Ontario Electricity Financial Corporation

2003 Annual Report

Ontario

Ontario Electricity Financial Corporation

Corporate Overview

Ontario Electricity Financial Corporation (OEFC), an agency of the Province of Ontario, is a statutory, non-share capital corporation and the legal continuation of Ontario Hydro.

OEFC retains services from the Ontario Financing Authority (OFA) and the Ministry of Finance to carry out its daily operations. The OFA is the agency of the Province of Ontario responsible for provincial borrowing and debt management activities. The OFA manages OEFC's debt, derivatives and non-utility generator (NUG) portfolios, and provides cash management, accounting and other financial services and support to the corporation. The Ministry of Finance manages the collection and reporting of payments-in-lieu of tax on behalf of OEFC.

OEFC's Board of Directors is responsible for supervising OEFC's operations, which are as follows:

- Manage the outstanding debt and derivatives portfolios, financial risks and other liabilities of the former Ontario Hydro;
- Manage the long-term power purchase agreements and provide the associated risk management infrastructure;
- Manage the Electricity Consumer Price Protection Fund (ECPPF);
- Receive payments and administer assets, liabilities, rights and obligations of the Corporation that have not been transferred to other Ontario Hydro successor corporations, and dispose of these as it deems appropriate or as directed by the Minister of Finance; and
- Perform any additional functions as required by the Lieutenant-Governor-in-Council.

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Message from the Chair

I am pleased to present the 2003 Annual Report of the Ontario Electricity Financial Corporation (OEFC). The report describes OEFC's objectives and responsibilities, operational highlights and financial results for the year ended March 31, 2003.

As outlined in the *Electricity Act, 1998,* OEFC's primary objective is to ensure that the outstanding debt and derivatives portfolios and certain other liabilities of the former Ontario Hydro are managed efficiently and prudently and are ultimately retired.

For the year ended March 31, 2003, revenues totalled $3,797 million, while expenses totalled $3,895 million, resulting in a deficiency of revenue over expense of $98 million, compared to the prior year's deficiency of revenue over expense of $69 million. In 2002-03, the Province completed OEFC's borrowing requirements, including long-term debt maturities of $2,775 million, through $2,084 million raised from the sale of Hydro One notes held since April 1, 1999 and the issuance of $967 million in long-term debt.

During the year, OEFC achieved its objectives of cost-effective borrowing and debt management and prudent risk management, negotiated revisions to non-utility generator (NUG) contracts to facilitate their integration into the competitive electricity market, and continued to develop the necessary infrastructure to manage the NUG contracts and related exposures in a competitive market in a cost-effective and prudent manner.

On December 9, 2002, the *Electricity Pricing, Conservation and Supply Act, 2002* was passed to freeze the price that low volume and designated consumers pay for electricity at 4.3 cents per kilowatt-hour until at least 2006. OEFC is responsible for managing the Electricity Consumer Price Protection Fund (ECPPF) established as a result of the Act.

OEFC will continue to monitor new developments in the electricity industry that will affect the operating results of the corporation in the 2003-04 fiscal year.

Bob Christie
Chair

Management's Discussion and Analysis

OEFC accomplished its key objectives for 2002-03:

- Achieved cost-effective borrowing and debt management and prudent risk management;
- Negotiated revisions to certain contracts with non-utility generators (NUG contracts) to facilitate their integration into the competitive electricity market;
- Continued to develop the necessary infrastructure to manage the NUG contracts and related exposures in a competitive market in a cost-effective and prudent manner; and
- Managed the Electricity Consumer Price Protection Fund (ECPPF) created under the *Electricity Pricing, Conservation and Supply Act, 2002.*

2002-03 Highlights

- Sold $1.9 billion of the Hydro One notes held since April 1, 1999, resulting in a gain of $206 million for OEFC. This sale represented the largest-ever corporate debt trade in the Canadian domestic debt market.
- Reduced total debt outstanding by $2.5 billion to $26.8 billion from $29.4 billion as at March 31, 2002.
- Lowered total debt exposed to fluctuations in foreign currencies to 6.3 per cent of outstanding debt from 7.5 per cent and down from 14.5 per cent at the time of OEFC's establishment in 1999.

Overview of Financial Results

For the year ended March 31, 2003, revenues totalled $3,797 million, while expenses totalled $3,895 million, resulting in a deficiency of revenue over expense of $98 million, compared to the prior year's deficiency of revenue over expense of $69 million.

Revenues

OEFC's total revenues for 2002-03 were $3,797 million, an increase of $253 million from 2002. OEFC's revenues consisted of the Debt Retirement Charge and revenue pool residual up to market opening; payments-in-lieu of tax; interest income from the Province, OPG, Hydro One, and IMO; power sales; a net reduction of power purchase contracts; a gain on the sale of Hydro One notes; and electricity sector dedicated income.

The Debt Retirement Charge, which replaced the revenue pool residual when Ontario's electricity market opened to competition on May 1, 2002, amounted to $889 million over 11 months in 2002-03.

In the year ended March 31, 2003, OPG and Hydro One earned an aggregate amount of $717 million. After taking into account the Province's financing cost of its investment in its electricity subsidiaries of $520 million, OEFC recorded $197 million in electricity sector dedicated income. In 2001-02, the aggregate earnings of the subsidiaries did not exceed the Province's financing cost.

In February 2003, OPG reached an agreement with OEFC to defer payment on $700 million principal amount of senior notes owing to OEFC by extending the maturity dates by two years. The interest rates on these notes remain unchanged.

Expenses

OEFC's total expenses for 2002-03 were $3,895 million, an increase of $282 million from 2002. OEFC's expenses consist of interest on its debt and nuclear funding liability, amortization of deferred charges, expenditures in the Electricity Consumer Price Protection Fund (ECPPF), power purchases, a debt guarantee fee and operating costs.

Borrowing Program

In 2002-03, the Province completed OEFC's borrowing requirements, including long-term debt maturities of $2,775 million, through $2,084 million raised from the sale of Hydro One notes held since April 1, 1999, and the issuance of $967 million in long-term debt.

Long-term borrowing was completed through two Province of Ontario U.S. dollar global issues and two domestic issues that were on-lent to OEFC:

- C$425 million (Canadian dollar equivalent) raised through a portion of a US$750 million U.S. dollar global issue maturing in December 2005;
- C$447 million (Canadian dollar equivalent) raised from a US$300 million U.S. dollar global issue maturing in March 2008; and
- C$95 million raised from two non-public debentures maturing in January and June 2022.

Debt Management

The repayment of OEFC obligations remains a priority and is an integral part of Ontario's electricity sector restructuring objectives. Pursuant to the *Electricity Act, 1998*, a long-term plan was established to retire debt from within the electricity sector. The long-term debt repayment plan supports a current estimate that OEFC's obligations will likely be defeased in 2012.

Debt Repayment Plan

OEFC's obligations are being repaid from the following revenue sources:

Notes Receivable

OEFC receives principal and interest payments from the Province, Ontario Power Generation Inc. (OPG), Hydro One and the Independent Electricity Market Operator (IMO) arising from the restructuring of the electricity sector.

Payments-in-Lieu of Tax (PILs)

OEFC receives payments-in-lieu of corporate income, capital and property taxes made by OPG, Hydro One and municipal electric utilities (MEUs).

Debt Retirement Charge (DRC)

The DRC was introduced on May 1, 2002, the date the electricity market opened to competition, and is paid by electricity consumers. The DRC is administered by the Ministry of Finance on behalf of OEFC and will end once the residual stranded debt is retired. Prior to May 1, 2002, OEFC received the residual of the revenue pool. This pool, managed by OPG, collected revenues from electricity consumers and allocated revenues to OPG, Hydro One and IMO, with the residual going to OEFC.

Electricity Sector Dedicated Income

The combined net incomes of OPG and Hydro One in excess of the Province's interest cost of its investment in its electricity subsidiaries are dedicated to the retirement of OEFC's debt.

Stranded Debt and Residual Stranded Debt

OEFC assumed approximately $38.1 billion in total debt and other liabilities from the former Ontario Hydro upon the restructuring of Ontario's electricity sector on April 1, 1999. As part of the restructuring, OEFC received a total of $17.2 billion in notes owing from the Province, OPG, Hydro One and the IMO. The difference of approximately $20.9 billion represented "stranded debt," which is defined under the *Electricity Act, 1998* as the amount of debt and other liabilities of OEFC that cannot reasonably be serviced and retired by commercial companies in a competitive electricity market.

The *Electricity Act, 1998* requires that payments-in-lieu of taxes must be paid by the successor entities and municipal electric utilities (MEUs) to OEFC to service stranded debt. As at April 1, 1999, the present value of these dedicated revenues and Electricity Sector Dedicated Income was estimated at $13.1 billion, resulting in an estimated $7.8 billion of residual stranded debt. The *Electricity Act, 1998* provided for a Debt Retirement Charge (DRC) to be paid by consumers until the residual stranded debt is retired.

The April 1, 1999 Unfunded Liability (the stranded debt from electricity sector restructuring to be recovered from ratepayers) of $19.4 billion of OEFC was composed of the $38.1 billion (described above) less notes receivable of $17.2 billion, less loans receivable and other assets of $1.5 billion.

Unfunded Liability as of March 31, 2003 was $20.2 billion.

Debt and Liabilities

OEFC's total debt outstanding declined by $2.5 billion to $26.8 billion as of March 31, 2003. OEFC has reduced total debt outstanding by over $4.5 billion from its peak on March 31, 2000.

OEFC's total debt and liabilities are $34.7 billion as of March 31, 2003, down from $37.6 billion as of March 31, 2002.

On March 5, 2003, with the prior approval of Hydro One, OEFC completed the sale of $1,878 million (face value) of Hydro One notes. OEFC realized a gain of $206 million on the sale, as interest rates payable on the notes were above market interest rates, which allowed the Province to reduce OEFC's total debt. The notes had maturities ranging from January 2004 to August 2007 and coupons ranging between 5.375 per cent to 14.25 per cent. In order to facilitate the sale of these notes in the Canadian public capital markets, OEFC and Hydro One agreed to restructure the debt by converting the coupons and principal amounts to reflect current interest rates. The sale represented the largest ever corporate debt trade in the Canadian domestic debt market.

For more information on debt and other liabilities, see Notes 8 to 12 to the Financial Statements.

Risk Management

Risk Exposures (Percentage of Outstanding Debt)	2003	2002	Policy Limit
Foreign Exchange Exposure	6.3	7.5	20.0*
Floating Interest Rate Exposure (net of liquid reserves)	13.5	9.8	20.0

*The foreign exchange policy limit will be reduced to five per cent as soon as feasible and prudent.
March 31, 2003

OEFC has risk management policies and procedures in place to address the management of OEFC's market, credit and operational risk exposures, primarily pertaining to OEFC's debt, derivatives and NUG portfolios, and capital markets transactions. A description of OEFC's risk management policies can be found in the Corporate Policies section.

OEFC's foreign exchange and floating interest rate exposures remained within policy limits of 20 per cent in 2002-03.

OEFC's total debt exposed to fluctuations in foreign currencies ("foreign exchange exposure") declined to 6.3 per cent as a result of active debt management and hedging strategies which took advantage of a strengthening Canadian dollar to reduce the foreign exchange exposure of OEFC's debt portfolio. The reduction in the OEFC's foreign exchange exposure was in line with the OEFC's Annual Financing and Debt Management Plan. When the OFA became responsible for the management of OEFC's debt portfolio, total debt exposed to fluctuations in foreign currencies was 14.5 per cent.

The OEFC's exposure to changes in short-term rates ("floating interest rate exposure") was 13.5 per cent as at March 31, 2003.

When issuing new debt, the OFA, on behalf of OEFC, aims for a smooth debt maturity profile to diversify the interest rate risk inherent in refinancing maturing and floating rate debt.

OEFC has also developed the NUG Market Risk Policy and Credit and Related Legal Risks Policy to address risks related to the sale of electricity from NUG contracts. NUG contracts involve risk in both financial and commodity markets.

Management of Power Purchase Agreements

In the late 1980s and early 1990s, the former Ontario Hydro entered into approximately 90 long-term power purchase agreements (PPAs) with non-utility generators (NUGs) located in Ontario. These PPAs, which expire on various dates until 2048, represent approximately 1,700 megawatts of generating capacity and approximately $750 million per year in cash outflow. The PPAs account for about six to eight per cent of the generating capacity available to meet Ontario's energy requirements.

As the continuation of Ontario Hydro, OEFC is responsible for these contracts. The NUG liability had been valued at $4,286 million on a discounted cash-flow (DCF) basis since Ontario Hydro was continued as OEFC on April 1, 1999. Since the electricity market was opened in this fiscal year, the DCF model was updated as of March 31, 2003, which reduced the estimated liability from $4,286 million to $3,745 million. The revaluation change will be amortized to operations over a 10-year period. In addition, each year, interest at the DCF rate is added to the liability and the estimated in-year loss in the DCF model is deducted from the liability. Details are set out in Note 10 to the Financial Statements.

OEFC has retained UBS Warburg Energy (Canada) Ltd. to act as settlement services manager of the PPAs with the NUGs, and to establish systems and procedures for the administration of the PPAs in the open electricity market as well as develop and implement strategies for hedging OEFC's price risk associated with sales of electricity. OEFC continues to negotiate revisions to the NUG contracts to ensure that the contracts are consistent with the open electricity market.

A policy framework for the prudent risk management of NUG electricity sales associated with the PPAs, including market and credit risk management policies, was approved. These policies establish the foundation for the assessment, monitoring and reporting of electricity market and credit risks and are similar in structure to the corresponding policies for the management of traditional financial market and credit exposures.

The Electricity Pricing, Conservation and Supply Act, 2002

Ontario's electricity market opened to competition on May 1, 2002. The wholesale price of electricity is determined by supply and demand in a competitive market.

While the wholesale market continues to operate in a competitive environment, on December 9, 2002, the *Electricity Pricing, Conservation and Supply Act, 2002* was passed to freeze the price that low volume and designated consumers pay for electricity at 4.3 cents per kilowatt-hour (¢/kWh) until at least 2006. OEFC is responsible for managing the Electricity Consumer Price Protection Fund (ECPPF or the "Fund") established as a result of the Act.

Fund Management

OEFC is required to pay to or receive from the IMO any difference between the current market price (the "spot price") and the fixed 4.3¢/kWh charged to consumers designated under the Act.

- When spot prices are higher than 4.3¢/kWh, OEFC will make a payment to the IMO equal to the difference between spot price and 4.3¢/kWh based on the quantity consumed. The IMO will reduce the amount payable by the distributors for amounts consumed by a corresponding amount down to 4.3¢/kWh.
- When spot prices are lower than 4.3¢/kWh, OEFC will receive a payment from the IMO equal to the difference between spot price and 4.3¢/kWh based on the quantity consumed. The IMO will increase the amount payable by the distributors for amounts consumed by a corresponding amount up to 4.3¢/kWh.

The Fund will receive a large proportion of its funding from the portion of the Market Power Mitigation Agreement (MPMA) rebate paid by OPG that is attributable to the low volume and designated consumers. The initial $75 consumer refund for the May 1, 2002 to November 30, 2002 period was funded from OPG's MPMA rebate liability.

Net costs were higher than originally expected due to higher-than-expected prices arising from a long and severe winter. Program costs were also higher than initially expected due to higher costs to maintain the contractual rights of retailers. Annual results for the Fund are expected to improve as new supply comes on-line and reduces electricity prices.

The financial statements reflect the net expense of the Fund for this fiscal year. More information on the Fund can be found in Note 13 to the Financial Statements.

Objectives for 2003-04

OEFC's activities for 2003-04 will be focused on the following corporate objectives:

- Continue to perform borrowing, risk management, cash management, banking and accounting services as required in managing and retiring the outstanding debt and derivative contracts of the former Ontario Hydro;
- Assist in the implementation of the government's electricity policy decisions and coordinate economic and financial issues related to the industry. This includes management of the Electricity Consumer Price Protection Fund, managing financial relationships with the successor companies of Ontario Hydro (Hydro One, Ontario Power Generation Inc. and the Independent Electricity Market Operator) and assisting the Ministry of Energy and the Ministry of Finance in analyzing and implementing new supply initiatives, such as the temporary generation initiatives for the summer and fall of 2003;
- Continue negotiating revisions to the non-utility generator (NUG) contracts to ensure that the contracts are consistent with the competitive market. Develop and implement the necessary infrastructure to manage, in a cost-effective and prudent manner, the NUG contracts and related exposures and their integration into the power market administered by the Independent Electricity Market Operator (IMO); and
- Discharge OEFC's liability to the nuclear decommissioning fund related to generating stations of the former Ontario Hydro.

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Responsibility for Financial Reporting

The accompanying consolidated financial statements of the Ontario Electricity Financial Corporation have been prepared in accordance with accounting principles recommended for governments by the Canadian Institute of Chartered Accountants and are the responsibility of management. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to July 25, 2003.

Management maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. Internal Audit Services of the Ministry of Finance independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit Committee of the Board of Directors.

The Board of Directors, through the Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee meets periodically with management, the internal auditors and the external auditor to deal with issues raised by them and to review the financial statements before recommending approval by the Board of Directors.

The financial statements have been audited by the Provincial Auditor. The Provincial Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with accounting principles recommended for governments by the Canadian Institute of Chartered Accountants. The Auditor's Report, which appears on the following page, outlines the scope of the Auditor's examination and his opinion.

On behalf of Management:

M. Gourley

Michael L. Gourley
Vice-Chair and Chief Executive Officer

Office of the
Provincial Auditor
of Ontario

Bureau du
vérificateur provincial
de l'Ontario

AUDI ALTERAM PARTEM

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Auditor's Report

To the Ontario Electricity Financial Corporation
and to the Minister of Finance

I have audited the consolidated balance sheet of the Ontario Electricity Financial Corporation as at March 31, 2003 and the consolidated statements of revenue, expense and unfunded liability and of cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I 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 my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at March 31, 2003 and the results of its operations and its cash flows for the year then ended, in accordance with the accounting principles recommended for governments by the Canadian Institute of Chartered Accountants.

Toronto, Ontario
July 25, 2003

Erik Peters, FCA
Provincial Auditor

Ontario Electricity Financial Corporation
Consolidated Balance Sheet
as at March 31, 2003
($ Millions)

	2003	2002
ASSETS		
Current Assets		
Cash and cash equivalents (Note 5)	$ 3	$ 23
Accounts receivable	248	292
Interest receivable	31	106
Current portion of notes receivable (Note 7)	651	443
	933	864
Payments-in-lieu of tax receivable (Note 12)	218	236
Due from Province of Ontario (Note 6, 12)	351	524
Notes and loans receivable (Note 7)	12,337	14,949
Deferred debt costs	673	905
	$ 14,512	$ 17,478
LIABILITIES		
Current Liabilities		
Accounts payable	$ 210	$ 442
Interest payable	556	659
Short-term notes payable (Note 8)	3,413	3,996
Current portion of long-term debt (Note 8)	1,665	2,548
	5,844	7,645
Long-term debt (Note 8)	21,752	22,820
Power purchase contracts (Note 10)	4,125	4,286
Nuclear funding liability (Note 11)	2,974	2,812
	34,695	37,563
UNFUNDED LIABILITY (Note 4, 12)	(20,183)	(20,085)
Contingencies and guarantees (Note 14)		
	$ 14,512	$ 17,478

Approved on behalf of the Board of Directors:

Bob Christie
Chair

Michael L. Gourley
Vice-Chair

See accompanying notes to financial statements

Ontario Electricity Financial Corporation

Consolidated Statement of Revenue, Expense and Unfunded Liability

for the Year Ended March 31, 2003

($ Millions)

	2003	2002
REVENUE		
Debt retirement charge (Note 1)	$ 889	$ -
Revenue pool residual (Note 1)	24	1,296
Payments-in-lieu of tax (Note 12)	711	387
Interest	964	1,028
Power sales (Note 10)	635	815
Net reduction of power purchase contracts (Note 10)	161	-
Electricity sector dedicated income (Note 6, 12)	197	-
Gain on sale of Hydro One notes (Note 7)	206	-
Other	10	18
Total Revenue	3,797	3,544
EXPENSE		
Interest - short-term debt	147	113
- long-term debt	1,867	2,223
Interest on nuclear funding liability (Note 11)	162	153
Amortization of deferred charges	105	140
Electricity Consumer Price Protection Fund (Note 13)	665	-
Power purchases (Note 10)	786	815
Debt guarantee fee	147	153
Operating	16	16
Total Expense	3,895	3,613
Deficiency of revenue over expense	98	69
Unfunded Liability, beginning of period	20,085	20,016
Unfunded Liability, end of period	$ 20,183	$ 20,085

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation

Consolidated Statement of Cash Flows

for the Year Ended March 31, 2003

($ Millions)

	2003	2002
CASH FLOWS USED IN OPERATING ACTIVITIES		
Deficiency of revenue over expense	$ 98	$ 69
Adjustments for:		
Amortization of deferred charges	(105)	(140)
Net reduction of power purchase contracts (Note 10)	161	-
Interest on nuclear funding liability (Note 11)	(162)	(153)
Payments-in-lieu of tax receivable	(18)	(48)
Net change in other balance sheet accounts	69	(89)
Net cash required by (provided from) operations	43	(361)
CASH FLOWS FROM FINANCING ACTIVITIES		
Long-term debt issues	967	1,123
Less long-term debt retired	2,775	3,826
Long-term debt retired (issued), net	1,808	2,703
Short-term debt retired (issued), net	583	(1,426)
Sale of notes receivable (Note 7)	(1,878)	-
Repayment of notes receivable	(536)	(540)
Net cash required by (provided from) financing activities	(23)	737
Increase (decrease) in cash and cash equivalents	(20)	(376)
Cash and cash equivalents, beginning of year	23	399
Cash and cash equivalents, end of year	$ 3	$ 23
Interest paid during the year and included in deficiency of revenue over expense	$ 2,117	$ 2,411

See accompanying notes to financial statements.

Ontario Electricity Financial Corporation
Notes to Financial Statements

1. Restructuring of the Ontario Electricity Industry

Effective April 1, 1999, pursuant to the *Electricity Act, 1998*, Ontario Hydro was continued as a corporation without share capital under the name Ontario Electricity Financial Corporation (OEFC). It is exempt from federal and provincial income taxes under paragraph 149(1)(d) of the Income Tax Act of Canada. OEFC is a Crown agency created to manage the debt and administer the assets, liabilities, rights and obligations of Ontario Hydro not transferred to other successor entities. These other successor entities include:

- Ontario Power Generation Inc. (OPG), an electricity generation company;
- Hydro One Inc. (Hydro One), a regulated electricity transmission and distribution business;
- Independent Electricity Market Operator (IMO), the regulated centralized independent system co-ordinator responsible for directing system operations and operating the electricity market; and
- Electrical Safety Authority (ESA), which performs a regulatory function related to electrical inspections.

On April 1, 1999, the respective business units, including assets, liabilities, employees, rights and obligations of the former Ontario Hydro, were transferred to OPG and Hydro One (and their subsidiaries) and the IMO for $8.5 billion, $8.6 billion and $78 million respectively in exchange for debt payable to OEFC. On the same day, the Province exchanged equity of $5,126 million and $3,759 million in OPG and Hydro One respectively for debt payable to OEFC.

OEFC debt, liabilities and associated financing costs will be repaid from interest on notes receivable from the Province and successor entities, and, as provided under the *Energy Competition Act, 1998*, from dedicated electricity revenues in the form of payments-in-lieu (PILs) of corporate income, capital and property taxes made by the successor entities and municipal electric utilities. Any residual debt will be serviced through a Debt Retirement Charge (DRC) to be paid by electricity consumers after open access at a rate of 0.7 cents per kilowatt hour in most Ontario communities. Until open access on May 1, 2002, OEFC continued to be a party to a revenue-allocation agreement among successor entities and was entitled to the forecast residual amount in the revenue pool after allocations to OPG, Hydro One and the IMO are paid.

2. Summary of Significant Accounting Policies

Basis of Accounting

As OEFC is a government organization, these financial statements are prepared in accordance with the recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants.

Measurement Uncertainty

Uncertainty in the determination of the amount at which an item is recognized in the financial statements is known as measurement uncertainty. Such uncertainty exists when it is reasonably possible that there could be a material variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used. Measurement uncertainty in these financial statements exists in the estimated amount for the Electricity Consumer Price Protection Fund, the valuation of the power purchase contracts and the estimated defeasance date for OEFC's obligations. Estimates are based on the best information available at the time of preparation of the financial statements and will be updated annually to reflect new information as it becomes available.

Consolidation

These financial statements include the residual accounts of OEFC's wholly owned subsidiary, Ontario Electricity Pension Services Corporation (see Note 3).

Deferred Debt Costs

Deferred debt costs includes the unamortized amounts related to unrealized foreign exchange gains or losses resulting from the translation of long-term debt issued in foreign currencies and discounts, premiums or commissions arising from the issuance of debt or the acquisition of debt prior to maturity. These costs are amortized to operations over the life of the underlying debt.

Revenue Recognition

Revenues are recognized in the period in which they are earned.

Foreign Currency Translation

Debt is composed of short-, medium- and long-term bonds, notes and debentures. Debt denominated in foreign currencies that have been hedged is recorded at the Canadian dollar equivalent using the rates of exchange established by the terms of the hedge agreements. Other foreign currency debt, liabilities and assets are translated to Canadian dollars at period-end rates of exchange and any exchange gains or losses are deferred and amortized over the remaining term to maturity.

Power Purchase Contracts

The power purchase contracts liability is valued on a discounted cash-flow (DCF) basis. Periodic revaluations of this liability will give rise to changes in the estimated cost of the contracts and will be amortized to operations over a maximum 10-year period.

3. Ontario Electricity Pension Services Corporation

OEFC was the administrator of the Ontario Electricity Financial Corporation Pension Plan and Fund. It was responsible for negotiating an agreement with each of the successor corporations for the division and transfer of the assets and liabilities of the OEFC pension plan to the pension plans of the successor corporations. The Ontario Electricity Pension Services Corporation, (OEPSC), a wholly owned subsidiary of OEFC, acted as agent for OEFC to carry out the required administrative, investment and other responsibilities of the OEFC Pension Plan and Fund.

OEPSC made application to the Superintendent of Financial Services for Ontario for approval to transfer all of the assets of the OEFC Pension Plan to the pension plans of the four successor operating entities. The Superintendent agreed to the transfer on June 6, 2001. With the exception of certain records and assets of nominal value, all pension fund assets were transferred to the pension plans of successor corporations on June 29, 2001. As OEPSC's functions have been completed, OEFC is in the process of winding up the company.

4. Economic Dependence

OEFC does not have its own credit rating and is, therefore, dependent on the Province to borrow and on-lend the funds required to refinance maturing debt and to cover any cash shortfalls in the Corporation. It is also dependent on the long-term plan to defease the unfunded liability described in Note 12. Based on the Province's support in refinancing maturing debt and the long-term plan, OEFC is considered a going concern.

5. Cash and Cash Equivalents

Cash and cash equivalents includes cash on deposit and highly liquid investments with maturities of less than three months. They are recorded at cost, which approximates current market value.

6. Due from Province of Ontario

The Province has committed to dedicate the combined net income of OPG and Hydro One in excess of the Province's financing cost of its investment in its electricity subsidiaries to OEFC. In the year ended March 31, 2003, OPG and Hydro One earned an aggregate amount of $717 million, $197 million in excess of the Province's $520 million financing cost of its investment. In 2001-02, the aggregate earnings of the subsidiaries did not exceed the Province's financing cost. The $197 million amount has been reflected as income in OEFC. In July 2002, the Province paid $370 million to OEFC towards the outstanding balance.

7. Notes and Loans Receivable

($ millions)

	Maturity date	Interest rate	Interest payable	March 31, 2003	March 31, 2002
Province of Ontario	2039 - 2041	5.85	Monthly	$ 8,885	$ 8,885
OPG	2005 - 2011	5.44 to 6.65	Semi-annually	3,200	3,200
Hydro One	2003	5.4 to 13.5	Semi-annually	651	2,972
IMO	2009	7.90	Semi-annually	78	78
				12,814	15,135
Less: Current portion of notes receivable				651	443
				12,163	14,692
Loans receivable from non-utility generators (NUGs) (See Note 10)				174	257
				$ 12,337	**$ 14,949**

OEFC has agreed with OPG and IMO not to sell notes owing from these successor entities without their prior approval.

On March 5, 2003, with the prior approval of Hydro One, OEFC completed the sale of $1,878 million (face value) of Hydro One notes. OEFC realized a gain of $206 million on the sale as interest rates payable on the notes were above market interest rates.

In 2002, OEFC had agreed with OPG to defer principal payments of $200 million originally due in March and September, 2002 until December 2004. These maturities totalling $200 million have been further deferred until December 2006. In addition, OEFC has agreed with OPG to defer principal repayments totalling $500 million originally due in the period March 2003 to September 2004. The new maturity dates on these notes have been extended until March 2005 to September 2006.

8. Debt

Debt at March 31, 2003 is set out below by maturity and by currency of repayment, expressed in Canadian dollars.

($ millions) Currency	Canadian Dollar	U.S. Dollar	Japanese Yen	2003 Total	2002 Total
Maturing in:					
1 year	4,781	232	65	5,078	6,544
2 years	3,250	—	—	3,250	1,666
3 years	1,000	425	—	1,425	3,250
4 years	119	—	—	119	1,000
5 years	389	1,570	—	1,959	119
1-5 years	9,539	2,227	65	11,831	12,579
6-10 years	6,178	1,489	—	7,667	8,237
11-15 years	648	—	—	648	1,843
16-20 years	3,678	—	—	3,678	2,702
21-25 years	2,077	—	—	2,077	3,037
26-50 years	929	—	—	929	966
Total	**$ 23,049**	**$ 3,716**	**$ 65**	**$ 26,830**	**$ 29,364**

The effective rate of interest on the debt portfolio is 6.78 per cent (March 2002 - 6.96 per cent) before considering the effect of derivative instruments used to manage interest rate risk. The longest term to maturity is to October 17, 2031. Total foreign currency denominated debt at March 31, 2003 was $3.8 billion (March 2002 - $3.6 billion), of which $2.6 billion or 67.7 per cent (March 2002 - $1.9 billion or 52.8 per cent) was fully hedged to Canadian funds. Bonds and notes payable are either held, or guaranteed as to principal and interest, by the Province as set out below:

	March 31, 2003			March 31, 2002		
($ millions)	Held by the Province	Guaranteed by the Province	Total	Held by the Province	Guaranteed by the Province	Total
Short-term debt	3,413	—	3,413	3,996	—	3,996
Current portion of long-term debt	350	1,315	1,665	48	2,500	2,548
Long-term debt	9,791	11,961	21,752	9,173	13,647	22,820
Total	**$ 13,554**	**$ 13,276**	**$ 26,830**	**$ 13,217**	**$ 16,147**	**$ 29,364**

Fair value of debt issued approximates amounts at which debt instruments could be exchanged in a current transaction between willing parties. In valuing the OEFC's debt, fair value is estimated using discounted cash flows and other valuation techniques and is compared to public market quotations where available. These estimates are affected by the assumptions made concerning discount rates and the amount and timing of future cash flows.

The estimated fair value of OEFC debt at March 31, 2003 is $31.2 billion (March 2002 - $32.8 billion). This is higher than the book value of $26.8 billion (March 2002 - $29.4 billion) because current interest rates are generally lower than the interest rates at which the debt was issued and because of exchange rate movements. The fair value of debt does not reflect the effect of related derivative contracts.

9. Risk Management and Derivative Financial Instruments

OEFC employs various risk management strategies and operates within strict risk exposure limits to ensure exposure to risk is managed in a prudent and cost-effective manner. A variety of strategies are used, including the use of derivative financial instruments ("derivatives"). Derivatives are financial contracts, the value of which is derived from underlying instruments. OEFC uses derivatives for the purpose of hedging and to minimize interest costs. Hedges are created primarily through swaps, which are legal arrangements under which OEFC agrees with another party to exchange cash flows based upon one or more notional amounts during a specified period. This allows OEFC to offset its existing obligations and thereby effectively convert them into obligations with more desirable characteristics. Other derivative instruments used by OEFC include forward foreign exchange contracts, forward rate agreements, futures and options.

Foreign exchange or currency risk is the risk of debt servicing costs and principal payments varying due to fluctuations in foreign exchange rates. To minimize currency risk, OEFC uses derivative contracts to convert foreign currency cash flows into Canadian dollar denominated cash flows. The current policy allows unhedged foreign currency cash flows to reach a maximum of 20 per cent of total debt. At March 31, 2003, 6.3 per cent (March 2002 - 7.5 per cent) of this debt was unhedged, with most of the currency exposure to US dollars.

Floating rate risk is the exposure of OEFC to changes in short-term interest rates over a 12-month period. OEFC reduces its exposure to rate changes by entering into derivative contracts that convert floating interest payments to fixed interest payments. The current policy allows unhedged floating rate debt, net of liquid reserves, to reach a maximum of 20 per cent of total debt. At March 31, 2003, OEFC's floating rate debt as a percentage of total debt was 13.5 per cent (March 2002 - 9.8 per cent).

Liquidity risk is the risk that OEFC will not be able to meet its current short-term financial obligations. As explained in Note 4, OEFC is dependent on the Province to borrow and on-lend the funds required to refinance maturing debt and to cover any cash shortfalls in the Corporation.

The table below presents a maturity schedule of OEFC's derivatives, by type, outstanding at March 31, 2003, based on the notional amounts of the contracts. Notional amounts represent the volume of outstanding derivative contracts and are not indicative of credit risk, market risk or actual cash flows.

Derivative Portfolio Notional Value
($ millions)
As at March 31, 2003

Maturity in Fiscal Year	2004	2005	2006	2007	2008	6-10 Years	Over 10 Years	Total 2003	Total 2002
Cross-currency swaps	1,046	-	425	-	496	388	-	2,355	1,528
Interest rate swaps	2,214	292	1,515	132	1,246	158	1,486	7,043	6,420
Forward foreign exchange contracts	720	-	-	-	-	-	-	720	974
Other[1]	-	50	-	-	-	-	-	50	250
Total	$ 3,980	342	1,940	132	1,742	546	1,486	10,168	$ 9,172

[1]Other includes swaptions and forward rate agreements.

The use of derivatives introduces credit risk, which is the risk of a counterparty defaulting on contractual derivative obligations in which OEFC has an unrealized gain. The table below presents the credit risk associated with the derivative financial instrument portfolio, measured through the replacement value of derivative contracts, at March 31, 2003.

Credit Risk Exposure ($ millions)	March 31, 2003	March 31, 2002
Gross credit risk exposure[1]	4,167	4,569
Less: Netting[2]	(4,293)	(4,709)
Net credit risk exposure[3]	$ (126)	$ (140)

Notes:
[1] Gross credit risk exposure includes credit exposure on swaps, options, futures, forward rate agreements and forward foreign exchange agreements.
[2] Master agreements provide for close out netting as contracts do not have coterminous settlement dates.
[3] Total exposure to counterparties with positive exposure (meaning that counterparties owed OEFC) was $202 million (March 2002 - $111 million) and the total exposure to counterparties with negative exposure (meaning that OEFC owed the counterparties) was $328 million (March 2002 - $251 million) for a total net credit exposure of ($126) million (March 2002 - ($140) million).

OEFC manages its credit risk exposure from derivatives by, among other things, dealing only with high credit quality counterparties and regularly monitoring compliance to credit limits. In addition, OEFC enters into contractual agreements (master agreements) that provide for termination netting and, if applicable, payment netting with virtually all of its counterparties. Gross credit risk exposure represents the loss OEFC would incur if every counterparty to which OEFC had credit risk exposure were to default at the same time and the contracted netting provisions were not exercised or could not be enforced. Net credit risk exposure is the loss including the mitigating impact of these netting provisions.

As at March 31, 2003, OEFC's most significant concentrations of credit risk were with three A+ or higher rated counterparties, each of which represented more than 10 per cent of the Net Credit Risk Exposure. The net cost to OEFC, if it had to replace all of the swap contracts with these three counterparties is $23 million, $62 million and $85 million, respectively.

10. Power Purchase Contracts

Power purchase agreements and related loan agreements were entered into by Ontario Hydro with non-utility generators (NUGs) located in Ontario. As the continued Ontario Hydro, OEFC is the counterparty to these contracts. These contracts, expiring on various dates to 2048, provide for the purchase of power at prices that are expected to be in excess of the market price. Since open access on May 1, 2002, this power has been sold at market prices that generally have been less than cost. Prior to open access, power purchased from NUGs was resold at cost to the revenue pool managed by OPG.

During the year, OEFC purchased power in the amount of $786 million (2002 - $815 million) and sold this power for $635 million (2002 - $815 million). Effective April 18, 2002, the NUG Contract Management Agreement between Enron Canada Corporation and OEFC was assigned to UBS Warburg Energy (Canada) Ltd. Annual fees include both a fixed fee of approximately $750,000 plus a variable fee based on performance in minimizing losses under NUG power purchase agreements that amounted to $10 million (2002 - $ nil).

The NUG liability had been valued at $4,286 million on a discounted cash-flow (DCF) basis since Ontario Hydro was continued as OEFC on April 1, 1999. Since the electricity market was opened in this fiscal year, the DCF model was updated as of March 31, 2003 which reduced the estimated liability from $4,286 million to $3,745 million. The revaluation change will be amortized to operations over a 10-year period. In addition, each year, interest at the DCF rate is added to the liability and the estimated in-year loss in the DCF model is deducted from the liability as set out below:

Statement of NUG Liability
($ millions)

NUG Liability, March 31, 2002		$ 4,286
Interest charged during the year		253
Deduct estimated in-year loss		(372)
Revaluation as of March 31, 2003		(422)
Sub total		3,745
Add: Unamortized Revaluation Changes		
Gross Revaluation	422	
Accumulated Amortization	(42)	380
		$ 4,125

Loans to NUGs decreased during the period by a net $83 million to $174 million at March 31, 2003 (March 31, 2002 - $257 million), primarily due to principal repayments.

11. Nuclear Funding Liability

OEFC as the continued Ontario Hydro received a liability in the amount of $2,378 million representing nuclear waste management and asset removal liabilities that were incurred prior to April 1, 1999. In March 2002, the Province and OPG entered into the Ontario Nuclear Funds Agreement (ONFA) to establish, fund and manage segregated funds to ensure that sufficient funds are available to pay for costs of nuclear waste management and station decommissioning. The OEFC liability will be directed to the Decommissioning Custodial Fund, which is expected to be established later in 2003.

The Board of Directors of OEFC approved the funding of the Decommissioning Custodial Fund over the next four years, thus discharging the nuclear funding liability. OEFC reflected the nuclear funding liability at April 1, 1999 and has been accruing interest annually at an estimated 5.75 per cent since that time. At March 31, 2003, this estimated accrued interest was included in the liability amount of $2,974 million (2002 - $2,812 million). The calculation of the interest rate is still under negotiation between the parties, but is expected to be finalized later in 2003. The impact of the finalization of the interest rate calculation is not expected to result in a material difference to the liability balance.

12. Unfunded Liability

The opening unfunded liability of $19.4 billion at April 1, 1999 was composed of $38.1 billion in liabilities assumed from old Ontario Hydro less the value of assets transferred to OEFC at April 1, 1999 including $17.2 billion in notes receivable and $1.5 billion in loans receivable and other assets. A long-term plan was established to retire OEFC liabilities from within the electricity sector. The Plan includes cash flows from the following sources as at **April 1, 1999**:

Notes receivable from the Province of $8.9 billion, OPG of $3.4 billion, Hydro One of $4.8 billion and IMO for $0.1 billion for a total of $17.2 billion as a result of the transfer of assets to successor companies,

Payments-in-lieu of corporate income, property and capital taxes made by OPG, Hydro One and municipal electric utilities,

a **Debt Retirement Charge** to be paid by ratepayers based on the consumption of electricity, and

Electricity Sector Dedicated Income - The combined net income of OPG and Hydro One in excess of the Province's cost of its investment in its electricity subsidiaries will be allocated to the retirement of OEFC's debt.

The long-term plan supports a current estimate that OEFC's obligations will likely be defeased in 2012.

13. Electricity Consumer Price Protection Fund

On November 11, 2002, the Province announced a program designed to provide electricity to low volume and designated consumers at a fixed price of 4.3 cents per kilowatt-hour (kWh) until at least 2006, retroactive to May 1, 2002. Power generators continue to receive the free market price as set in the IMO electricity market. The program is administered through the Electricity Consumer Price Protection Fund (ECPPF) managed by OEFC.

During periods where the average price of electricity is greater than the fixed rate of 4.3 cents per kWh, the balance is funded by the ECPPF. Conversely, the ECPPF will receive funds during periods where the average price of electricity is lower than the fixed rate of 4.3 cents per kWh. Expenditures from the Fund amounting to $1,461 million in the year were reduced by a portion of the rebate paid by OPG under the Market Power Mitigation Agreement (MPMA) in the amount of $796 million leaving a net cost in OEFC of $665 million.

14. Contingencies and Guarantees

OEFC is involved in various legal actions arising out of the ordinary course and conduct of business, some of which relate to the former Ontario Hydro prior to the establishment of OEFC on April 1, 1999. Under the terms of the April 1, 1999 restructuring of Ontario Hydro, each successor entity (OPG, Hydro One, ESA and IMO, and their respective subsidiaries) is responsible for any liabilities relating to those operations of the former Ontario Hydro that were transferred to it. In the event any such liabilities remained with OEFC, the successor entity is also required to indemnify OEFC. With respect to legal actions relating to operations of Ontario Hydro that were retained by OEFC, the outcome and ultimate disposition of these legal actions is not determinable at this time. Accordingly, no provision for the above actions is reflected in the financial statements. Settlements of these contingencies, if any, will be reflected in the period in which settlement occurs.

Subject to a $10 million and $20 million deductible respectively, OEFC has agreed to indemnify Hydro One and OPG with respect to any adverse claim to title to any asset, right or thing transferred or intended to be transferred to the companies at April 1, 1999 and any failure of the transfer order to transfer such assets, rights or things and with respect to payment to or from or other dealing with any equity account of Ontario Hydro, including certain related litigation. The Province of Ontario has guaranteed any liability arising from these indemnifications.

OEFC is contingently liable under guarantees given to third parties that have provided long-term financing to certain independent power producers in connection with the power purchase agreements described in Note 10. These guarantees total approximately $113 million at March 31, 2003 (2002 - $124 million).

Corporate Governance

The Board of Directors

Bob Christie Chair and Deputy Minister of Finance.
[Appointed from September 2000 to September 2006]

Michael L. Gourley Vice-Chair and Chief Executive Officer, Vice-Chair and Chief Executive Officer of the Ontario Financing Authority.
[Appointed from July 2002 to June 2005]

Brian FitzGerald Fellow of the Canadian Institute of Actuaries.
[Appointed from March 2003 to March 2004]

Bryne Purchase Deputy Minister, Ministry of Energy.
[Appointed from April 2001 to March 2004]

Tom Sweeting Assistant Deputy Minister, Office of the Budget and Taxation, Ministry of Finance.
[Appointed from April 2001 to March 2004]

Bruce Macnaughton Director, Pension and Income Security Policy Branch, Ministry of Finance.
[Appointed from April 2001 to March 2004]

Robert Siddall Chair, OEFC Audit Committee, Provincial Controller, Ministry of Finance.
[Appointed from November 2002 to November 2005]

Karen Sadlier-Brown Assistant Deputy Minister, Corporate and Electricity Finance Division, Ontario Financing Authority.
[Appointed from July 2003 to July 2006]

Corporate Governance

Appointed by the Lieutenant Governor in Council, the Board of Directors is responsible for supervising OEFC's business. OEFC retains services from the Ontario Financing Authority (OFA) and the Ministry of Finance to carry out its daily operations. The Board of Directors meets at least quarterly. It monitors OEFC's financial performance and approves OEFC's financial policies and its business plan for each year.

The Minister of Finance reviews and approves the OEFC's annual business plan, which contains long- and short-term objectives and reports on accomplishments for the preceding year. In keeping with the government's Agency Establishment and Accountability Directive, once every three years the Minister of Finance recommends the OEFC business plan to Management Board of Cabinet for approval.

The OEFC Audit Committee supports the Board of Directors with the review and recommendation for approval of OEFC's financial statements. The Audit Committee also recommends the annual internal audit plan and reviews the findings of the internal auditors regarding the adequacy of internal controls. The OEFC Audit Committee has recommended to the Board that the legislation regarding the timing of the delivery and tabling of the Corporation's annual report, including audited financial statements, be made consistent with the timing of the Province's Public Accounts, because of the relationship of OEFC's statements to the Public Accounts.

OEFC's Board also has a NUG Committee. This committee makes decisions concerning OEFC's Power Purchase Agreements. Membership includes OEFC Directors representing the Ministry of Finance and the Ministry of Energy.

Corporate Policies

Overview and Structure

Board of Directors

- Reviews and approves key risk management policies.
- Supervises the management of the OEFC's debt portfolio and NUG power sales.

Audit Committee

- Oversees the financial reporting process on behalf of the Board of Directors.
- Reviews key risk management policies, internal audit reports and the financial statements.

Management Committees

Risk Management Committee

- Reviews daily market updates and outlook.
- Reviews current borrowing, investing and debt management positions and strategies.

Borrowing Strategy Committee

- Reviews economic conditions, fiscal plan and capital markets outlook.
- Reviews borrowing and debt management activities and management reports, cash flows and the annual financing charge forecast.
- Reviews operational limits and procedures related to financial operations.
- Approves amendments and exceptions to approved risk management policies and procedures.
- Approves risk management policies for recommendation to the Board of Directors.

Risk Control Division

- Monitors, measures and assesses market risks and performance associated with borrowing and NUG power sales.
- Develops and updates risk management policies in response to best industry practices in an evolving business environment and underlying risks of the programs and compliance with all policies on a timely basis to senior management and the Board of Directors.
- Monitors compliance with Board-approved policies, limits and procedures, and monitors portfolio performance and trends.
- Assesses counterparty credit risk and manages rating agency relations.

Risk Management Policies and Procedures for Borrowing and Debt Management

The OFA incurs credit, market, operational and liquidity risks for OEFC in managing the debt of OEFC. These risks are managed in accordance with risk management policies approved by the OEFC Board of Directors. The Board and management committees establish and approve risk management policies and monitor OEFC's compliance with the policies and the performance of the OFA's OEFC-related capital market activities.

OEFC has a number of policies in place to mitigate financial risks: market risk, credit risk, operational risk and risks related to the use of derivatives. These policies were developed following the Group of Thirty's best practices, the guidelines and directives of regulatory bodies, such as the Office of the Superintendent of Financial Institutions of Canada, the Bank for International Settlements (BIS), and consulting with Canadian bank representatives on their risk management practices.

With the advent of the electricity market and the exposures inherent in the management of the NUGs contracts and related transactions, policies specifically addressing these exposures were recommended to the Board of Directors and approved. These policies and associated procedures will be used to develop and implement an infrastructure for monitoring and assessing NUG-related exposures.

Market Risk

- Market Risk is the risk of financial loss attributable to changes in the values of financial indices including interest rates, credit spreads, foreign exchange rates and liquidity condition.

- This policy provides a framework for borrowing and integrates several aspects dealing with the management of market risk.

    - Foreign Exchange Exposure Limit - OEFC's exposure to unhedged foreign currencies is limited to 20 per cent of outstanding debt. This limit will be reduced to five per cent as soon as feasible and prudent. Foreign exchange exposures are limited to Group of Seven currencies and the Swiss franc or the equivalent currencies (i.e., the Euro).

    - Floating Rate Exposure - OEFC is limited to a maximum floating rate exposure of 20 per cent of debt.

    - Risk Management Loss Limits - The total amount of financial losses resulting from market risk and the default of counterparties shall not exceed a debt cost loss limit specified by the Board of Directors. Additionally, the CEO establishes a debt management trigger level to ensure that losses will not reach the debt cost loss limit. The trigger level is included in the Annual Financing and Debt Management Plan.

    - Risk Measurement - OEFC identifies and quantifies exposures to market risk in its Annual Financing and Debt Management Plan to ensure that risk exposures and losses remain within the approved exposure and loss limits. Exposure to market, credit and liquidity risk is measured daily.

    - Debt Maturity Profile - When issuing new debt on behalf of OEFC, the OFA will aim for a smooth debt maturity profile to diversify the interest rate risk for the refinancing of maturing and floating rate debt.

Credit Risk

Credit risk is risk that a counterparty does not meet, or defaults on its obligations. Credit risk arises when the OFA undertakes financial and derivative transactions on behalf of OEFC. The minimum credit rating of a counterparty for a new swap transaction is AA- and R1-mid for money market investments. The resulting exposure is capped at mark-to-market limits depending on the counterparty's credit rating and capital base.

Operational Risk

OEFC's operational risk is managed through procedures that deal with model risk, legal risk, settlement risk and information systems risks.

Model Risk

OEFC's pricing models are regularly reviewed for accuracy and compliance with industry standards. OEFC's valuation of financial instruments is also reviewed regularly.

Legal Risk

Procedures and standards have been implemented to ensure that documentation of OEFC debt issues, debt management and money market transactions meet industry standards and is enforceable.

Settlement Risk

On behalf of OEFC, the OFA has established internal control procedures and systems, involved external service providers and trained its staff to ensure that transactions are settled correctly and in a timely manner, are recorded accurately, and that service providers are appropriately involved.

Information Systems Risk

As OEFC's service provider, on behalf of OEFC, the OFA has taken measures to protect computer systems and access to the offices of the OFA, monitoring the computer room environment, the establishment of a back-up power source, regular data back-ups, off-site storage, firewalls to protect against unauthorized network intrusions and computer virus scanning. Security is reviewed periodically and when major changes occur.

Use of Derivatives

Derivatives are used solely to advance the objective of providing OEFC's financing and liquidity requirements in a sound and cost-effective manner. Derivatives are used to manage exposures arising from existing and planned debt, and in a manner consistent with the Annual Financing and Debt Management Plan. Risks arising from the use of derivatives are identified, monitored, evaluated and managed prudently.

Risk Management Policies for NUG Power Sales

Market Risk

The NUG Market Risk Policy for Electricity Risk Management provides for a framework governing the use of electricity derivatives for the program, as well as volumetric limits on the level of forward sales and financial loss limits. A key requirement for electricity forwards and other derivative contracts is OEFC's ability to price and measure the risk associated with them. The policy mandates an annual NUG risk management plan, which delineates the assumptions for the upcoming fiscal year, including economic and electricity price assumptions, base case and contingency plans for managing and diversifying risk, and supply availability assumptions. A risk assessment for all assumptions is also required.

Credit Risk

OEFC incurs credit risk in the course of its forward transactions with counterparties in the marketplace. This policy addresses that risk through minimum credit ratings and through exposure, term-, and concentration limits. Additionally, the policy sets out requirements for documentation and enforceability. Monitoring and reporting of credit exposures and credit quality are performed by Risk Control Division.

Supply Availability Risk

Supply Availability Risk is the risk associated with having to meet contractual obligations associated with portfolio hedging transactions through open market transactions. As with financial market activities, management of OEFC's NUGs electricity generation portfolio must assess both market and counterparty credit risks. In addition, managing these risks is further complicated by such risks as equipment breakdown, fuel availability and fuel costs, all of which could affect OEFC's ability to meet its contractual obligations through NUGs supply.

Risk Management Reporting

At its regular quarterly meetings, the OEFC Board of Directors is informed of OEFC's activities, positions and risk exposures through three types of reports:

- CEO's report;
- Exposure and performance report; and
- Exception report provided by the Director of Risk Control, OFA.

OEFC's Annual Financing and Debt Management Plan, which indicates how OEFC risk exposures and losses will be maintained within the approved exposure and loss limits, is approved by the Board of Directors each year.

The CEO provides the Board of Directors with a progress report on the implementation of the Annual Financing and Debt Management Plan, staffing and other administrative and operational matters. The CEO also reports on OEFC's compliance with applicable government directives, and OFA Legal Counsel reports on compliance with applicable laws.

In addition, OFA Management is kept informed of OEFC's risk exposures and positions on a daily basis.

Additional Sources of Information

Internet

Ontario Electricity Financial Corporation **www.oefc.on.ca**

Provides information on OEFC's debt, the Board of Directors, and contains other related publications.

Ontario Financing Authority (OFA) **www.ofina.on.ca**

Provides a description of the OFA's activities, Ontario debt issues and retail products and contains publications from the OFA and the Ontario Ministry of Finance.

Other Links

Ministry of Finance	www.fin.gov.on.ca
Ministry of Energy	www.ene.gov.on.ca
Ontario Power Generation Inc.	www.opg.com
Hydro One Inc.	www.hydroone.com
Ontario Electrical Safety Authority	www.esainspection.net
Independent Electricity Market Operator	www.iemo.com

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