OEPSC

ANNUAL REPORT

2000 – 2001

CORPORATE PROFILE

The *Electricity Act, 1998* (the EA) provides that the Ontario Electricity Financial Corporation (OEFC) is the administrator of the OEFC Pension Plan. As administrator, the OEFC is responsible for administering the Pension Plan and investing the Pension Fund. As required by the EA, the OEFC established the Ontario Electricity Pension Services Corporation (OEPSC), a wholly owned subsidiary, to act as the OEFC's agent in carrying out its pension administrator responsibilities.

The OEPSC was established pursuant to subsection 110 (1) of the EA and was incorporated under the *Business Corporations Act*.

PENSION PLAN PROFILE

The OEFC Pension Plan (formerly the Ontario Hydro Pension and Insurance Plan) provides pension benefits to employees, to pensioners, and to the beneficiaries of former plan members of the Ontario Hydro successor companies: **Electrical Safety Authority**, **Hydro One Inc.**, **Independent Electricity Market Operator** and **Ontario Power Generation Inc.**

Pension benefits are based on a formula that takes into account a plan member's earnings and years of service. Members contribute a percentage of earnings to the Plan, and the successor companies contribute whatever amount is necessary to fully fund the Plan.

All contributions, including employee and employer contributions, and the interest on those contributions, are held for the plan members in the OEFC Pension Fund, separate from the assets of each of the successor companies. The Fund is invested according to the Statement of Investment Policies and Goals (SIPG) of the OEFC Pension Plan. The SIPG is filed with the Superintendent of Financial Services of Ontario.

The fiscal year for the OEPSC is April 1, 2000, to March 31, 2001. The information in this report on the OEFC Pension Plan and Fund is as at December 31, 2000.

FINANCIAL SUMMARY, 1999–2000

(millions of dollars)

	2000	**1999**
Net Assets Available for Benefits – before liability to successor plans	**12,428**	11,930
Due to Successor Plans (see Notes to Financial Statements)	**(12,428)**	0
Net Assets Available for Benefits	**0**	11,930
Employee Contributions*	**0**	69
Employer Contributions*	**0**	0
Investment Income	**476**	445
Increase in Fair Value of Investment	**429**	958
Benefits and Other Payments	**390**	335
Administrative Expenses	**18**	17

** Until December 31, 1999, any required employer and employee contributions were made to the Fund. With the commencement of the successor plans on December 31, 1999, employer and employee contributions, if any, became payable to the Successor Plans and not to the Fund.*

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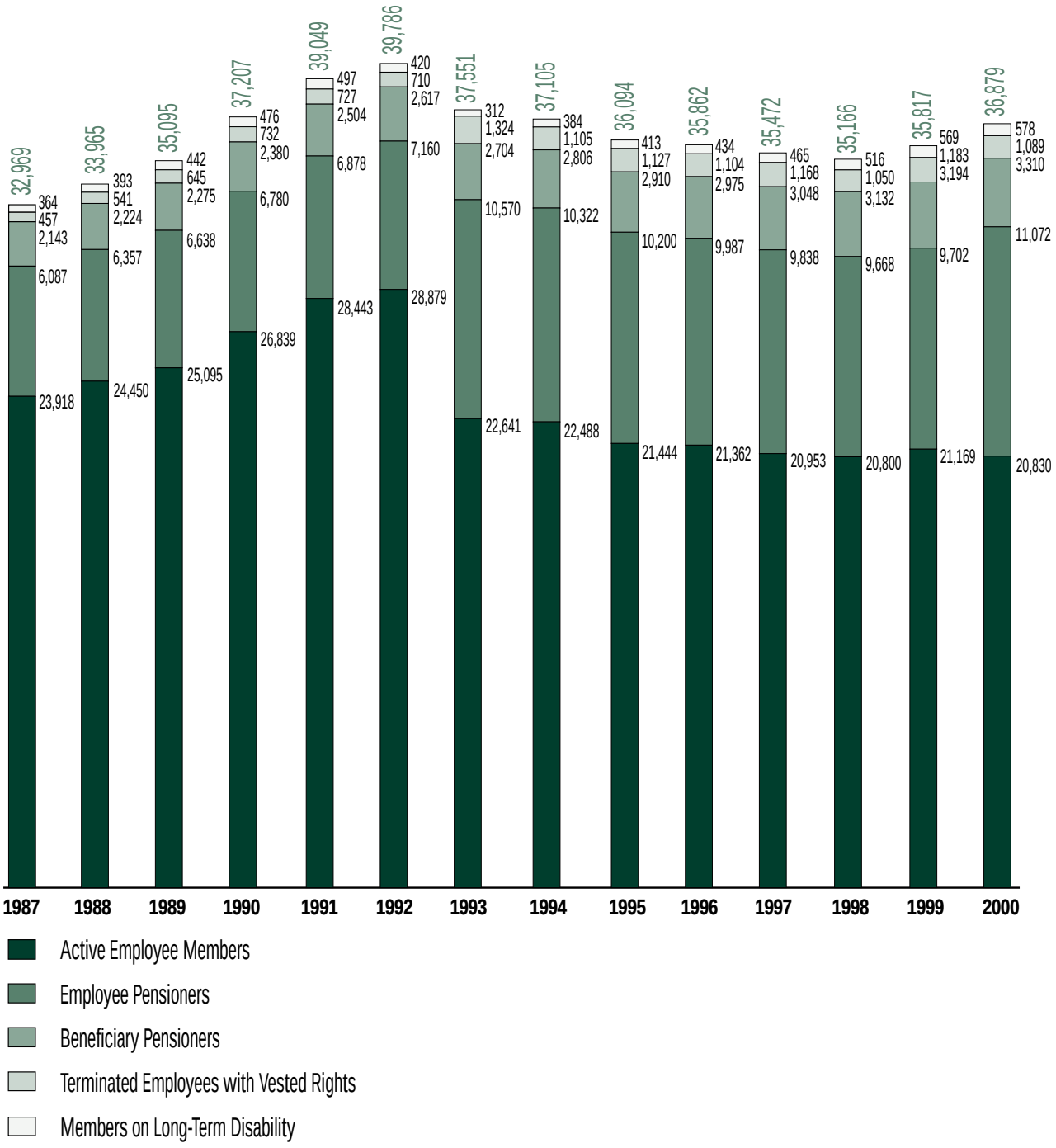
Pension Plan Membership

as at December 31, 2000



A Message from the Chair

I am pleased to present the annual report on the activities of the Ontario Electricity Pension Services Corporation (OEPSC) for the fiscal year ending March 31, 2001.

The OEPSC has been responsible for providing pension administration and investment services for the Ontario Electricity Financial Corporation (OEFC) Pension Plan since April 1, 1999. At that time, under the terms of the *Electricity Act, 1998*, the former Ontario Hydro Pension and Insurance Plan was renamed the OEFC Pension Plan.

Throughout the past year, the primary focus for the OEPSC has been to deliver the same high level of service to pension plan members, pensioners, surviving spouses and beneficiaries as in past years. At the same time, the OEPSC, along with the OEFC Board and Pension Committee members have been preparing for the smooth and timely transfer of assets and liabilities to each of the four successor pension plans.

An agreement was signed on March 29, 2001 to transfer the OEFC Pension Plan assets to the pension plans, of each of the four Ontario Hydro successor employers, in proportion to the liabilities to be transferred to these plans. An application to divide and transfer the assets will be submitted to the Superintendent of Financial Services in accordance with the *Pension Benefits Act (Ontario)*.

Along with the Board, I would like to thank the staff of the OEPSC for their hard work and dedication. I am looking forward to the final steps before handing over the torch to the new pension plans, and I am confident that each of the pension plans will be off to a good start as they begin to look toward tomorrow.

Brian FitzGerald
Chair, OEPSC,
OEFC Board of Directors

Plan Report

Overview

The OEFC Pension Plan provides pension benefits to employees of the Ontario Hydro successor companies: Electrical Safety Authority, Hydro One Inc., Independent Electricity Market Operator and Ontario Power Generation Inc. The Plan is a contributory, defined benefit pension plan. Members contribute to the Plan based on a formula, and the successor companies contribute whatever amount is necessary to fully fund the Plan.

As at December 31, 2000, the Plan was fully funded. It also has a substantial surplus. Accordingly, no employer contributions were required in 2000, in keeping with the terms of the *Electricity Act, 1998* and the Union negotiation processes. Under the Act, the successor companies may reduce or suspend their contributions to the Pension Fund (as permitted under the *Pension Benefits Act (Ontario)*), if the Plan has a surplus or a prior year credit balance. Also, as set out in the Act, the administration and investment management expenses for the Plan were paid out of the Pension Fund in 2000.

Plan members contribute 4% of base annual earnings up to the Year's Maximum Pensionable Earnings (YMPE) ($37,600 in 2000), and 6% of base annual earnings above the YMPE. All contributions, including employer contributions, and the interest on those contributions, have been held for the plan members in a Pension Fund, separate from the assets of each of the successor companies, up to the point at which the assets of the Fund were allocated among the successor companies. During 2000, the Fund was invested according to the Statement of Investment Policies and Goals of the OEFC Pension Plan. Administration expenses were deducted from the Fund.

Member contributions to the Plan, along with those of the successor companies, help pay for the pension benefits, but they do not determine the amount of pension received. Rather, plan members earn pension benefits based on their earnings and years of service according to the pension formula.

The basic pension, including the integration adjustment reduction, is known as the life pension. It is payable for life from a plan member's date of retirement, subject to any early retirement reduction.

A bridge pension – payable to age 65 – is payable to plan members who retire before age 65 and are not receiving a disability pension from the Canada Pension Plan.

Pension Formula

2% of your average base annual earnings
during your highest 36 consecutive months
multiplied by
your pensionable service,
to a maximum of 35 years
minus
an integration adjustment

Normal retirement age is age 65, or age 60 to age 65 for females hired before January 1, 1976. However, retirement benefits are available earlier or later, provided a plan member meets specific conditions.

A plan member may retire early with an unreduced pension if he or she

- has completed 35 years of continuous employment, or
- has a combination of age plus years of continuous employment that equals 84 or more.

If neither of the above conditions are met, but the plan member is age 55 or more (or age 50 or more for a female hired before January 1, 1976), and has at least 15 years of service, the early retirement pension will be reduced to account for the early start date. The amount of reduction will vary depending on the plan member's age and continuous service on the retirement date. Details about the applicable reduction are available upon request.

In addition, the Plan will pay pre- or post-retirement death benefits to the eligible spouse, same-sex partner, designated beneficiary, or estate of a plan member (or former plan member), in accordance with the Plan's provisions. The benefits payable under the Pension Plan are subject to the limits set out in the *Income Tax Act* (Canada).

2000 Review

In 2000, the OEFC Pension Plan paid pensions to 14,382 pensioners – including beneficiaries – with an average annual pension of $27,894. In total, the Plan paid benefits payments of $390,546,022. This figure included annual pensions, lump-sum benefits paid to former members on termination, refunds due to termination or death, refunds of additional voluntary contributions, and transfers to other pension plans.

Membership Statistics, 2000

- Average age[1] of active plan members: 45
- Average age[1] of pensioners[2]: 68
- Number of new pensioners[2] in 2000: 1,668
- Average annual pension[3] for new pensioners in 2000: $43,170
- Average annual bridge benefit[3] for new pensioners: $11,547

Administrative Services

The year 1999 was the first year in which the Ontario Electricity Pension Services Corporation (OEPSC) administered the OEFC Pension Plan.

As part of that transition, the OEPSC began work as a distinct company under the direction of the OEFC. Effective January 1, 2000, part of the OEPSC's responsibility included administering the Plan for the four individual Ontario Hydro successor companies. By using the same experienced team who managed administration for the former Ontario Hydro Pension and Insurance Plan, the OEPSC has maintained the same high level of service to both employers and individual plan members.

When the OEPSC first began to administer the pension plans of the four successor companies, these plans were each a mirror image of the previous OEFC Pension Plan. However, as the year progressed, the plans began to diverge, and the OEPSC helped each company to ensure that their specific plan entitlements were effectively communicated to both their human resources staff and the individual plan members.

[1] *Based on rounded age ranges, as at December 31, 2000.*
[2] *Figure does not include beneficiary pensioners.*
[3] *Amount includes the January 1, 2001 increase, and adjustments due to the level income option.*

New plan provisions were introduced that allowed plan members to purchase eligible past service. By purchasing this service plan, members were able to increase their eventual pension entitlements. To support these new provisions, the OEPSC processed a combined total of over 600 purchases of temporary and/or previous probationary service in 2000.

Working with Hydro One Inc., the OEPSC was also successful in processing over 1,400 early retirements between May 1 and December 31, 2000, under Hydro One Inc.'s Voluntary Retirement Program. In order to do this, the OEPSC streamlined and modified a system to deal with the final retirement data received from an external agency. This action was particularly important to administer the retirements for the 1,000 members who retired on May 1, 2000.

In the latter part of 2000, the OEPSC started a process to help its successor companies move toward in-house or third-party provider administration.

Administrative Services, 2000

1,085	new members
355	terminations
1,668	retirements
44	deaths (active, LTD, deferred)
444	pensioner and beneficiary pensioner deaths

Communication

The OEFC Board and Pension Committee remained committed to keeping all Plan stakeholders informed about the status of the OEFC Pension Plan. To that end, both the OEFC Pension Plan website and call-centre were maintained throughout the year. As well, a copy of the 1999 Pension Plan Annual Report was sent to all active plan members, pensioners, beneficiary pensioners and terminated employees with vested rights.

Pension Administration Systems

As each successor company diverged and developed its own plan rules, the OEPSC staff contributed considerable effort to modifying the pension system to accommodate specific amendments for each company.

The OEPSC has also taken the first steps in upgrading the pension system's technology to make it Internet-compatible. It is expected that this change will eventually allow plan members to easily access pension estimates on-line.

Governance

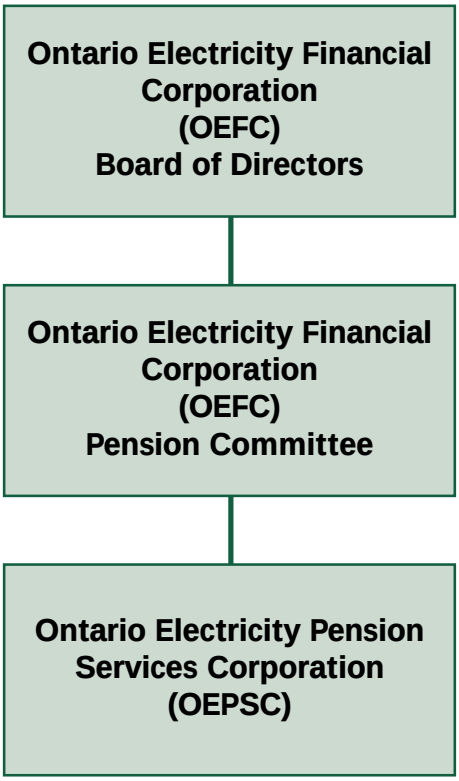
The governance structure for the OEFC Pension Plan was changed significantly on April 1, 1999. Prior to that date, the former Ontario Hydro was the sponsor and administrator of the Plan, then called the Ontario Hydro Pension and Insurance Plan. The changes were set out in the *Electricity Act, 1998*, and established the governance structure shown to the right.

The Ontario Electricity Financial Corporation (OEFC) is the legal administrator, as defined in the *Pension Benefits Act (Ontario)*, of the OEFC Pension Plan. The OEFC is accountable for the overall management of the OEFC Pension Plan and Fund.

The OEFC Pension Committee is responsible for providing oversight with respect to the duties of the Ontario Electricity Pension Services Corporation (OEPSC).

The OEPSC is responsible and accountable to the OEFC through the Pension Committee for the day-to-day management of the OEFC Pension Plan and Fund.

In accordance with the legislation, the OEFC will act as administrator of the Pension Plan until arrangements are completed to transfer the assets and liabilities of the Pension Plan and Fund to the successor companies: Electrical Safety Authority, Hydro One Inc., Independent Electricity Market Operator and Ontario Power Generation Inc. The transfer is expected to be completed in 2001.



Fund Report

Investment Markets in 2000

The early prognoses for 2000 were for strong economic growth and healthy corporate profits to provide a basis for good investment markets. Although monetary authorities were raising interest rates in order to moderate economic growth, it was felt that they would be successful in engineering the soft landing that would allow markets to continue improving.

As a result, markets improved until the second quarter of the year when investors became more concerned that higher interest rates would lead to a significant economic slowdown. The lofty valuations of technology and telecommunications sector stocks – those stocks that had driven the markets up – began to crumble, leading equity markets significantly lower. By year end, many stock markets were showing negative performance, with the notable exception of the TSE 300 which managed a 6.2% price increase.

Equity markets displayed extreme volatility in 2000, with most of them reaching new highs in the first quarter or half of the year, but then falling in value. The TSE 300 dropped from a mid year high of over 11,300 to 8,933 at year-end. Other market indices, such as the Dow Jones Industrials, the S&P 500 and the NASDAQ in New York, all closed down for the year. The Dow was off over 6%, the S&P over 10% and the NASDAQ 39%. European and Asian markets, Japan in particular, also were weaker.

Early market increases had been driven, in part, by the hope of continued profit growth. This was delivered in Canada as corporate profits before tax grew by over 35% in the first quarter; but by the fourth quarter, the growth rate was less than half that. The 25% annual growth improved from 20% in 1999. U.S. profits increased by more than 10%. These high levels were the result of continued economic growth, associated improvements in productivity and relatively high world commodity prices.

Fixed income markets rallied in the second half of 2000. Bond yields came down as the efforts of monetary authorities to slow economic growth took hold. Canadian bond returns were 10.2% for the year compared to a decline of 1.1% in 1999.

As the year progressed, there was stronger-than-expected growth in spite of climbing short-term rates. Canada benefited from strong exports to the U.S. as well as from higher prices for energy products and other raw materials. As the year went on, the Canadian dollar continued to weaken against a strong U.S. dollar and, as a result, Canada enjoyed a record trade surplus of $54 billion for the year as a whole.

Just prior to year-end, the business cycle returned with a vengeance. Economic growth all but stopped in December in the U.S. and threatened to do the same in Canada. Gross Domestic Product grew in the fourth quarter by only 2.6%, which bettered the U.S. performance of 1.1%. This was down from the 4.5% increase averaged over the first three quarters of 2000. Finally, the extended robust expansion had been impacted by higher rates and other factors such as the run-up in oil prices, the California energy crisis, and the tightening of general credit conditions.

Although the Federal Reserve and the Bank of Canada took prompt action to reduce interest rates and improve credit conditions, both economies were exhibiting the weakest business outlook in a decade. What the stock markets had been signalling in the summer had come to pass.

Pension Fund Investments

Background

The assets of the Pension Fund are invested with a primary objective of achieving a high rate of return over the long term within the limitations of both statutory regulation and a prudent investment policy, in order to provide secure income to retired employees and their beneficiaries. The policy is outlined in the Pension Plan's Statement of Investment Policies and Procedures approved by the OEFC Board of Directors (the Board) annually.

The Fund is invested in high-quality assets that offer a potential for favourable returns at a moderate level of risk. Senior management allocates investments among five principal asset categories: corporate shares, bonds, mortgages, real estate and short-term investments, in accordance with guidelines established by the Board. This mix of assets will vary over time between the permitted guideline ranges in response to price changes in the capital markets and management's assessment of the outlook for each sector.

Performance targets are set for each major portfolio in relation to an appropriate market index (benchmark). The Fund as a whole is measured against a target consisting of the central asset mix guidelines and the return levels of the respective asset class benchmarks. In all cases, the goal is to exceed the benchmark returns by specific margins over the latest four years.

Historical Perspective

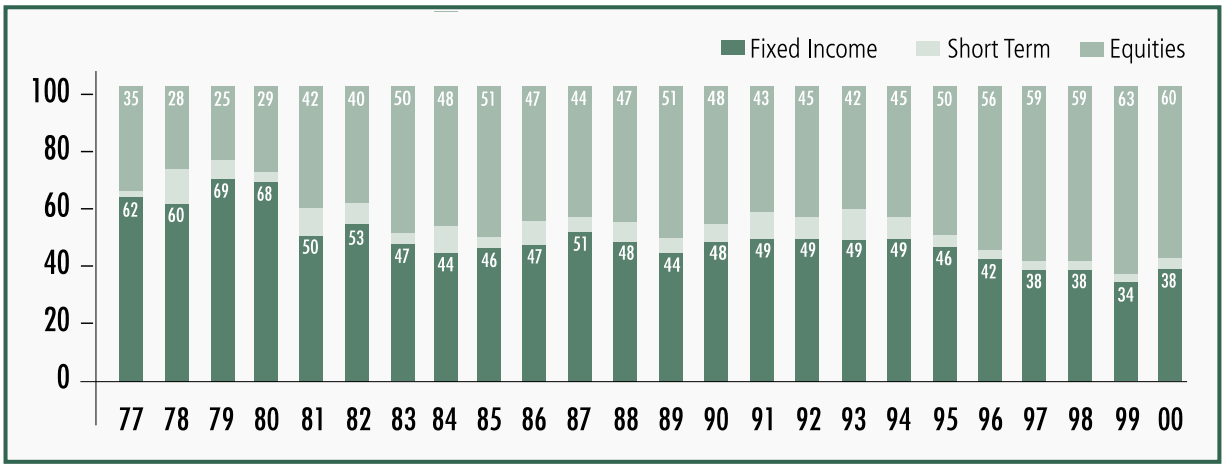
The upper graph on the next page shows the proportion of the Fund invested at the end of each of the past 24 years in the two major asset categories of fixed income and equities. Also shown is the normally smaller portion held in short-term reserves (every effort is made to ensure that interest is earned at all times). Funds that maintain at least 25% of total assets in each of the major classes are usually referred to as balanced funds. Over long periods of time, equity investments tend to outperform debt investments, but equity prices are much more volatile. The objective of a balanced strategy is to offset the high variability of equity returns with the more stable, income-oriented returns of debt investments such as bonds and mortgages. Although the overall return over the long term from this approach will likely be less than that from equities alone, a pension fund's solvency will be better protected during periods of severe stock price declines.

Note that at year-end 2000, the proportion of the Fund invested in fixed income increased for the first time since 1991. This was the result of the sharp decline in share prices during the second half of the year, together with the strategy of selling stocks to buy bonds and mortgages, which continued during the first six months of 2000.

The lower graph on the next page shows that Fund asset growth continued over the past year, although at a reduced pace from the late 1990s.

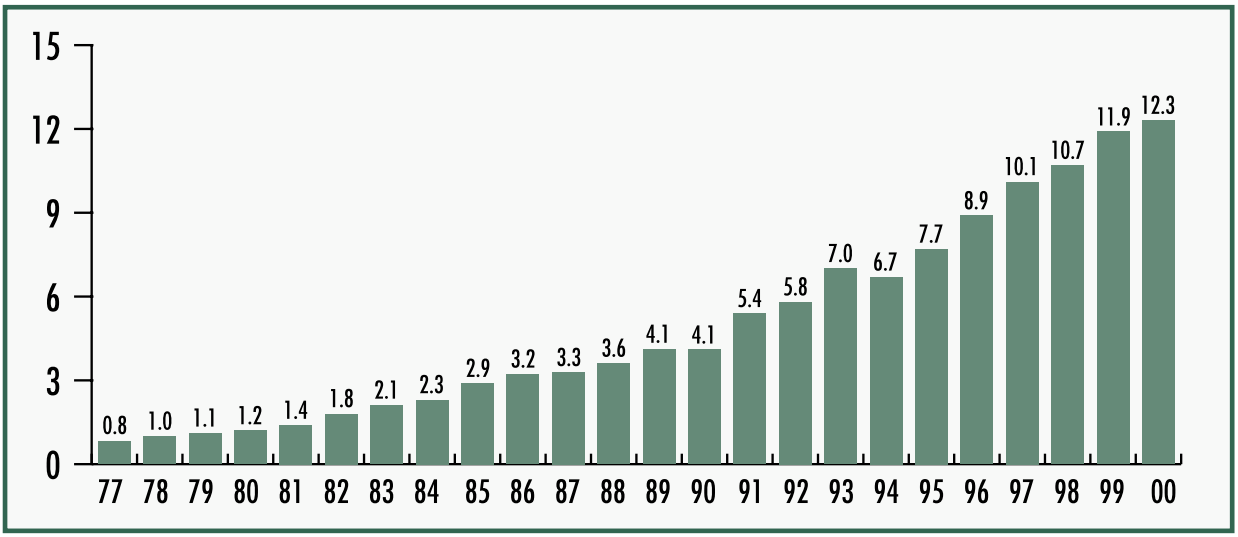
Year-End Asset Mix, 1977-2000

percent of invested assets



Market Value of Invested Assets

billions of dollars



Diversification

Many years ago, the Pension Fund began to diversify its investments beyond Canada, initially by purchasing stocks of companies based in the U.S. and, subsequently, in other developed countries. In 1994, further Fund initiatives employed external managers both to diversify Canadian portfolio management style and to expand the size and scope of international exposure.

Currently, three external managers are employed to invest portfolios that focus primarily on smaller Canadian companies. Four additional external managers have mandates to invest in stock markets in Europe, Australia and the Far East (EAFE).

All of the Fund's managers operate under conservative guidelines established by the OEFC and OEPSC.

At the end of the year, slightly less than 20% of Fund assets were invested in international common stocks. About 12% were in the U.S., with a portion in smaller developed markets such as Hong Kong and Singapore, and the remainder primarily in markets such as Germany, Japan, the United Kingdom, France and Italy

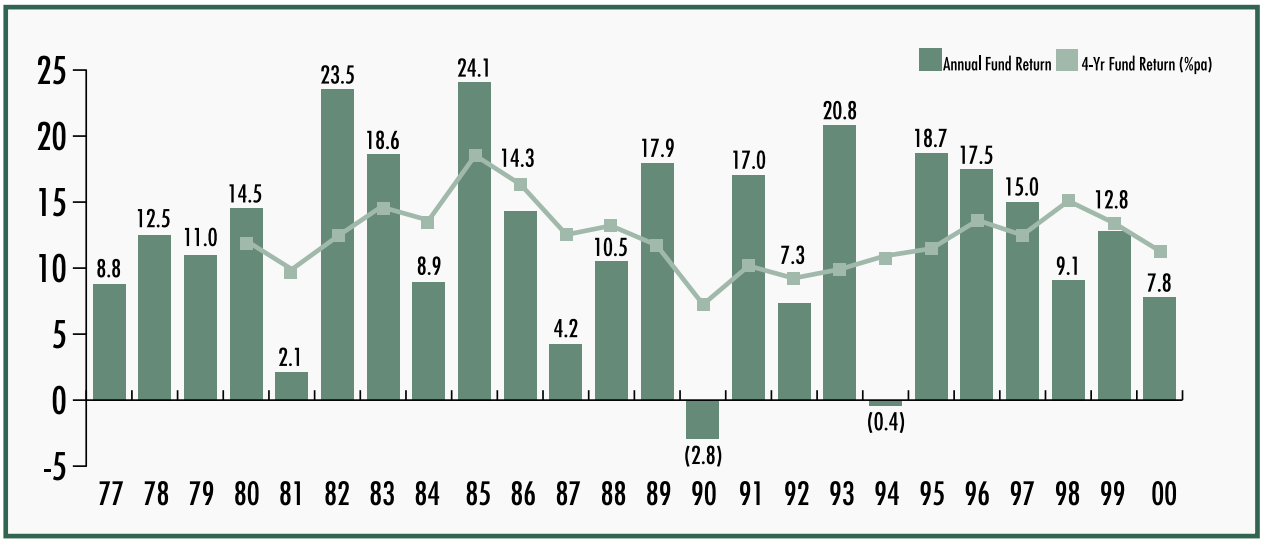
Rates of Return

The total return of the Pension Fund is a function of two major variables: the rate of return on each individual asset portfolio, and the percentage of the Fund allocated to each portfolio during the measurement period.

The following graph illustrates the annual return of the total OEFC Fund for the past 24 years together with the moving annualized rate of return for the last four years.

Pension Fund Rates of Return Annual and Moving Four-Year Rates

percent per annum



The year 2000 Fund return of 7.8% is at the median level of a representative group of 60 Canadian pension funds with assets in excess of $1 billion. It is also 2.4 percentage points above the total fund return benchmark. The primary sources of this result were superior security selection for internally managed Canadian large capitalization stocks, good real estate returns and a high absolute return from the private equity (venture capital) portfolio.

The Fund's compound return of 11.1% for the latest four years exceeds its comparable benchmark by 1.1 percentage points and marks the eighth consecutive year with a return in excess of 10% per annum.

Auditors' Report

To the Board of Directors of
Ontario Electricity Pension Services Corporation

We have audited the balance sheet of **Ontario Electricity Pension Services Corporation** as at March 31, 2001 and the statements of operations and cash flows for the year then ended. These financial statements are the responsibility of the **Ontario Electricity Pension Services Corporation**. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the **Ontario Electricity Pension Services Corporation** as at March 31, 2001 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Toronto, Canada,
May 11, 2001.

Chartered Accountants

Financial Statements

Ontario Electricity Pension Services Corporation

BALANCE SHEET
[in Canadian dollars]

As at March 31

	2001 $	2000 $
ASSETS		
Cash	**1**	1
Accounts receivable	**3,482,600**	3,209,900
	3,482,601	3,209,901
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Accounts payable	**3,482,600**	3,209,900
Shareholders' equity		
Share capital		
Authorized		
Unlimited common shares, no par value		
Issued		
1 common share	**1**	1
	3,482,601	3,209,901

See accompanying notes

On behalf of the Board: Director Director

Financial Statements

Ontario Electricity Pension Services Corporation

STATEMENT OF OPERATIONS
[in Canadian dollars]

Year ended March 31

	2001 $	2000 $
Revenue	**17,572,100**	17,264,000
Expenses		
Payroll	**4,338,400**	3,767,800
External consultants	**294,700**	535,500
External computer resources	**252,800**	432,300
Administration services and fees *[note 3]*	**159,900**	199,500
Legal, accounting and insurance fees	**1,487,200**	919,100
Portfolio verification services and licensing fees	**543,300**	1,009,400
External portfolio manager fees	**6,761,400**	6,806,000
Custody, trustee and other external contract services	**1,944,600**	1,773,400
Rent and telecommunications	**359,500**	455,500
Training, travel and conference fees	**280,700**	236,100
Goods and Services Tax	**1,149,600**	1,129,400
	17,572,100	17,264,000
Net income for the year	—	—

See accompanying notes

Financial Statements

Ontario Electricity Pension Services Corporation

STATEMENT OF CASH FLOWS
[in Canadian dollars]

Year ended March 31

	2001 $	2000 $
OPERATING ACTIVITIES		
Net income for the year	**—**	—
Changes in non-cash working capital balances related to operations	**—**	—
Accounts receivable	**(272,700)**	(3,209,900)
Accounts payable	**272,700**	3,209,900
Cash provided by operating activities	**—**	—
FINANCING ACTIVITIES		
Net proceeds from common shares issued	**—**	1
Cash provided by financing activities	**—**	1
Net increase in cash during the year	**—**	1
Cash, beginning of year	**1**	**—**
Cash, end of year	**1**	1

See accompanying notes

Notes to Financial Statements

Ontario Electricity Pension Services Corporation

March 31, 2001

1. ONTARIO ELECTRICITY PENSION SERVICES CORPORATION

The Pension Plan of Ontario Hydro was established under Section 24 of the *Power Corporation Act* [the "PCA"] as part of the Ontario Hydro Pension and Insurance Plan of Ontario Hydro. In November 1998 certain sections of the *Electricity Act, 1998* [the "EA"] were proclaimed in force. Part VII of the EA provides for the continuation of the pension plan which was subsequently renamed the Ontario Electricity Financial Corporation Pension Plan and Fund.

Ontario Electricity Pension Services Corporation ["OEPSC"] [the "Company"] was incorporated on March 24, 1999 and the effective date of commencement of operations was April 1, 1999. OEPSC issued 1 share for $1 to the Ontario Electricity Financial Corporation ["OEFC"]. OEPSC is owned by the Government of Ontario and is not subject to income taxes under Section 149(1)(d) of the Federal Income Tax Act.

OEPSC will act as OEFC's agent in the administration of the OEFC Pension Plan and Fund until arrangements are completed to transfer the assets and liabilities to the new pension plans of the successor entities to Ontario Hydro.

Under the PCA, Ontario Hydro paid for all administrative costs to maintain and administer the Plan. The EA provided for the costs of administering the Plan to be paid out of the pension fund. All expenditures of OEPSC with respect to administering the Plan are reimbursed by the Plan.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Revenue recognition

Revenue is recognized when the Company provides administrative services to the Plan and the related costs are incurred.

3. ADMINISTRATION SERVICES AND FEES

Ontario Power Generation Inc. ["OPG"], one of Ontario Hydro's successor entities, provided administrative services on a cost recovery basis to OEPSC during the year in accordance with a service agreement between the two parties. Under the current administrative services agreement, OPG is obligated to pay pension and other post-employment benefits to OEPSC employees.

The total fees paid to OPG for the fiscal year ended March 31, 2001 was $159,900 (2000 – $199,500).

Board of Directors and Staff Members

Ontario Electricity Pension Services Corporation

BOARD OF DIRECTORS

Brian FitzGerald (Chair and CEO)

Kanak Chopra

Bruce Macnaughton

Jim Stothers

OFFICERS AND SENIOR MANAGERS

Jim Stothers, President and Chief Investment Officer

Andrew Yu, Senior Vice-President, Plan Administration

Don Armour, Vice-President, Real Estate and Private Equity

John Cook, Vice-President, Finance and Administration, Vice-President, Canadian Equities

Paul Newby, Vice-President, Fixed Income

Jim Schetakis, Vice-President, U.S. and International Equities