNING OF YEAR** | **$** | **272** | $ | 348 |
| Interest earned on funds | | **18** | | 20 |
| Use of funds for funding deficiency | | **(24)** | | (24) |
| Use of funds for benefit improvements | | **–** | | (72) |
| | | **(6)** | | (76) |
| **EMPLOYER RATE STABILIZATION FUND, END OF YEAR** | **$** | **266** | $ | 272 |
| **TOTAL SURPLUS, END OF YEAR** | **$** | **1,338** | $ | 972 |

The accompanying notes to the consolidated financial statements are an integral part of this statement.

## 1. PLAN PROFILE

**a. OPSEU Pension Plan**
The OPSEU Pension Plan (the Plan) provides pension benefits for employees of the Province of Ontario (the Province or Government of Ontario) in bargaining units represented by the Ontario Public Service Employees Union (OPSEU) and certain other bargaining units and employers. The Plan was established under the terms of the April 18, 1994 Sponsorship Agreement between the Province and OPSEU, which also established the OPSEU Pension Plan Trust Fund (the Fund) to hold the net assets available for benefits of the Plan. These consolidated financial statements reflect the aggregate financial position of the Plan, including net assets available for benefits, accrued pension benefits, actuarial asset value adjustment and surplus of the Plan.

The OPSEU Pension Plan is registered under the *Pension Benefits Act* of Ontario and the *Income Tax Act* (Canada), registration number 1012046. The Plan is a Registered Pension Trust as defined in the *Income Tax Act* and is not subject to income taxes.

**b. OPSEU Pension Trust**
The Sponsorship Agreement establishes the Province and OPSEU as joint sponsors of the Plan. The Trustees of the OPSEU Pension Plan Trust Fund ("OPSEU Pension Trust" or "OPTrust") is responsible for the administration and management of both the OPSEU Pension Plan and the OPSEU Pension Plan Trust Fund, as described in the Trust Agreement between the sponsors. The Board of Trustees comprises five persons appointed by each of the Province and OPSEU.

## 2. DESCRIPTION OF THE OPSEU PENSION PLAN

The OPSEU Pension Plan is a contributory defined benefit pension plan. Membership within the Plan consists of members represented by OPSEU or certain other designated bargaining agents and employed by the following organizations:
The Province of Ontario (civil servants and crown employees)
Alcohol and Gaming Commission of Ontario
Centre for Addiction and Mental Health
Legislative Assembly of Ontario
Liquor Control Board of Ontario
New Democratic Party Caucus
Niagara Parks Commission
North East Mental Health Centre
Ontario Lottery and Gaming Corporation
Ontario Pension Board
Ontario Public Service Employees Union (seconded or acting employees)
Ontario Teachers' Pension Plan Board
OPSEU Pension Trust (includes non-bargaining unit employees)
St. Joseph's Health Care Group – Lakehead Psychiatric Hospital
Whitby Mental Health Centre
Workplace Safety and Insurance Appeals Tribunal

**a. Funding**
Contributions and investment earnings fund plan benefits. The determination of the value of the benefits and required contributions is based on periodic actuarial valuations for funding purposes.

**b. Contributions**
The OPSEU Pension Plan's contributions and benefits are integrated with the Canada Pension Plan (CPP).

The normal contribution formula is 6.4% of salary up to the year's maximum pensionable earnings (YMPE) and 8% of other eligible earnings up to the maximum earnings of $119,343 for the year.

**c. Purchase or Buyback of Past Service**
Eligible members of the Plan can purchase or "buy back" credit for past service for certain absences or non-contributory service, subject to *Income Tax Act* (Canada) limits. For some types of buybacks, employers make a matching payment.

**d. Pension Benefits**
The Plan provides for the payment of a pension benefit equal to 2% of the average of the best five consecutive years of salary, for each year of credited service. An unreduced pension can be received at age 65, or before age 65 if the member's age and credit total 90 (Factor 90) or when the member reaches age 60 and has 20 or more years of credit.

When a member reaches age 65, his or her pension is reduced by an amount that reflects the lower contributions made for CPP pensionable earnings. The reduction at age 65 equals 0.655% multiplied by the lesser of best average annual salary or final 5-year average of YMPE, multiplied by years of credit after 1965 (maximum of 35 years).

There is a time-limited provision that provides for an enhanced retirement opportunity for those members of the Plan whose age and credit totalled 80 (Factor 80) and who are laid off prior to January 1, 2009.

Reduced pensions are available to members who retire after age 55 and before age 65 who are not entitled to unreduced benefits. The pension reduction is equal to 5% for each year that the member is under age 65 when he or she retires.

**e. Inflation Protection**
An adjustment to pension benefits for inflation is made annually based on the Consumer Price Index to a maximum of 8% in any one year. Where the inflation adjustment exceeds 8% in any one year, the excess is carried forward to any subsequent year when the adjustment is less than 8%. The adjustment is made to both current pensions and the future value of deferred pensions. The inflation adjustment was 2.3% at January 1, 2007 (January 1, 2006 – 2.2%).

**f. Death Benefits**
Upon the death of a member or pensioner, death benefits are available to a surviving eligible spouse, eligible children, designated beneficiary, refund recipient or estate. The death benefit may be in the form of a survivor pension, a lump sum payment or both. The Plan provides a 60% survivor pension to an eligible spouse at no cost to the pensioner. Survivor pensions are also available to the pensioner's children in certain circumstances.

In the case of limited life expectancy, provisions exist to access lump sum payouts, provided spouses waive their entitlement to a survivor pension.

**g. Disability Pensions**
A disability pension is available to members with a minimum of 10 years of credit in the Plan and who meet the criteria as established in the Plan document. The amount of the disability pension depends on the years of credit and the average salary of the disabled member.

**h. Deferred Pensions**
Members who terminate from the Plan before age 55 have the option of leaving their money in the Plan and receiving a pension on retirement. In addition, members who are moved to other employers in a divestment situation and enrolled in a new pension plan may be required by law to accept a deferred pension from the OPSEU Pension Plan in order to protect benefits earned. The value of deferred pensions increases annually by the annual inflation protection adjustment.

**i. Termination Payments**
Subject to certain restrictions, a member who terminates employment may be entitled to transfer the commuted value of his or her pension and/or a refund of contributions to a registered retirement savings plan, or use these funds to purchase a life annuity. Some refunds of contributions or excess contributions may also be paid in cash, subject to withholding of income taxes.

**j. Transfers**
In certain circumstances, a member who terminates employment may be entitled to transfer the value of his or her pension to another pension plan if OPTrust has a reciprocal transfer agreement with this plan. In addition, members who do not terminate employment but must move to the Public Service Pension Plan due to a change in bargaining unit status are subject to mandatory transfer arrangements.

## 3. SIGNIFICANT ACCOUNTING POLICIES

**a. Presentation**
These consolidated financial statements are prepared on the going concern basis in accordance with accounting principles generally accepted in Canada. The financial statements present the aggregate financial position of the Plan as a separate financial reporting entity independent of the participating employers, bargaining units, plan members and pensioners.

**b. Principles of Consolidation**
The consolidated financial statements include the accounts of the Plan's wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation. The wholly-owned subsidiaries were formed for the purpose of investing in certain real estate and private market assets.

**c. Use of Estimates**
In preparing these consolidated financial statements, management must make certain estimates and assumptions that primarily affect the reported values of assets and liabilities, income and expenses and related disclosures. Actual amounts could differ from those estimates.

**d. Investments**
Investment transactions are recognized on a trade date basis.

*i) Valuation of investments*
Investments are accounted for at fair value, being the consideration that would be agreed upon in an arm's length transaction between knowledgeable willing parties who are under no compulsion to act. Fair values are determined as follows:

| CATEGORY | BASIS OF VALUATION |
|---|---|
| Fixed income | Average of market quotes of closing bid and ask prices. Where quoted prices are not available, estimated values are calculated using discounted cash flows based on current market yields for comparable securities. |
| Public equity | Closing quoted market price. Where a market price is not available, market value is determined by reference to current market information. |
| Real estate and private markets | Value based on estimated fair values using appropriate techniques and management's and/or third party best estimates. Income producing properties are valued based on independent appraisals that are conducted at least once every three years. |
| Mortgages and loans payable | The fair values have been estimated based on market yields of securities with comparable credit risk and term to maturity. |
| Derivative contracts | Market prices are used for publicly traded derivatives. Otherwise appropriate valuation techniques are used to determine fair value. |

These valuation principles are applied whether the investments are held directly, through pooling arrangements, or through limited liability companies.

*ii) Income recognition*
Investment income comprises interest and dividends, realized gains and losses on disposal of investments, and unrealized gains and losses resulting from changes in the fair value of investments.

| CATEGORY | BASIS OF RECOGNITION |
|---|---|
| Interest income | Accrual basis |
| Dividend income | Accrual basis on the ex-dividend date |
| Realized gains and losses for investments sold | Difference between proceeds on disposal and the average cost |
| Unrealized gains and losses for investments held | Change in the difference between estimated fair value and the average cost |

Average cost reflects the purchase cost of the investment, including direct acquisition costs.

**e. Actuarial Asset Value Adjustment**
The actuarial asset value adjustment reflects the portion of gains or losses not yet recognized for purposes of determining the actuarial net assets available for benefits. The actuarial asset value adjustment provides for the smoothing of gains and losses, mitigating volatility and providing a more stable basis for determining surplus.

The actuarial value of investments as at the reporting dates has been determined using a formula that smoothes out the effects of the changes in market values over a five-year period. The approach recognizes differences between the actual and management's best estimate of the return on investments in income evenly over the current and following four years. Management's best estimate of investment return is 7.25% for both 2006 and 2005.

**f. Accrued Pension Benefits**
The value of accrued pension benefits is determined based on actuarial valuations prepared by an independent actuarial firm. Actuarial valuations are prepared every year for financial statement reporting purposes (financial statement valuations) and at least every three years for purposes of determining funding requirements (funding valuations).

For financial reporting purposes, the Canadian Institute of Chartered Accountants (CICA) requires that pension plans report the actuarial value of accrued pension benefits using management's best estimate assumptions and the projected unit credit cost method prorated on service. This method calculates the actuarial value of pension benefits accrued up to the financial reporting date, after the projected benefits have been attributed equally to each year of a member's service.

**g. Contributions**
Contributions from members and employers that are due at year end, including those relating to purchases of credit for prior employment or leave and transfers into the Plan are recorded as a receivable.

**h. Payments**
Payments of pensions, refunds and transfers are generally recorded in the period in which they are incurred. Certain transfers to pension plans are accrued and recognized as an accrued liability. Any other benefit payment accruals not paid are reflected in the accrued pension benefits.

**i. Surplus**
Surplus results from the excess of the actuarial value of net assets available for benefits over the accrued pension benefits. The actuarial value of net assets available for benefits comprises net assets available for benefits and the actuarial asset value adjustment. Plan sponsors have the option of allocating any portion of their share of gains from a funding valuation to a rate stabilization fund. The rate stabilization funds can be used as a reserve against future contribution increases. The rate stabilization funds form part of surplus and earn income at the funding valuation interest rate. Unallocated surplus is the remainder of surplus after considering the rate stabilization funds.

**j. Property and Equipment**
Property and equipment are carried at cost less accumulated amortization. Amortization is provided on a straight-line basis over the estimated useful lives of the capital assets.

**k. Foreign Currency Translation**
Foreign currency transactions are translated into Canadian dollars at the rates of exchange prevailing at the dates of the transactions. The fair value of investments and cash balances denominated in foreign currencies are translated at the rates in effect at year end. The resulting unrealized gain or loss is included in the consolidated statement of changes in net assets available for benefits.

## 4. RISK MANAGEMENT

The Plan is subject to certain risks and engages in risk management practices to help ensure that sufficient assets will be available to fund pension benefits. These risks relate primarily to the uncertainty inherent in achieving sufficient investment returns and in making forecasts with respect to the ultimate pension liability. Investment risk management involves optimizing investment returns in a climate of uncertainty.

Additional information on risk related to accrued pension benefits is included in Note 6.

### a. Interest Rate Risk

Interest rate risk arises from interest rate fluctuations that may adversely affect the Plan's cash flows or the value of financial instruments. The potential exposure results from either changes in floating rates reducing cash flows, or changes in the asset values for fixed rate securities (e.g. bonds).

The Plan manages interest rate risk by establishing a target asset mix that provides an appropriate mix between interest-sensitive investments and those subject to other risks. A portion of the interest-sensitive portfolio is actively managed, allowing managers to anticipate interest rate movements to mitigate or take advantage of interest rate changes. The portion of the portfolio held in non-marketable debentures of the Government of Ontario is subject to changes in market value as interest rates fluctuate.

The Plan has exposure to interest risk as follows:

| As at December 31 ($ millions) | 2006 | | | | | 2005 | |
|---|---|---|---|---|---|---|---|
| | Term of maturity | | | | | | |
| | Within 1 year | 1 to 5 years | Over 5 years | Total | Yield to maturity | Total | Yield to maturity |
| Short-term investments | $ 3,312 | $ – | $ – | $ 3,312 | 4.3% | $ 803 | 3.2% |
| Government of Ontario debentures | 88 | 696 | 819 | 1,603 | 4.3% | 1,783 | 4.3% |
| Bonds | | | | | | | |
| Canadian government | – | 40 | 454 | 494 | 4.1% | 266 | 4.0% |
| Provincial governments | – | 25 | 600 | 625 | 4.5% | 411 | 4.6% |
| Corporate | – | – | 245 | 245 | 4.9% | 229 | 4.8% |
| Real return | – | – | 1,277 | 1,277 | 1.8% | 1,103 | 1.4% |
| **TOTAL** | $ 3,400 | $ 761 | $ 3,395 | $ 7,556 | 3.9% | $ 4,595 | 3.5% |

### b. Credit Risk

Credit risk refers to the potential loss arising from a security issuer being unable to meet its financial obligations.

The greatest credit exposure for the Plan is with the State Street Global Securities Lending Canadian Fund A, of which the Plan held $2,660 million (2005 – $Nil) in short-term investments from cash collateral received through its securities lending arrangement as at December 31, 2006.

Investment restrictions within the Plan have been set to limit the credit exposure to security issuers. Bonds and debentures require two minimum ratings of "A" or equivalent at time of purchase, short-term investments require a rating of "R-1" or equivalent and counterparties to over-the-counter (OTC) contracts require two minimum ratings of "AA-" or equivalent as at the contract date. As at December 31, 2006 and 2005, 100% of the short-term investment portfolio met the credit rating criteria. As of December 31, 2006, 99.9% (2005 – 98.9%) of the fixed income portfolio (excluding cash and short-term) was rated "A" or better.

### c. Foreign Exchange and Geographic Risk

Foreign exchange risk is the risk that the value of foreign investments will be affected by changes in foreign currency exchange rates for Canadian dollars. OPTrust employs currency managers that utilize currency forward contracts to manage the Plan's foreign currency exposure. The Plan's policy is to hedge approximately 50% of its currency exposure to investments in developed markets. In addition to the Plan's policy hedging program, the active currency managers may take positions that deviate above or below the 50% target. The currency exposure from foreign real estate and private markets investments are hedged 100%.

The Plan's exposure to foreign exchange risk is as follows:

| As at December 31 ($ millions) | 2006 | | | | 2005 |
|---|---|---|---|---|---|
| | Gross Exposure | Policy Hedge | Active Exposure | Net Exposure | Net Exposure |
| Canadian | $ 8,410 | $ 2,107 | $ (82) | $10,435 | $ 9,592 |
| Investments subject to currency risk | | | | | |
| Developed markets | | | | | |
| United States | 1,664 | (852) | 142 | 954 | 1,033 |
| United Kingdom | 675 | (424) | 148 | 399 | 246 |
| Eurozone | 666 | (323) | (7) | 336 | 120 |
| Asia Pacific | 998 | (440) | (64) | 494 | 210 |
| Europe – Other | 132 | (68) | (137) | (73) | 87 |
| Emerging markets | 581 | – | – | 581 | 502 |
| | 4,716 | (2,107) | 82 | 2,691 | 2,198 |
| **NET INVESTMENTS** | $ 13,126 | $ – | $ – | $ 13,126 | $ 11,790 |

The policy hedge and active exposure set out above represent the notional values of currency forward contracts and not the actual assets or liabilities of the Plan. Notional values are the basis on which fair values are determined and cash flows exchanged in respect to currency hedging, and therefore do not represent the potential gain or loss associated with the market or credit risk of these instruments.

The Plan's policy hedging program incorporates the foreign pooled equity linked investments, which are fully hedged to the Canadian dollar and therefore classified as gross Canadian currency exposures.

All currency forward contracts have a term to maturity of less than one year. The credit risk of the contracts, representing the replacement cost of all contracts that have a positive fair value at current market prices, as at December 31, 2006, is $48 million (2005 – $51 million).

Geographic risk reflects the risk related to operating in foreign jurisdictions including legal, political, settlement and market risk associated with various jurisdictions.

The Plan's exposure to geographic risk is as follows:

| As at December 31 ($ millions) | 2006 | 2005 |
|---|---|---|
| Canada | **$ 8,745** | $ 8,379 |
| **Investments subject to geographic risk** | | |
| Developed markets | | |
| United States | **1,050** | 1,025 |
| United Kingdom | **705** | 349 |
| Eurozone | **678** | 547 |
| Asia Pacific | **989** | 772 |
| Europe – Other | **148** | 106 |
| Emerging markets | **811** | 612 |
| | **4,381** | 3,411 |
| **NET INVESTMENTS** | **$ 13,126** | $ 11,790 |

### d. Market Risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether specific to the individual security or its issuer, or to factors affecting all securities in the market.

In addition to investment management practices designed to optimize the relationship between risk and return, the Plan uses the smoothing of investment gain and losses and uses margins of conservatism in economic assumptions to provide capacity to mitigate the negative impact of market risk.

### e. Liquidity Risk

Liquidity risk is the risk that the Plan has insufficient cash flows to meet its pension obligations and expenses as they become due.

Cash inflows are derived from member and employer contributions, earned income, principal repayments on fixed income investments and the proceeds from sales of other securities. Excess cash flows, after meeting pension obligations and operating expenses, are re-invested.

The Plan forecasts and manages cash flows to ensure it meets its obligations when due, without unintended early liquidation of assets. In addition, 88% (2005 – 85%) of the Plan's investments are marketable and can be liquidated relatively quickly.

### f. Securities Lending

To provide incremental income, the Plan participates in a securities lending agreement whereby it lends securities to approved borrowers. The program was expanded in 2006 to include cash collateral lending under which cash collateral held is reinvested in a short-term pooled fund to earn a rate of return in excess of the interest paid on the collateral to the borrower. Credit risk associated with the securities lending program is mitigated by requiring the borrower to provide the daily collateral with market values exceeding the market value of the loaned securities.

As at December 31, 2006, the Plan's investments included loaned securities with a fair value of $2,998 million (2005 – $179 million). The fair value of collateral received in respect of these loans was $3,073 million (2005 – $190 million) which included cash of $2,660 million (2005 – $Nil) and securities of $413 million (2005 – $190 million). Income earned from this program for the year was $2,236 thousand (2005 – $719 thousand).

## 5. INVESTMENTS

The following schedule summarizes the fair value and average cost of the Plan's investments before allocating the market exposure related to derivative financial instruments to the asset classes to which they relate, as at December 31:

| | | **2006** | | | 2005 | |
|---|---|---|---|---|---|---|
| As at December 31 ($ millions) | **Fair Value** | **Average Cost** | **Percentage of Assets** | Fair Value | Average Cost | Percentage of Assets |
| **Fixed income** | | | | | | |
| Cash | **$ 107** | **$ 106** | **1%** | $ 71 | $ 72 | 1% |
| Short-term investments | **3,312** | **3,312** | **25%** | 803 | 803 | 7% |
| Government and corporate bonds | **1,364** | **1,306** | **10%** | 906 | 840 | 8% |
| Real return bonds | **1,277** | **1,144** | **10%** | 1,103 | 900 | 9% |
| Government of Ontario debentures | **1,603** | **1,268** | **12%** | 1,783 | 1,378 | 15% |
| | **7,663** | **7,136** | **58%** | 4,666 | 3,993 | 40% |
| **Public equity** | | | | | | |
| Canadian | **2,878** | **2,031** | **22%** | 2,917 | 2,096 | 25% |
| Foreign | **3,949** | **2,961** | **30%** | 3,114 | 2,642 | 26% |
| Foreign pooled equity linked investments | **399** | **350** | **3%** | 566 | 557 | 5% |
| | **7,226** | **5,342** | **55%** | 6,597 | 5,295 | 56% |
| **Real estate** | **785** | **698** | **6%** | 542 | 519 | 5% |
| **Private markets** | **228** | **227** | **2%** | – | – | –% |
| **Investment-related assets** | | | | | | |
| Accrued income | **35** | **35** | **–%** | 30 | 30 | –% |
| Due from brokers | **5** | **5** | **–%** | 15 | 15 | –% |
| Unrealized gains and amounts receivable on derivative contracts | **48** | **–** | **1%** | 51 | – | –% |
| | **96** | **48** | **1%** | 96 | 45 | –% |
| **INVESTMENT ASSETS** | **$15,990** | **$ 13,443** | **122%** | $ 11,901 | $ 9,852 | 101% |
| **Investment-related liabilities** | | | | | | |
| Due to brokers and mortgages | **(77)** | **(71)** | **(1%)** | (77) | (77) | (1%) |
| Unrealized losses and amounts payable on derivative contracts | **(127)** | **–** | **(1%)** | (34) | – | –% |
| Payable related to securities lending | **(2,660)** | **(2,660)** | **(20%)** | – | – | –% |
| | **(2,864)** | **(2,731)** | **(22%)** | (111) | (77) | (1%) |
| **NET INVESTMENTS** | **$13,126** | **$ 10,712** | **100%** | $ 11,790 | $ 9,775 | 100% |

At December 31, the Fund held the following investments, each having a fair value or cost exceeding one per cent of the fair value or cost of net investment assets.

| ($ millions) | **2006** | | | 2005 | | |
|---|---|---|---|---|---|---|
| | **Number of Investments** | **Fair Value** | **Cost** | Number of Investments | Fair Value | Cost |
| Fixed income | **10** | **$5,452** | **$5,008** | 13 | $3,328 | $2,743 |
| Public equity | **1** | **399** | **350** | 3 | 844 | 720 |
| Real estate | **2** | **248** | **216** | – | – | – |
| Private markets | **1** | **228** | **227** | – | – | – |

The public equity and fixed income investments where the individual issue has a cost or fair value exceeding one per cent of the cost or fair value of net investment assets are comprised of one or more holdings of the following: The State Street Global Securities Lending Canadian Fund A, Province of Ontario, Government of Canada and the Barclays Global Investors US Equity Index Fund.

Real estate investments where the individual issue has a cost or fair value exceeding one per cent of the cost or fair value of net investment assets are comprised of GWL Realty Advisors, the Canadian Real Estate Investment Fund No.1 and the Morgan Stanley, Prime Property Fund.

Private markets investments where the individual issue has a cost or fair value exceeding one per cent of the cost or fair value of net investment assets is comprised of Kemble Water Holdings Limited.

**a. Derivative financial instruments**

Derivatives are financial contracts, the value of which is derived from the value of underlying assets, interest rates, indices, or exchange rates.

Derivative contracts transacted by OPTrust either directly with counterparties in the over-the-counter (OTC) market or on regulated exchanges include the following types:

*i) Interest rate swaps*

An interest rate swap is a contractual agreement between two parties to exchange a series of fixed or floating cash flows based on a notional amount of principal. Interest rate swaps are used to manage interest rate exposures.

*ii) Foreign exchange forwards*

A foreign exchange forward contract is a contractual agreement between two parties to exchange a notional amount of one currency for another at a specified price for settlement on a predetermined date in the future. OPTrust uses foreign exchange forward contracts to modify currency exposure for both hedging and active currency management.

The Plan has exposure to derivatives as follows:

| ($ millions) | **2006** | | | 2005 | | |
|---|---|---|---|---|---|---|
| | **Notional Amount** | **Fair Value Assets** | **Fair Value Liabilities** | Notional Amount | Fair Value Assets | Fair Value Liabilities |
| Interest rate swaps | **$ 715** | **$ –** | **$ 2** | $ – | $ – | $ – |
| Foreign exchange forwards | **5,424** | **48** | **125** | 5,134 | 51 | 34 |
| **TOTAL** | **$ 6,139** | **$ 48** | **$ 127** | $ 5,134 | $ 51 | $ 34 |

The term to maturity based on notional value is as follows:

| ($ millions) | **2006** | | | 2005 | | |
|---|---|---|---|---|---|---|
| | **Interest rate swaps** | **Foreign exchange forwards** | **Total** | Interest rate swaps | Foreign exchange forwards | Total |
| Under 1 year | **$ –** | **$ 5,424** | **$ 5,424** | $ – | $ 5,134 | $ 5,134 |
| 1 to 5 years | **–** | **–** | **–** | – | – | – |
| Over 5 years | **715** | **–** | **715** | – | – | – |

## 6. ACCRUED PENSION BENEFITS

**a. Financial Statement Valuation as at December 31, 2006**

The accrued pension benefits as at December 31, 2006 were valued at $10,460 million for financial statement purposes. This is based on membership data taken from the actuarial valuation for funding purposes as at December 31, 2004, the same data used for the December 31, 2005 financial statement valuation. In 2006, accrued pension benefits increased by $516 million.

**b. Actuarial Assumptions**

The Plan annually reviews the economic assumptions used in the financial statement valuation to ensure that they reflect management's best estimate of expected trends. The key economic assumptions used for the extrapolation of the financial statement valuation as at December 31 are as follows:

| | **2006** | 2005 |
|---|---|---|
| Assumed actuarial rate of return on plan assets | **7.25%** | 7.25% |
| Assumed rate of inflation | **3.00%** | 3.00% |
| Assumed rate of pensionable earnings increases | **3.75%** | 3.75% |

The impact of a change (0.5%) in certain assumptions on Accrued Pension Benefits is shown in the table below, keeping all other assumptions unchanged. In measuring the effect of the change in the assumed rate of inflation, the assumed real rate of return on assets and the assumed real rate of increase in pensionable earnings remained unchanged.

| ($ millions) | +0.50% | –0.50% |
|---|---|---|
| Assumed rate of inflation | $ (47) | $ 50 |
| Assumed actuarial rate of return on plan assets | (649) | 727 |
| Assumed rate of pensionable earnings increases | 161 | (150) |

## 7. ACTUARIAL ASSET VALUE ADJUSTMENT

The actuarial value of net assets available for benefits is determined by using a formula that smoothes out the effects of the changes in market values over a five-year period. The adjustment represents the deferred portion of gains or losses resulting from the difference between the actual and management's best estimate of the return on those investments. Differences are deferred and amortized over the current and following four years.

As at December 31, 2006, the actuarial asset value adjustment amounted to $1,341 million, which is an increase of $442 million (2005 – $899 million) from a year ago.

The following schedule provides the composition of the actuarial asset value adjustment as at December 31:

| ($ millions) | Deferred gains 2006 | Timing of future recognition of deferred gains 2007 | 2008 | 2009 | 2010 | Deferred gains/ (losses) 2005 |
|---|---|---|---|---|---|---|
| **2002** | **–** | **–** | **–** | **–** | **–** | (282) |
| **2003** | **152** | **152** | **–** | **–** | **–** | 304 |
| **2004** | **151** | **76** | **75** | **–** | **–** | 227 |
| **2005** | **488** | **163** | **163** | **162** | **–** | 650 |
| **2006** | **550** | **138** | **138** | **137** | **137** | – |
| **TOTAL** | **$1,341** | **$ 529** | **$ 376** | **$ 299** | **$ 137** | $ 899 |

In addition to the amounts identified above, the recognition of investment gains and losses in years after 2006 is dependent on the extent to which actual returns will differ from management's best estimate of return in any given year. For 2006, that estimate is 7.25%.

If net investment income were not subject to smoothing, surplus would be increased in 2006 and 2005 by the amount of the actuarial asset value adjustment.

## 8. SURPLUS

As at December 31, 2006, the surplus for financial statement purposes was $1,338 million (2005 – $972 million), which was comprised of rate stabilization funds of $427 million (2005 – $446 million) and unallocated surplus of $911 million (2005 – $526 million). OPSEU and the Province of Ontario have each set aside a portion of the Plan's funding gains from 1999 – 2001 as rate stabilization funds.

Changes in surplus result from differences between actual and expected investment return; differences between actual experience and that expected in accordance with the assumptions used in valuing the accrued pension benefits; differences between the actual contributions made to the plan and the benefits accrued during the year; and the use of surplus to fund benefit improvements and contribution reductions.

Experience gains or losses related to investment return represent the difference between actual investment earnings, adjusted for the impact of smoothing, and the income required on accrued pension benefits.

## 9. FUNDING VALUATION

In accordance with the *Pension Benefits Act* of Ontario and the *Income Tax Act* (Canada) and Regulations, an actuarial valuation for funding purposes is required to be filed at least every three years to estimate the Plan's gains or losses, and to determine the Plan's funding requirements.

The funding valuation is based on the aggregate funding method. This method considers a time horizon that includes accumulation of benefits and receipt of contributions in respect of current members in future periods. Generally, the actuarial assumptions used to determine the pension liabilities for funding purposes are more conservative than those used for the financial statement valuation. The funding valuation is used to identify gains or losses, which are allocated equally between members and the Government of Ontario. Gains are allocated at the discretion of the sponsors to fund benefit improvements, reduce contributions, reduce any existing funding deficiencies, or are set aside in the form of rate stabilization funds. Funding deficiencies resulting from losses must be funded over a maximum of 15 years from either increased contributions or rate stabilization funds. Accrued pension benefits are valued using economic assumptions developed by reference to long-term market conditions.

The last funding valuation filed with the Financial Services Commission of Ontario was prepared by Buck Consultants as at December 31, 2004. The funding deficiency reported in that funding valuation was $428 million. The member and employer Rate Stabilization Funds are being utilized to fund each sponsor's respective share of contributions required to pay for this deficiency.

The key economic assumptions used for the funding valuation as at December 31, 2004, were as follows:

| | **2004** |
|---|---|
| Assumed actuarial rate of return on plan assets | **7.50%** |
| Assumed rate of inflation | **3.50%** |
| Assumed rate of pensionable earnings increases (for 2005 and 2006)* | **4.50%** |
| Assumed rate of pensionable earnings increases (after 2006)* | **4.25%** |

*Percentage shown plus service-related promotion scale

## 10. NET INVESTMENT INCOME

| For the years ended December 31 ($ millions) 2006 | Earned Income | Realized Gains/ (Losses) | Unrealized Gains/ (Losses) | Net Investment Income/ (Loss) |
|---|---|---|---|---|
| **Fixed income** | | | | |
| Cash and short-term investments | $ 57 | $ – | $ 18 | $ 75 |
| Government and corporate bonds | 46 | 16 | (8) | 54 |
| Real return bonds | 12 | – | (69) | (57) |
| Government of Ontario debentures | 158 | (18) | (70) | 70 |
| | 273 | (2) | (129) | 142 |
| **Public equity** | | | | |
| Canadian | 55 | 425 | 24 | 504 |
| Foreign | 85 | 261 | 518 | 864 |
| Foreign pooled equity linked investments | – | 16 | 41 | 57 |
| | 140 | 702 | 583 | 1,425 |
| **Real estate** | 28 | 14 | 57 | 99 |
| **Private markets** | 3 | – | 1 | 4 |
| **Foreign exchange forward contracts** | – | 13 | (97) | (84) |
| | 444 | 727 | 415 | 1,586 |
| **Investment expenses** | | | | |
| Investment manager fees | | | | (35) |
| Custodial fees | | | | (2) |
| Other investment expenses | | | | (12) |
| **NET INVESTMENT INCOME** | | | | $ 1,537 |

| 2005 | Earned Income | Realized Gains/ (Losses) | Unrealized Gains/ (Losses) | Net Investment Income/ (Loss) |
|---|---|---|---|---|
| **Fixed income** | | | | |
| Cash and short-term investments | $ 9 | $ – | $ – | $ 9 |
| Government and corporate bonds | 32 | 36 | 31 | 99 |
| Real return bonds | 25 | (2) | 129 | 152 |
| Government of Ontario debentures | 168 | (19) | (67) | 82 |
| | 234 | 15 | 93 | 342 |
| **Public equity** | | | | |
| Canadian | 107 | 436 | 139 | 682 |
| Foreign | 74 | 140 | 177 | 391 |
| Foreign pooled equity linked investments | – | 70 | (54) | 16 |
| | 181 | 646 | 262 | 1,089 |
| **Real estate** | 30 | 3 | 20 | 53 |
| **Foreign exchange forward contracts** | – | 107 | 15 | 122 |
| | 445 | 771 | 390 | 1,606 |
| **Investment expenses** | | | | |
| Investment manager fees | | | | (31) |
| Custodial fees | | | | (2) |
| Other investment expenses | | | | (9) |
| **NET INVESTMENT INCOME** | | | | $ 1,564 |

## 11. CONTRIBUTIONS

| For the years ended December 31 ($ millions) | 2006 | 2005 |
|---|---|---|
| **Members** | | |
| Current service | $ 142 | $ 136 |
| Prior service | 10 | 10 |
| Long term income protection* | 9 | 7 |
| | 161 | 153 |
| **Employers** | | |
| Current service | 142 | 136 |
| Prior service | 10 | 11 |
| Long term income protection* | 9 | 6 |
| | 161 | 153 |
| **Transfers from other plans** | 13 | 17 |
| **TOTAL CONTRIBUTIONS** | $ 335 | $ 323 |

*The employer pays the members' contribution.

## 12. BENEFIT PAYMENTS

| For the years ended December 31 ($ millions) | 2006 | 2005 |
|---|---|---|
| Retirement pensions | $ 411 | $ 398 |
| Transfers to the Ontario Pension Board | 78 | 79 |
| Transfers to other plans | 8 | 6 |
| Refunds and commuted value transfers | 32 | 41 |
| **TOTAL BENEFIT PAYMENTS** | $ 529 | $ 524 |

## 13. ADMINISTRATIVE EXPENSES

| For the years ended December 31 ($ millions) | 2006 | 2005 |
|---|---|---|
| Salaries and benefits | $ 9.8 | $ 10.3 |
| Information technology | 2.6 | 3.2 |
| Professional and administrative services | 3.2 | 5.0 |
| Office premises and operations | 2.6 | 2.8 |
| Communications | 1.0 | 0.9 |
| **TOTAL ADMINISTRATIVE EXPENSES** | $ 19.2 | $ 22.2 |

Audit expenses were $0.2 million in 2006 (2005 – $0.2 million). Non-audit fees comprising tax and risk management services totalled $0.2 million in 2006 (2005 – $0.2 million). Actuarial expenses paid to Buck Consultants, the plan actuaries, were $0.5 million in 2006 (2005 – $0.9 million).

## 14. COMPENSATION

**a. Trustees' Compensation**

The Trustees of the Plan do not receive compensation from the Trust. They are, however, reimbursed for travel-related expenses. Expenses for amounts paid to or on behalf of Trustees totaled $280 thousand in 2006 (2005 – $190 thousand). The Trustees appointed by the Province of Ontario receive $200 per meeting that they attend and are paid directly by the Province.

**b. Senior Management Compensation**

Compensation earned by the Chief Administrative Officer & Plan Manager, Chief Investment Officer and Vice-President Finance over the past three years was as follows:

| Name and Position | Year | Base Salary | Supplementary pension benefit | Other compensation | Total |
|---|---|---|---|---|---|
| Heather Gavin [1] *Chief Administrative Officer and Plan Manager* | **2006** | **$ 272,289** | **$ 21,629** | **$ 17,745** | **$ 311,663** |
| Morgan Eastman *Chief Investment Officer* | **2006** | **376,231** | **36,728** | **43,585** | **456,544** |
| | 2005 | 358,392 | 22,051 | 54,406 | 434,849 |
| | 2004 | 332,577 | 20,485 | 30,418 | 383,480 |
| Charles Eigl *Vice-President, Finance* | **2006** | **197,786** | **14,453** | **17,130** | **229,369** |
| | 2005 | 188,098 | 8,625 | 16,330 | 213,053 |
| | 2004 | 178,469 | 10,132 | 14,636 | 203,237 |

[1] Position occupied effective January 1, 2006

**Supplementary pension benefit** – Employees of the OPTrust are eligible to contribute to the OPSEU Pension Plan, which provides pension benefits based on years of credit and average salary up to the maximums allowed under the *Income Tax Act*. In addition to regular pension benefits, compensation arrangements provide for the accumulation of pension benefits under a supplementary pension plan in excess of that maximum based on the same pension plan formula without regard to regulatory maximums. This supplementary plan is administered by the Province of Ontario. The supplementary pension benefit disclosed above reflects the present value of the increase in the future benefit accrued since the end of the previous year less employee contributions paid during the year.

**Other compensation** – includes vacation payouts, other taxable benefits and the employer's share of all employee benefits (excluding the supplementary pension benefit) made on behalf of employees.

**Changes in disclosure**

Senior management compensation disclosure has been changed from disclosure of the five most highly compensated individuals to the three key senior management fiduciary positions, which are listed above. The Chief Administrative Officer and Plan Manager and the Chief Investment Officer in particular, discharge their responsibilities, including the establishment of competitive compensation practices for the management and staff under their control and which may contain bonus and retention payments, with the direct oversight of the Board of Trustees through its Governance and Compensation Committee. The Board's advisor for compensation purposes is Mercer Human Resource Consulting. Additional disclosure on the supplementary pension benefit and the employer's share of employee benefits has also been provided.

## 15. GUARANTEES, COMMITMENTS AND CONTINGENCIES

In the normal course of its business, the Plan may, from time to time, provide guarantees to various counterparties and enter into commitments which may be considered material within the context of the Fund. OPSEU Pension Trust indemnifies its trustees and staff against certain claims that may be made against them. Otherwise, in the opinion of management, there are no guarantees that might be considered material outstanding as at December 31, 2006 and 2005.

As at December 31, 2006, the Plan was involved in litigation and claims which arise in the normal course of business. The outcome of such litigation and claims is inherently difficult to predict. However, in the opinion of management, any liability that may arise from contingencies would not have a significant adverse effect on the consolidated financial statements of the Plan.

# 10 year review

| For the years ended December 31 ($ millions) | **2006** | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|---|---|---|---|---|
| **CHANGES IN NET ASSETS** | | | | | | | | | | |
| ***Increase in net assets*** | | | | | | | | | | |
| Net investment income/(loss) | **1,537** | 1,564 | 1,069 | 1,408 | (688) | (359) | 654 | 970 | 867 | 981 |
| Member contributions | **161** | 153 | 108 | 82 | 55 | 54 | 60 | 131 | 137 | 141 |
| Employer contributions | **161** | 153 | 148 | 145 | 124 | 127 | 132 | 132 | 137 | 127 |
| Transfers from other plans | **13** | 17 | 20 | 15 | 16 | 10 | 17 | 36 | 2 | 2 |
| Special and other payments | **–** | – | – | – | 99 | 40 | 38 | 36 | 34 | 24 |
| | **1,872** | 1,887 | 1,345 | 1,650 | (394) | (128) | 901 | 1,305 | 1,177 | 1,275 |
| ***Decrease in net assets*** | | | | | | | | | | |
| Pension payments | **411** | 398 | 370 | 341 | 316 | 283 | 250 | 213 | 177 | 140 |
| Termination payments and transfers | **118** | 126 | 123 | 135 | 201 | 145 | 202 | 135 | 93 | 154 |
| Operating expenses | **19** | 22 | 22 | 23 | 22 | 20 | 18 | 17 | 17 | 15 |
| | **548** | 546 | 515 | 499 | 539 | 448 | 470 | 365 | 287 | 309 |
| **INCREASE/(DECREASE) IN NET ASSETS** | **1,324** | 1,341 | 830 | 1,151 | (933) | (576) | 431 | 940 | 890 | 966 |
| **NET ASSETS** | | | | | | | | | | |
| ***Investments*** | | | | | | | | | | |
| Cash and short-term investments | **3,419** | 874 | 219 | 172 | 204 | 202 | 514 | 192 | 209 | 200 |
| Government and corporate bonds | **1,364** | 906 | 765 | 853 | 686 | 658 | 506 | 542 | 477 | 612 |
| Real return bonds | **1,277** | 1,103 | 804 | 582 | 549 | 493 | 528 | 440 | 419 | 340 |
| Government of Ontario debentures | **1,603** | 1,783 | 1,953 | 2,090 | 2,200 | 2,243 | 2,313 | 2,296 | 2,631 | 2,554 |
| Public equities – Canadian | **2,878** | 2,917 | 2,792 | 2,601 | 2,017 | 2,192 | 3,184 | 2,873 | 3,279 | 2,310 |
| Public equities – Foreign | **4,348** | 3,680 | 3,680 | 3,265 | 2,784 | 3,546 | 2,884 | 3,145 | 1,529 | 1,652 |
| Real estate | **777** | 542 | 220 | 40 | 41 | 45 | 43 | 32 | 26 | 15 |
| Private markets | **228** | – | – | – | – | – | – | – | – | – |
| Investment-related receivables | **96** | 96 | 122 | 108 | 23 | 26 | 26 | 24 | 39 | 24 |
| | **15,990** | 11,901 | 10,555 | 9,711 | 8,504 | 9,405 | 9,998 | 9,544 | 8,609 | 7,707 |
| Contributions receivable from members | **12** | 12 | 11 | 10 | 7 | 6 | 7 | 7 | 13 | 14 |
| Contributions receivable from employers | **22** | 25 | 24 | 21 | 25 | 21 | 19 | 22 | 19 | 21 |
| Other assets | **4** | 5 | 7 | 10 | 13 | 12 | 5 | 5 | 3 | 4 |
| **TOTAL ASSETS** | **16,028** | 11,943 | 10,597 | 9,752 | 8,549 | 9,444 | 10,029 | 9,578 | 8,644 | 7,746 |
| ***Liabilities*** | | | | | | | | | | |
| Accounts payable and accrued charges | **(25)** | (17) | (25) | (20) | (44) | (7) | (15) | (4) | (3) | (5) |
| Investment-related liabilities | **(2,864)** | (111) | (98) | (88) | (12) | (11) | (12) | (3) | (10) | – |
| **TOTAL LIABILITIES** | **(2,889)** | (128) | (123) | (108) | (56) | (18) | (27) | (7) | (13) | (5) |
| **NET ASSETS AVAILABLE FOR BENEFITS** | **13,139** | 11,815 | 10,474 | 9,644 | 8,493 | 9,426 | 10,002 | 9,571 | 8,631 | 7,741 |
| Accrued pension benefits | **10,460** | 9,944 | 9,525 | 8,865 | 8,389 | 7,832 | 7,713 | 7,242 | 7,201 | 6,648 |
| Actuarial asset value adjustment | **1,341** | 899 | (30) | (704) | (1,774) | (774) | 316 | 701 | 844 | 993 |
| **SURPLUS** | **1,338** | 972 | 979 | 1,483 | 1,878 | 2,368 | 1,973 | 1,628 | 586 | 100 |
| **INVESTMENT PERFORMANCE (%)** | | | | | | | | | | |
| Rate of Return | **13.4%** | 15.6% | 11.7% | 17.3% | (7.2%) | (3.5%) | 7.0% | 11.4% | 11.3% | 14.7% |
| After inflation | **11.4%** | 13.4% | 9.6% | 15.3% | (11.1%) | (4.2%) | 3.8% | 8.8% | 10.3% | 14.0% |
| Benchmark | **11.7%** | 14.6% | 11.5% | 13.6% | (7.8%) | (4.4%) | 3.3% | 14.6% | 13.2% | 13.7% |
| After inflation | **9.7%** | 12.4% | 9.4% | 11.6% | (11.7%) | (5.1%) | 0.1% | 12.0% | 12.2% | 13.0% |

# Public market investment managers and strategies

| As of December 31, 2006 | **Manager** | **Strategy** | **Focus** |
|---|---|---|---|
| Canadian Equities | Beutel, Goodman and Company | Active | Canadian large capitalization |
| | Guardian Capital | Active | Canadian large capitalization |
| | PCJ | Active | Canadian large capitalization |
| | Sceptre | Active | Canadian small capitalization |
| | Barclays Global Investors | Enhanced passive | Canadian large capitalization |
| Foreign Equities | Barclays Global Investors | Quantitative | Synthetic foreign index strategies |
| | Wellington Asset Management | Enhanced passive | U.S. large capitalization |
| | JL Kaplan | Active | U.S. small-medium capitalization |
| | Rothschild Asset Management | Active | U.S. small-medium capitalization |
| | Grantham Mayo Otterloo | Active | Foreign ex-U.S. |
| | Walter Scott Partners | Active | Foreign ex-U.S. |
| | Alliance Bernstein | Active | All foreign markets |
| | Marathon London | Active | All foreign markets |
| | Baillie Gifford | Active | Emerging markets |
| Foreign Currency | Barclays Global Investors | Active and passive | Developed market currencies |
| Fixed Income | Phillips, Hager & North Investment Management | Active | Canadian government and corporate bonds |
| | Goldman Sachs Asset Management | Quantitative | Canadian fixed income swaps |

# Board of Trustees and committees

The OPSEU Pension Trust was established to give plan members and the Government of Ontario an equal voice in the administration of the OPSEU Pension Plan through joint trusteeship. As sponsors, the Government of Ontario and the Ontario Public Service Employees Union (OPSEU) each appoint five Trustees to the OPTrust Board. One Government appointee and one OPSEU appointee fill the positions of Chair and Vice-Chair, with the roles alternating between Government and OPSEU appointees every two years.

The Trustees are responsible for all aspects of the Plan's operation. They review OPTrust's investment policies and performance to ensure that money is available to pay members' and pensioners' benefits. They take appropriate steps to make sure that pension liabilities are properly evaluated and that the Plan's financial statements accurately reflect OPTrust's financial position. The Trustees also monitor the Plan's administration to ensure that members and pensioners receive the benefits to which they are entitled, along with timely and effective information and services.

To fulfill these responsibilities, new Trustees receive an intensive orientation to the Plan and ongoing training in pension plan governance and administration. The Board retains independent legal, actuarial, investment and accounting professionals and an independent custodian. The Trustees also set policy and strategic priorities and monitor the performance of the OPSEU Pension Trust through its senior management team.

**Standing Committees of the Board**

The Trustees have established five standing committees reporting to the Board:

> The Administration Committee oversees the Plan's operations including its organizational plans, and operating and capital budgets. It monitors and makes recommendations on administrative policies, plan amendments and legislative changes, and oversees the preparation of actuarial valuations.

> The Audit Committee ensures that OPTrust's financial statements are complete and objective, reviews the Plan's accounting and financial policies and ensures OPTrust's systems and processes comply with legal and professional standards. The committee also oversees OPTrust's risk management program and the selection and monitoring of our professional advisors and agents.

> The Governance and Compensation Committee is responsible for reviewing OPTrust's internal governance practices, establishing performance criteria and objectives for OPTrust's Chief Administrative Officer and Plan Manager and Chief Investment Officer, and for establishing the compensation structure and succession planning for senior management.

> The Investment Committee monitors the performance of the OPSEU Pension Trust Fund and its investment managers, and reviews their compliance with OPTrust's investment policies and related legal and regulatory requirements. It also researches and recommends changes to the Plan's investment policies, asset mix and investment managers.

> The Adjudication Panel gives plan members and pensioners access to a review process in the event of disputes concerning OPTrust's decisions on eligibility, benefit entitlements or other pension-related rights under the OPSEU Pension Plan.

# Corporate governance and auditor independence

## Corporate Governance

As a major institutional investor, OPTrust has an interest in promoting high standards of corporate governance and ensuring the effective functioning of capital markets.

## Proxy Voting

OPTrust uses a leading independent proxy voting organization, Institutional Shareholder Services (ISS), to actively vote our shares. This approach allows us to benefit from detailed research on voting issues and ensures that our voting rights are exercised consistently.

The Plan's shares are voted according to detailed Proxy Voting Guidelines approved by the Trustees. These guidelines address key governance issues such as the appointment of independent auditors and directors, compensation and stock option plans, and mergers and acquisitions. They also address a range of social, ethical and environmental concerns. Where voting issues arise that fall outside the guidelines, the voting fiduciary refers the matter to OPTrust for guidance.

## Advocacy on Governance Issues

As part of our ongoing commitment to promoting sound corporate governance, OPTrust continued in 2006 as an active member of the Canadian Coalition for Good Governance (CCGG). This organization includes a number of leading Canadian pension plans and institutional investment managers, representing over $500 billion in institutional investment assets. The coalition's mission is to represent Canadian institutional shareholders through the promotion of corporate governance best practices and to align the interests of boards and management with those of shareholders.

## Auditor Independence

The Board of Trustees has established a policy for pre-approval of services performed by the external auditor, PricewaterhouseCoopers, aimed at preserving and enhancing their accountability and independence.

The pre-approval process requires the Audit Committee to review and approve a schedule of anticipated permissible services required from the external auditor. These services include the statutory audit, tax consulting, risk management and other audit-related services. Prohibited services include bookkeeping, systems implementation, services for actuarial, valuation or internal audit purposes, and other services that could compromise the independence of the external auditor.

Auditors' Fees, 2006 versus 2005

| ($ thousands, including taxes) | **2006** | 2005 |
|---|---|---|
| External audit [1] | **308** | 162 |
| Operational risk management | **61** | 28 |
| Tax services | **47** | 112 |
| Total | **416** | 302 |

[1] Includes external audit services for related legal entities

# Trustees, advisors and senior management



**Professional Advisors and significant agents**

**Actuaries**
Buck Consultants, an ACS company

**Auditors**
PricewaterhouseCoopers LLP

**Custodian**
RBC Dexia Investor Services Trust

**Investment Consultants**
Hewitt Associates

**Legal Counsel**
Koskie Minsky LLP

**Senior Management, Administration Division**

**Heather Gavin**
*Chief Administrative Officer*
*and Plan Manager*

**Bob Breens**
*Vice-President,*
*Policy and Communications*

**Charlie Eigl, CA**
*Vice-President, Finance*

**Bill Foster**
*Vice-President,*
*Member and Pensioner Services*

**Graeme Isdale**
*Vice-President, Information Technology*

**Senior Management, Investment Division**

**Morgan Eastman**
*Chief Investment Officer*

**August Cruikshanks, CFA**
*Managing Director,*
*Public Market Investments*

**Robert Douglas, CFA**
*Managing Director,*
*Real Estate Investments*

**Anca Drexler, CFA**
*Managing Director,*
*Investment Operations Research and Risk*

**Kevin Warn-Schindel**
*Group Head and Managing Director,*
*Private Markets Group*

Trustees

## Members of the Board of Trustees

Jordan Berger

Tony Ross

Ann Marshall

Don Jordan

Alicia Czekierda

Michael Beswick

Richard Johnston

Maurice Gabay

Deborah Stark

Ruth Galinis

# How to reach us

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*Les états financiers de la Fiducie du Régime de retraite du SEFPO sont aussi disponibles en français.*

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*Your Pension and the Canada Pension Plan*
*Your Pension and Buying Back Credit*
*Your Pension and Leaving Your Employment*
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*Your Pension and Your Retirement*
*OPTrust Proxy Voting Guidelines*
*OPTions* newsletter for plan members
*The Pension Connection* newsletter for pensioners

Many OPTrust publications are available online at www.optrust.com.

OPTrust

OPSEU Pension Trust

Fiducie du régime de retraite du SEFPO

*This report summarizes certain provisions of the OPSEU Pension Plan. Please note that this report does not create any rights to benefits not provided for in the actual terms of the Plan. In the event of any conflict or omission, the legal requirements of the OPSEU Pension Plan will govern in all cases.*