UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 188 OF THE BUSINESS BOARD

April 4, 2011

To the Governing Council,
University of Toronto.

Your Board reports that it met on Monday, April 4, 2011 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Mr. W. David Wilson (In the Chair)
Ms Shirley Hoy, Vice-Chair
Ms Catherine J. Riggall, Vice-President, Business Affairs
Professor Angela Hildyard, Vice-President, Human Resources and Equity
Mr. P. C. Choo
Mr. Jeff Collins
Ms Mary Anne Elliott
Ms Paulette L. Kennedy
Mr. Kent Kuran
Mr. Gary P. Mooney*
Mr. Tim Reid
Ms Melinda Rogers
Ms Penny Somerville
Mr. Olivier Sorin
Mr. W. John Switzer
Ms B. Elizabeth Vosburgh

* By telephone.

Mr. David Palmer, Vice-President, Advancement
Ms Judith Wolfson, Vice-President University Relations
Ms Sheila Brown, Chief Financial Officer
Mr. Paul Donoghue, Chief Administrative Officer, University of Toronto Mississauga
Ms Sally Garner, Executive Director, Planning and Budget
Professor Scott Mabury, Vice-Provost, Academic Operations
Ms Anne E. MacDonald, Director, Ancillary Services
Ms Christina Sass-Kortsak, Assistant Vice-President, Human Resources
Ms Elizabeth Sisam, Assistant Vice-President, Campus and Facilities Planning
Mr. Ron Swail, Assistant Vice-President, Facilities and Services

Mr. Neil Dobbs, Secretary

Regrets:

Mr. William Crothers
Mr. George E. Myhal
Mr. J. Mark Gardhouse
Mr. Steve (Suresh) Gupta
Ms Deborah Ovsenny
Professor Arthur S. Ripstein
Mr. Howard Shearer
Professor Janice Gross Stein

In Attendance:

Ms Maria Pilar Galvez, Member-Elect, the Governing Council
Dr. Anthony Gray, Special Advisor to the President
Mr. John Hsu, Managing Director, Risk Management and Operations, University of Toronto Asset Management Corporation

Ms Ania Lindenbergs, Senior Executive Director, Advancement Communications and Marketing
Mr. Michel Malo, Managing Director, Investment Strategy and Co-Chief Investment Officer, University of Toronto Asset Management Corporation
Mr. William W. Moriarty, President and Chief Executive Officer, University of Toronto Asset Management Corporation
Ms Gillian Morrison, Assistant Vice-President, Divisional Relations and Campaigns
Mr. Daren Smith, Director, Hedge Funds, University of Toronto Asset Management Corporation
Mr. Anwar Kazimi, Committee Secretary, Office of the Governing Council
Mr. Henry T. Mulhall, Assistant Secretary of the Governing Council

ALL ITEMS ARE REPORTED TO THE GOVERNING COUNCIL FOR INFORMATION.

1. Report of the Previous Meeting

Report Number 187 (March 7, 2011) was approved.

2. Business Arising from the Report of the Previous Meeting

Item 5 - Cost-Recovery Ancillary Fees and Administrative User Fees and Fines (fees reported for information), 2011-12

The Chair noted that at the previous meeting the Board had received for information the annual list of cost-recovery ancillary fees and administrative user fees and fines for 2011-12. That list contained a small error on page 15, in which the two fees were transposed: the fees for domestic and international students in the New College International Foundations Program. A corrected page 15 had been placed on the table.

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010

Ms Riggall recalled that the University of Toronto Asset Management Corporation (UTAM) had been established at a time of very strong financial markets in 2000, but its establishment had been followed very quickly by a serious market reversal (characterized as the "tech wreck."). Similarly, Mr. William Moriarty, the current President and C.E.O., had been appointed at a time of sharply rising markets, and his appointment had been followed by another market reversal. The University and pension fund portfolios had suffered particularly sharp declines. As a result, the President had appointed a group, under the leadership of Chancellor Emeritus H. N. R. Jackman, to examine oversight of University investments. Substantial governance re-organization had taken place following that review, and also following an arbitration decision which had led to the recent establishment of a Pension Committee of the Governing Council. A key change was the establishment of an Investment Advisory Committee, a group of highly experienced and highly regarded investment professionals, who provided advice to the

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010 (Cont'd)

President and to Ms Riggall. That group was completely separate from UTAM. It advised on: return targets and risk tolerance, investment strategy, asset allocation, limitations on investments in particular asset classes, performance benchmarks, and evaluation of UTAM performance. The Board of UTAM had become much smaller, consisting of the President, Ms Riggall, Ms Brown, Mr. Moriarty and the President of the Faculty Association, and its responsibility was limited to the governance of UTAM as an organization, including: approval of its budget, review of its financial statements, review of internal audit reports on investment matters, review of its processes for selecting and overseeing managers, review of compliance processes with respect to external managers and internal staff, review of compliance with the requirements of the Ontario Securities Commission, recruitment and evaluation of the UTAM President and C.E.O., and approval of general corporate strategy.

Ms Riggall outlined the current division of responsibility for oversight of investments. That responsibility differed for University funds and for the pension fund. The main University fund was the Long-Term Capital Appreciation Pool (the L.T.CAP), consisting largely of the endowment funds but also (a) the funds set aside to assist the University to meet its obligations under the Supplemental Retirement Arrangement, and (b) the funds set aside to meet the University's obligations to repay the debentures that had been issued to pay for capital projects. For the L.T.CAP, the target return and risk tolerance parameters were recommended by the University administration after consultation with the Investment Advisory Committee, and they were subject to approval by the Business Board. Asset allocation was recommended by the UTAM staff and approved by the President, with the advice of the Investment Advisory Committee. Investment strategy was proposed by UTAM staff and reviewed by the Investment Advisory Committee. The strategy was approved by the President of the University and then implemented by UTAM.

For the pension fund, the target return and risk tolerance parameters were again recommended by the University administration after consultation with the Investment Advisory Committee, but the Pension Committee had approval authority. Asset allocation was recommended by the UTAM staff and the University administration, with the advice of the Investment Advisory Committee. In the case of the pension fund, the Pension Committee had the authority to approve the asset allocation. Investment strategy was proposed by UTAM staff, reviewed by the Investment Advisory Committee, recommended by the University's administration, and (again for the pension fund) approved by the Pension Committee. The strategy was then implemented by UTAM.

Ms Riggall summarized the role of the committees of the Governing Council with respect to investment matters. The Business Board approved the return targets and risk tolerance for the endowment funds. It received reports on investment performance and its impact on the financial health of the University. Because of that general responsibility for the financial health of the University, the reports to the Business Board on investment performance included not only information about the endowment fund and other university funds but also information about the

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010 (Cont'd)

pension fund. Finally, the Board received UTAM's annual report and audited financial statements. Those documents were approved by the UTAM Board and then presented to the Business Board for information. The Pension Committee approved the return target, the risk tolerance and the asset allocation for the pension fund. That Committee also approved the pension funds' Statement of Investment Policies and Procedures. In carrying out its work, it received reports on the investment performance of the pension fund.

The following matters arose in discussion of Ms Riggall's review of the division of responsibility for the oversight of investment management.

(a) Investment Advisory Committee. In response to a member's question, Ms Riggall said that the administration was very pleased with, and grateful for, the advice received from the Investment Advisory Committee. There was work on-going to establish a pattern for the timely flow of information to that Committee and receipt of advice from it.

(b) Differentiation between the L.T.CAP and the pension fund. In response to a member's question, Ms Riggall said that the assets of the Long-Term Capital Appreciation Pool and the pension fund were completely separate. The return targets and risk tolerances for the two funds happened to be the same, leading to the two funds' having the same asset mix and external investment managers. That situation might continue in the future, or the two funds might diverge.

(c) In-house management of investments. A member asked whether the administration was considering moving the investment-management function back in-house. Ms Riggall replied that there was no consideration to moving that function further back into the University than it already was. UTAM was a wholly controlled corporation. There had previously been some confusion about the role of its Board, which had been responsible both for governance of the corporation and for the determination of investment strategy. Under the current arrangements, the Board remained responsible for the governance of the corporation, but the responsibility for such matters as asset allocation and investment strategy was clearly that of the University's administration (for the endowment fund) and of the Pension Committee (for the pension fund).

Mr. Moriarty presented UTAM's annual report for 2010. Among the highlights of his report were the following.

- **Investment return**. The University's target return for 2010 for both the Long-Term Capital Appreciation Pool (the L.T.CAP) and the Pension Fund had been 6.4%. That represented a real return of 4% after all costs and after inflation. The actual return for the L.T.CAP had been 9.3% and the pension fund 9.5%. The year had been a good one for return relative to the target – the best since 2006. The 2010 return had been helped by strong capital markets during the second half of the year, after a very volatile first half.

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010 (Cont'd)

Performance was also measured relative to a benchmark – a composite consisting of index returns in the same proportions as the UTAM 2010 target portfolio. UTAM's performance for both major funds in 2010 had been in line with the benchmark return at ±10 basis points (or 1/10 of 1%) of the benchmark. (A basis point is 1/100 of 1%.)

Since early in 2009, the focus had been on returns relative to a reference portfolio. The reference portfolio was a hypothetical portfolio established by the University consisting of a composite of five securities indices: 30% Canadian equities, 15% U.S. equities, 15% international equities, 35% bonds, and 5% real-return bonds. The foreign currency segments were deemed to be 50% hedged back to the Canadian dollar. The return on the reference portfolio subtracted 15 basis points (or 15/100 of 1%) to represent the assumed cost of implementing the passive portfolio. The 2010 return on both major funds had trailed the reference portfolio return by about 100 basis points (or 1%).

For the Expendable Funds Investment Pool (the EFIP or short/mid-term working capital pool), the only benchmark used was the target return, which was the return on 365-day Canadian treasury bills plus 50 basis points. The 2010 year had been a good one for the EFIP, with its return of 2.2% being well above the 1.4% University target return.

Looking at the longer term, over the past five years, the average return of the L.T.CAP and the pension fund had trailed all three measures (the University target return, the benchmark return and the reference portfolio return) primarily because of the very poor outcome in 2008 – the year of the major market correction. Over the past ten years, again because of market conditions, the hypothetical reference portfolio as well as the benchmark portfolio and the UTAM portfolios, had failed to achieve the University target return. The funds' returns over five and ten years was, by and large, in line with the benchmark return. But the funds' return and the benchmark return had trailed that of the reference portfolio primarily because of the funds' and the benchmark's heavy exposure to foreign investments and underweight in Canadian equities.

- **Asset mix**. UTAM established a policy portfolio each year. That portfolio represented the asset mix that UTAM believed was the most appropriate one to achieve the best possible return within the University's risk tolerance. The portfolio for 2010 had been approved in March of that year. Owing to limits on the liquidity of certain asset classes and owing to the absence of the staffing required for a thorough review, the 2010 target asset mix had been

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010 (Cont'd)

very similar to that of the previous year. The Policy Asset Mix had been:

Canadian equities	12.5%
U.S. equities	12.5%
International equities	15.0%
Fixed income	17.5%
Hedge Funds	17.5%
Private equity	10.0%
Real assets (real estate and commodities	15.0%

The policy asset mix for 2011 had been thoroughly reviewed, and UTAM would later in the month be discussing it with the President of the University and with the Investment Advisory Committee.

The benchmark portfolio reflected the asset mix that UTAM sought to achieve in the light of certain limitations that prevented it from achieving the Policy asset mix in the short term. The benchmark portfolio differed somewhat from the policy portfolio because of the need for time to move assets out of and into certain asset classes, especially private-equity and real-asset funds and, to a lesser degree, hedge funds. The rule used historically to establish the benchmark portfolio was that any under- or over-allocation in the illiquid asset classes would be allocated *pro rata* to the very liquid, public-market asset classes.

The actual 2010 asset mix again differed somewhat from that of 2009 because of several factors: differences in the value of investments arising from the performance of the investment markets for each asset class, changes in the value of foreign currencies, movements of money into and out of private equity funds, and changes to the 2010 Policy portfolio referred to above. The average actual asset mix for the L.T.CAP for 2010 had been as follows:

Canadian equities	14.6%
U.S. equities	14.6%
International equities	17.4%
Fixed income	20.4%
Hedge Funds	14.6%
Private equity	13.0%
Real assets (real estate and commodities	5.6%
Cash (reflecting mark-to-market losses on currency hedging)	- 0.1%

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010 (Cont'd)

- **2010 asset-class performance**. Mr. Moriarty compared the performance of investments in the various asset classes in the L.T.CAP to that of the relevant benchmark indices. Canadian equities in the L.T.CAP had earned 16.6% for 2010, which was 102 basis points under the return of the S&P Toronto Stock Exchange Index. The shortfall was the result of the returns on the passive portion of the Canadian investments. The returns of the active managers had matched the index return.

  The 16.3% return on U.S. investments (in U.S. dollar terms) had trailed the Russell 3000 Index return by 65 basis points. In this case, the active managers' performance had trailed the index, and a substantial portion of the U.S. equity investments had been moved to passive management. Some losses had been incurred as a result of the timing of the move. The passive investments in the U.S. market had a return of 17.4%, which had exceeded the index return.

  The 5.5% return on international equity investments (in local currency terms) had exceeded the return of the Morgan Stanley EAFE (Europe, Austalasia, Far East) Index by 69 basis points owing to the returns earned by the active managers. The passive component had detracted from performance.

  The 6.9% return on fixed income investments was 15 basis points better than the DEX Canadian Universe Bond Index.

  The 7.6% return of the L.T.CAP hedge funds (in U.S. dollars) was 229 basis points better than the benchmark Hedge Funds Research Inc. Conservative Fund of Funds (Trued Up) Index. A part of the outperformance had been the outcome of the move from investing in funds of hedge funds to direct investment in individual hedge funds. The latter had provided an average return in excess of 8% for the year.

  The return on private investments had been 20.2% in local currency terms. While there was no benchmark against which to measure that return, private investments could be regarded as substitutes for U.S. public-market investments, in which the index return had been 16.9%. The private market strategy had therefore provided a return that was 359 basis points in excess of the U.S. equity–market alternative.

  Finally, the return on real-asset investments had been 13.1%. Again, there was no benchmark for purposes of comparison. Again, however, the real-asset investments could in some ways be regarded as a substitute for fixed-income investments, and on that basis they had outperformed.

- **Investment performance relative to the reference portfolio**. The return on the hypothetical reference portfolio for 2010 had been 10.49%, whereas the return of the L.T.CAP had been 9.30%. Mr. Moriarty said that the reason for the underperformance had been the greater

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010 (Cont'd)

unhedged exposure to foreign currency. Apart from that factor, the portfolio differences in the L.T.CAP had added 13 basis points in value. The hypothetical reference portfolio had only 30% invested in the U.S. and international markets, with half of that exposure hedged, leaving 15% exposure unhedged. The L.T.CAP portfolio, in contrast, had been 60% - 70% invested abroad, with 50% of that exposure hedged, leaving the fund 30% - 35% exposed to foreign currency. The U.S. dollar and most foreign currencies had fallen in value relative to the Canadian dollar, with the outcome of 110 basis points of underperformance. In response to a question, Mr. Moriarty said that the 22 basis points of "unexplained" underperformance by the L.T.CAP had been the result of other factors which could not be readily explained. The pension fund had a slightly better return of 9.5% in 2010, underperforming the reference portfolio by 99 basis points for the same reason.

- **Foreign currency hedging policy**. In hindsight, it would have provided better performance had UTAM hedged more than 50% of foreign currency exposure. However, UTAM continued to believe that the 50% hedge ratio was desirable going forward in order to reduce risk. On the basis of purchasing power parity (the exchange rate that would make purchasing power the same for both currencies), the Canadian dollar had been 14% overvalued relative to the U.S. dollar at the end of 2009. By the end of 2010, that overvalue of the Canadian dollar had increased to 22%. There were many reasons for the discrepancy, but currencies usually returned to their fair value in terms of purchasing power parity. Therefore, an increase in the hedge ratio would involve an unattractive risk/reward relationship.

- **Volatility and portfolio risk**. Mr. Moriarty displayed a graph showing the volatility of the major UTAM portfolios in terms of their rolling 60-month standard deviation of returns. The volatility of the portfolio on that basis had remained within the University's stated risk tolerance of a maximum 10% standard deviation of returns (in nominal terms) averaged over ten years. However, UTAM did not regard standard deviation as a wholly satisfactory measure of risk because it was backward looking. It was, therefore, adopting a more granular and forward-looking measure to enhance risk control. To that end it was acquiring and implementing a third-part risk system that would enable the examination of risk more fully at the level of each external manager and each asset class as well as at the portfolio level. That system should facilitate more informed decisions about accepting risk and about dealing with future periods of market stress.

- **Performance in 2011**. While the figures available for investment returns in 2011 were very limited to date, returns in January had been good. The return of the L.T.CAP and the pension fund of just under 1½% had outperformed the reference portfolio by about 40 – 50 basis points.

- **Current investment environment**. The 2010 year had been a very tough one until the middle to the end of the third quarter, when capital-market conditions in Canada and the U.S. had improved remarkably. UTAM expected that 2011 would be a also be a difficult year particularly in the

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report and Financial Statements, 2010 (Cont'd)

second half of the year. That expectation reflected the fact that while an economic expansion was underway, it was likely to be a bumpy one and a less vigorous one than usual.

The economies of the developed world were likely to be constrained by the unwinding of the massive fiscal and monetary stimulus of recent years. There was considerable deleveraging underway as households and businesses paid down high levels of debt. Changing capital requirements for banks would also restrict lending and the way business was done.

Many of the economies in the developing world were apparently on a very buoyant growth trajectory, but it was unlikely that all would be smooth sailing for those economies. Their export-driven economies would be constrained by the unwinding of economic stimulation in the developed countries that were the customers for their exports. Their exports had benefited from advantageous currency exchange rates, but those same advantageous rates were causing higher prices for imports of commodities and other goods and services, bringing about inflationary pressures and increases in interest rates designed to cool inflation. Those developments tended not to be beneficial to equity markets. In addition, those economies needed to make a transition from reliance on exports to more internal demand.

UTAM sought to translate that economic backdrop into a set of return expectations for various markets. It did so in the light of knowledge that the past was a poor predictor of the future. It did bear in mind that valuations of securities did tend to revert to the mean, and that cash yield was an important component of return.

With respect to the bond market, interest rates, and especially short-term rates, were lower than those that might be expected during a period of economic recovery. That suggested that the thirty-year bull market for bonds had ended – unless the economies in the developed world fell into a long period of stagnation – like that in Japan for the past fifteen years – where there had been be no pressure to raise interest rates.

Equity markets had historically provided very good returns overall, but one half of that good return had been provided by dividends. Historically, the average dividend yield had been around 4%. Currently, the average dividend yield was only about 2%. Given the facts of the current low dividend yield, the current economic backdrop of bumpy and sluggish growth, and rich equity valuations, there was a high probability that equity investors would be facing a range-bound market. Moreover, that market was probably now closer to the higher than the lower end of the range.

Mr. Moriarty concluded that those various factors suggested the likelihood of a challenging market environment for portfolios, particularly for portfolios relying solely on traditional asset classes and traditional strategies.

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- **Developments at UTAM**. For UTAM, 2010 had been a year of transition, with substantial progress being made in that transition. UTAM had been understaffed until the end of 2009. It had remedied that situation and had successfully integrated the new members of the UTAM team. It had developed new models and new analytics that would help it to make good decisions about the management of the portfolios. It had initiated an advisory relationship with the firm Morgan Creek in the area of private investments – a very significant development. As a result, UTAM's infrastructure was in much better condition, although more work would be required in 2011 to implement the changes.

  There had been further restructuring of the portfolios. UTAM had indexed U.S. public market investments. It had continued with its restructuring of the hedge-fund portfolio, moving from funds of funds to direct investments in individual hedge funds. UTAM had pursued this change aggressively and successfully. For indexed investments, UTAM had ended synthetic indexing (using index futures) and had moved to purchase physical index funds (containing all of the securities in the relevant index). UTAM had also engaged a new foreign-exchange hedging provider. Mr. Moriarty anticipated that the portfolios would show the benefits of those changes in 2011.

  In terms of operational changes, UTAM had identified and approved the purchase of a third-part risk-management system and was in the process of implementing the system. It had implemented an improved system for performance and attribution analysis which should provide much better visibility of developments in the portfolios. Over the past two years, UTAM had reduced the costs of external investment management by close to $17-million per year. It had revised its processes for rebalancing its portfolios to keep them aligned with its benchmark asset mix and it had improved its foreign-exchange hedging process. The outcome of those changes should be improved performance. UTAM had devoted substantial time to developing a new unitization structure for its various asset classes. That would enable the design of new "giving" products for the University, and it would enable UTAM to administer them in an efficient and cost-effective manner. Finally, UTAM was operating under its new governance structure.

- **Final thoughts**. 2010 had been a year of improved performance for the portfolios relative to the benchmark portfolio and the reference portfolio. There was, however, still more to do. The expansion of UTAM's analytical tools and of its pool of staff experience had brought both to a level much more in keeping with the University's original vision for UTAM. In 2011, UTAM hoped to achieve a better balance of focus between offence and defence. Much of the focus over the past two years had been on defensive measures – a situation Mr. Moriarty expected to be able to change.

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Among the matters that arose in questions were the following.

(a) Benchmarks. In response to a member's question, Mr. Moriarty said that the most important benchmark to use in evaluating UTAM's performance was the reference portfolio, with the comparison made over a reasonable time period. The reference portfolio was a simple 60% equities / 40% bonds portfolio. If UTAM did not exist to manage the University's long-term portfolios, the University could turn to the alternative of a passively managed portfolio, adopting the asset mix of the reference portfolio which had historically earned a return that would have achieved the University's target. In fact, the reference portfolio had set a high standard in recent years, having outperformed many of its peer benchmarks. The member observed that using the reference portfolio as a measure, it should then be regarded as UTAM's job to obtain better performance after all costs and fees. Mr. Moriarty agreed that outperforming the reference portfolio was an important objective for UTAM, but it was also important that it achieve a good control of risk. The measurements used in the past had, for many reasons, understated risk. With its new, more sophisticated risk-management system, UTAM would be able to achieve and provide a much better view of the risk being assumed by the funds.

(b) Quantifying external investment manager skill. A member noted that in comparing the performance of the UTAM portfolios to that of the reference portfolio, one positive factor that had been cited was the skill of the active managers. The member asked how that skill had been identified and quantified. Mr. Moriarty replied that an appropriate benchmark was established for each manager. For example, a manager that used a value style of investing would be measured against an appropriate value index. A manager of small-company stocks would be measured against an appropriate small-cap index.

(c) Number of active managers. In response to a member's question, Mr. Moriarty said that there was now only one management firm for actively managed U.S. equities, five managers for actively managed international equities (with the management of that portion of the portfolio under review), and four managers for actively managed Canadian equities. With respect to hedge funds, when he had arrived at UTAM, hedge fund investments had been in sixteen funds of hedge funds, with 450 – 500 underlying hedge funds. Today, that number had been reduced to about 360 underlying funds, with many of those being stubs where the investment was being unwound but where the manager was not able to provide cash immediately. That number of funds would decline substantially in the near future. Including remaining funds of hedge funds, there would soon be about 50 underlying hedge funds. Mr. Moriarty estimated that about 70% of the weight of hedge-fund investments was now concentrated in about 15 funds. There were about 65 managers of private-investment funds. UTAM was contractually obligated to see those funds through to the end of their contractual life, meeting calls for capital as they came in. The secondary market for private-investment funds was a rather poor one, except for the best investments, which UTAM would want to retain. UTAM was working with its new advisor, Morgan Creek, to dissect the portfolio investments of each fund and to map them back to public-

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market investments – something that would be very helpful in making asst allocation decisions to the public markets and in controlling risk.

(d) Information from the managers. A member was struck that at this meeting in April UTAM had good performance data only for periods ending in January. Was UTAM getting information from managers on a timely basis? Mr. Moriarty replied that it was in fact obtaining good information from the managers. UTAM spoke regularly with the managers, mostly on a monthly basis, with more immediate communication if there was some unusual development. UTAM received an early estimate of investment return each month perhaps eight or nine days after month-end. The information was also communicated to the custodians, who processed it to provide overall information, which became available about six weeks later. That was a common timeframe for the provision of information about a complex portfolio.

(e) Risk metrics. A member asked for information about the measurements used for UTAM's new risk-management system. Mr. Moriarty replied that for public-market portfolios, the task was relatively easy. The system would look at each position held in a portfolio and consider its historical volatility as well as such other risk factors affecting risk as industry group and region. For hedge funds, the task was more difficult. When engaging new hedge-fund managers, UTAM regularly asked if they would be willing to make their portfolio positions transparent to a third-party risk aggregator. An affirmative answer to that question would be an important criterion in the decision to invest in any particular hedge fund. With respect to private investments, UTAM would work with Morgan Creek as well as the custodian, State Street, to look at the individual companies owned by the private-investment fund. It would map those positions back to the public markets, producing in the process a better sense of the real risk involved in the fund. The advantage of the new approach was that it would not be backward looking. Rather, it would take into account the positions in the portfolio at the particular time and calculate the volatility that, taken together, they would be expected to generate. Mr. Moriarty thought that, at a conservative estimate, it would require a further six months' work to have the system functioning fully and providing a reasonable picture of portfolio risk.

(f) Hedge funds. Invited to respond to a member's question, Mr. Smith said that UTAM would not invest in a hedge fund unless it provided an acceptable level of transparency. He outlined the level of transparency in the current portfolio of funds. Since 2008, UTAM had asked all hedge fund managers to provide their positions to a third-party risk aggregator, and something over 75% of current funds did so. At a minimum, funds provided regular reports on the risk they were assuming. The reports varied, depending on the type of strategy the funds employed. For example, long/short equity funds typically reported, at a minimum, their gross and net exposure to securities classified by industry sector and region. Credit managers reported on the types of credit exposures in their portfolios. By and large, the level of disclosure in the portfolio was acceptable at the fund level. What UTAM lacked was an overall framework to roll up the risk involved in the individual funds into an overall risk assessment. It was for that reason that it

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employed the third-party risk aggregator. For those hedge funds that did not provide a good level of transparency, UTAM worked with the manager and the risk aggregator to establish proxies for the funds so that they could be included in the overall risk assessment. Mr. Moriarty added that UTAM also employed two outside consultants on hedge funds to provide advice and to consider operational matters. It had proven interesting and useful to compare the reports of the two consultants.

Further in response to the member's question, Mr. Moriarty said that the current target for hedge funds was 17½% of the portfolio, but UTAM was considering a change in that proportion. Mr. Moriarty stressed that it was very important to be flexible with respect to the proportion of hedge funds in the asset mix, enabling action in response to market conditions.

4. Audit Committee: Terms of Reference

Ms Kennedy said that the proposal to revise the Audit Committee's terms of reference had emerged (a) from both a special meeting held in September to consider (among other things) the Committee's role, and (b) from the first regular meeting of the year, which routinely reviewed the terms of reference. The largest part of the proposal consisted of relatively minor revisions that could be regarded as housekeeping changes. It also contained one significant substantive change, involving a change both in the name of the Committee and in its mandate to stress the Committee's responsibility to oversee risk management. The Committee's role was already set out in item 5.1.5 of its terms of reference, which charged the Committee to review "an annual management report on significant business, financial and regulatory risks" and to monitor "the University's processes for identifying and controlling those risks. In carrying out this responsibility, the Committee focuses primarily on the adequacy of key controls over, and mitigations of, those vital risks considered to be, currently or in the future, more significant and likely to occur, meets with management and the internal or external auditors to come to a fuller understanding and better assessment of management's response to controlling important risk situations." The Committee had for some years carried out that responsibility. It had decided beginning in 2010-11 to devote a full meeting each year to monitoring risk management. As a result, it had more time to consider the annual report and to obtain a fuller understanding of the risks facing the University and the steps being taken to mitigate them. The proposed revisions to the terms of reference were to stress that role (a) by changing the name of the Committee to the "Audit and Risk Committee" and (b) by specifically requiring the administration to prepare "an annual report on the key risks facing the University, including controls, procedures and other actions taken to mitigate known risks and procedures and other actions to enhance the organization's ability to respond to unexpected events."

It was duly moved and seconded,

> THAT the proposed revised Terms of Reference for the Audit Committee be approved.

4. Audit Committee: Terms of Reference (Cont'd)

A member raised, and the Board considered, two areas of concern.

(a) Need for governance oversight of comprehensive and integrated risk management. A member cited his experience with a crown corporation, which had made manifest to him the need for an organization's risk-management efforts to be comprehensive and integrated. The terms of reference limited risk-management oversight to "business, financial and regulatory risks." It would be important that the University's governance go beyond those areas to deal with other highly important risks. One area was competitive risk: the risk that competition would prevent the University from attracting and retaining the highest quality students, faculty and staff. Another area was reputational risk. He cited a recent instance where the Board had declined to endorse a proposed real-estate transaction where the form of that transaction might have tarnished the University's reputation. It was also important that risk-management be integrated. It was always necessary to make trade-offs in decisions to assume or not to assume certain risks.

Ms Kennedy said that the list of risks cited in the terms of reference was not intended to be a comprehensive listing of the risk universe or a listing excluding the Committee's monitoring of other risks. The reports received annually by the Audit Committee did contain a comprehensive view of risk. The most recent risk-assessment report included, for example, risk with respect to students. The member who had raised the matter commented that it would be helpful if the terms of reference were more transparent on the nature of the risk management that was being monitored.

Ms Kennedy noted that the Audit Committee, in discussing its role in governance oversight of risk management, had been concerned that not all of its members would have access to all of the information required to understand the risks facing the University. That information was provided to the Business Board; however, while most members of the Audit Committee were also members of the Business Board, that was not always the case. To ensure that those members did have the opportunity to be informed, it was agreed that they be informed about relevant meetings of the Business Board.

A member, who was also a member of the Audit Committee, stressed that the role of the Audit Committee was not to manage risk but rather to be satisfied that appropriate risk-management was being carried out by the University's administration. It would not be desirable for the Audit Committee to limit its focus purely to financial risk simply because no other governance body dealt with the matter of risk management in general. At its recent meeting, the Committee simply sought to be sure that the President and the administration were assessing risk and were acting effectively to deal with it. Ms Riggall had established a risk-management group consisting of senior staff who had responsibility for some area of risk, and that group was working on various issues. It was important that it be understood in the University that the work on monitoring risk and mitigating it was being carried out and that it was being monitored by a committee of the Governing Council.

A member observed that the terms of reference were specific in identifying the Committee's responsibility for "business, financial and regulatory risks," and she suggested that it might well

4. Audit Committee: Terms of Reference (Cont'd)

be appropriate for the Executive Committee, the Business Board or the Governing Council itself to have a role in monitoring broader areas of risk.

Ms Riggall said that the annual risk- assessment profile identified each area of risk, specified the senior administrative officer responsible for the area, and listed the reports made by that officer to a governance committee, which reports would demonstrate risk management. It was not intended that the Audit Committee itself would review risk in each area. Rather, it would satisfy itself that the area or risk had been identified, that a plan had been put into place to deal with it, and that reports were being made to the appropriate governance body. The Audit Committee played a coordinating role.

The member who raised the matter said that he remained concerned, notwithstanding the role of the Audit Committee, that there was no body that ensured integration of risk control and that arrived at the necessary trade-offs in accepting some risks and acting to deal with others. Ms Riggall replied that the role described by the member was being played by the University's senior administration through the group of the President and Vice-Presidents. The member thought that there should be oversight of comprehensive risk management in the governance system.

Ms Kennedy said that the Audit Committee had recognized the need for further consideration of the matter as part of the implementation of the Report of the Task Force on Governance. A Committee member who was also a member of the Implementation Committee had undertaken to raise the matter in that Committee. While there was recognition of management's responsibility to implement an integrated program of risk management, there should be a mechanism for review of that activity. One of the questions to be considered was whether the annual report on risk management should stop at the level of the Audit Committee or go on further into the governance system. The proposed changes to the terms of reference did represent a very positive first step. Such areas as competitive risk and reputational risk could and should be regarded as aspects of business risk. Given the changing nature of the risk universe, it made sense not to be too specific about the risks and areas of risk management to be monitored.

A member suggested that the drafting of section 5.1.5(a) be revised to words such as: "Reviews annually a comprehensive report on all significant areas of risk facing the University including but not limited to business, financial and regulatory risks, and monitors the University's processes for identifying and controlling those risks." The member who had raised the concern said that he would view that change as a helpful one, but there should be further work on the matter before the terms of reference went forward to the Governing Council for approval.

(b) Committee membership. The member expressed concern about the description of the Committee's membership: "about eight independent voting members, who are normally not members of the teaching staff, administrative staff or students of the University." The member was concerned about the word "normally," combined with the additional provision that "notwithstanding the above, . . . the voting membership may include a senior member of the teaching staff of the University with expertise in accounting." The member argued that a

4. Audit Committee: Terms of Reference (Cont'd)

member of the teaching staff (or a member of the administrative staff or a student) was not independent of the University and should not be a voting member. Two members suggested that it would be worthwhile to determine whether a member of the University such as a faculty member could legally be a member of an audit committee. Moreover, the terms of reference concerning the Chair and Vice-Chair of the Committee simply specified that they were to be "appointed annually by the Business Board." There was nothing that would prevent the appointment of a faculty member as Chair or Vice-Chair. Other members suggested that the requirement concerning membership in general be made more specific, avoiding the use of the words "about" ("about eight independent voting members"), and "normally" ("normally not members of the teaching staff, administrative staff or students of the University"), as well as avoiding the use of the word "independent" ("independent voting members") in a way that would include any faculty member who might be appointed to the Committee.

Ms Kennedy said that in practice the Audit Committee was clearly an independent one. In the membership of the Committee, the independent external members were always predominant. It was in fact helpful to the Committee, and to its independence, to have amongst its members a faculty member with specialized knowledge of accounting who could provide a point of view other than that of the administration and the auditors. The current faculty member had proven that on numerous occasions. His work for the Canadian Coalition for Good Governance had enabled him to bring particularly valuable insights to the Committee. She agreed that it would be inappropriate for any faculty member of the Committee to be appointed as Chair or Vice-Chair.

A member, who also served on the Audit Committee, agreed that it was very valuable to have a knowledgeable faculty member on a Committee that was regarded as a "technical committee." He suggested the addition of a provision that would make it clear that the large majority of members would be government-appointee or alumni members of the Governing Council or co-opted members who were not faculty, staff or students of the University.

The Chair observed that a frequent item of debate in discussions of governance in the for-profit sector concerned how many independent members Board needed to be deemed an independent one. He suggested that it would be advisable to change the drafting of the membership provision to ensure that the term "independent" was clearly not meant to include the faculty member. He stated that there was no urgency that the matter be concluded at an early date. He therefore suggested that the motion be withdrawn and that the Audit Committee consider further the matters that had been raised at the current meeting.

With the agreement of the mover and seconder, THE MOTION WAS WITHDRAWN to enable further consideration by the Audit Committee and by the Implementation Committee for the Task Force on Governance.

A member urged that, as a matter of good governance process, the revised terms of reference should include a provision requiring the dissemination of adequate information to members of the Committee to enable them to carry out effectively their responsibility to monitor risk management.

5. Procurement Policy

Ms Brown noted that the University's Purchasing Policy had been approved by the Business Board in 1995 and had not been before the Board since that time. The University had developed numerous services, processes and procedures for the purchase of good and services. In 2007, the threshold amounts requiring the invitation of tenders had been adjusted to reflect the requirements of the 1995 Agreement on Internal Trade signed by the first ministers of Canada, the Provinces and the Territories. In the past few years, the Ministry for Finance had taken considerable interest in the matter and had issued guidelines in an effort to improve and standardize procedures in the broader public sector in the Province. Ultimately, the Management Board of the Ontario Cabinet had issued a Procurement Directive to apply to all institutions in the Province's broader public sector, effective April 1, 2011.

Ms Brown reported that the University was broadly compliant with the requirements of the Directive. There were, however, two areas in which the Directive's requirements would require change. The first concerned construction and renovation projects. The threshold for projects requiring an open tendering process had been reduced to $100,000. The second area was consulting services, where the requirement was far more restrictive than any previous University requirement: the engagement of all consulting services would require a competitive process. Proposals could be invited from suppliers for consulting services costing up to $100,000, and an open competitive process would be required for consulting services costing $100,000 or more. The Directive required that the Board, on behalf of the Governing Council, approve the Code of Ethics contained in the Directive and approve the schedule of thresholds for processes for: (a) the procurement of goods, services (other than consulting), and construction / renovation projects, and (b) the procurement of consulting services. The new Policy simply affirmed that the University would comply with the requirements contained in the Directive.

A member referred to the requirement for Business Board approval of the procurement of consulting services costing more than $100,000 that did not follow an open (in contrast to an invitational) competitive process. She asked how many proposals for approval of consulting services were likely to come before the Board. Ms Brown replied that the answer to that question was uncertain at the moment. A meeting scheduled for the following day would seek to come to grips with the issue. A great deal would depend on the definition of consulting services, and the Council of Finance Officers of the Universities of Ontario was currently working on an appropriate categorization of services that should be considered as consulting services and those that should not be so regarded.

On the recommendation of the Vice-President, Business Affairs,

YOUR BOARD APPROVED

The proposed Procurement Policy, a copy of which is attached hereto as Appendix "A", effective April 1, 2011, replacing the Purchasing Policy approved by the Business Board on October 10, 1995.

6. Ancillary Operations: Residential Housing – Operating Results for 2010-11 and Budget, 2011-12

Ms Riggall noted that the ancillary operations classified as service ancillaries submitted their reports and budget proposals to the University Affairs Board. (They included student residences, food services, parking, etc.) Those ancillary operations classified as business ancillaries submitted their reports and budget proposals to the Business Board. There was at this time only one unincorporated business ancillary – the Residential Housing ancillary, which owned and rented 83 of the 108 houses in the Huron Sussex area (the area between Bloor Street West and Harbord Avenue and between Spadina Avenue and St. George Street).

A member noted that the Huron / Sussex area comprised one quarter of the St. George west campus, and he asked why the University had no plan to use the area for the expansion of the Campus. Ms Riggall replied that the University did not own all of the properties in the area, and some of the properties it did own were rented to tenants who were not members of the University. As houses became vacant, the University was converting them to housing for new or visiting faculty or for students with families. The area would therefore become more and more integrated into University use. In addition, the University did not currently have the funds required to develop the area through the construction of larger academic and other buildings. Until such time as adequate funding became available, the University would continue with its strategy of using the houses in the area it owned or acquired for purposes of faculty or student-family housing.

On the recommendation of the Vice-President, Business Affairs,

YOUR BOARD APPROVED

The operating budget for the St. George Campus Residential Housing Ancillary for 2011-12, as contained in the “2011-12 Budget” column of Appendix “B” hereto.

7. Sustainability: Annual Report, 2010

Mr. Swail presented the Annual Report on Sustainability for the St. George Campus for 2010. He noted that the current report on Sustainability was the first presented by the Facilities and Services Department. That Department had in many respects been a pioneer in the area of sustainability, having undertaken efforts for four decades to provide a safe, clean, comfortable and attractive environment for the University’s activities in a manner that would also contribute to the sustainability of the environment. For example, a number of utilities projects had both reduced the Campus’s environmental footprint and its operating expenses. The Department aimed to enhance a triple bottom line: to do things that served the University community, that saved money, and that were good for the environment.

Mr. Swail said that since 1973, this work had avoided the generation of over 1-million tonnes of greenhouse gases, saved over 60-billion litres of water, saved 423,000 megawatt hours

7. Sustainability: Annual Report, 2010 (Cont'd)

of electricity, recycled to achieve the saving of the equivalent of 250,000 trees, and saved over $200-million in operating costs. He cited a number of examples. The new cooling system for the Robarts Library, for instance, saved 59-million litres of water per year.

Mr. Swail reported that the University's efforts had been recognized by a number of sustainability awards. Among them were: in 1989 Ontario Hydro's first "Saving by Design" incentive award, the 2009 National Third Prize of the Canadian Association of University Business Officers for the Rewire Project, and the 2007 City of Toronto Environmental Award of Excellence for the $20-million energy reduction project and the Rewire Project. The University's achievements had also been recognized in a number of articles in the media.

In 2009, President Naylor was one of the twenty Ontario university presidents who had signed "Ontario's Universities Commitment to a Greener World." That Commitment included the use of locally produced food in the University's food-service operations, the reduction of greenhouse gas emissions, and the generally more efficient use of utilities. In 2010, the revised Environmental Protection Policy had been approved by the Business Board, updating the 1994 Policy.

Mr. Swail said that the University compared very favourably with others rated in the College Sustainability Report Card produced by the Sustainable Endowments Institute. The University of Toronto "A-" rating was the highest of any Canadian university, tied with the University of British Columbia and the University of Calgary. The University had in 2008-09 prepared a greenhouse-gas inventory as an essential first step in measuring and managing the University's emissions. That inventory included three scopes of emissions. Scope 1 was emissions directly under the University's control, which derived primarily from burning natural gas to generate heat, steam and electricity. It also included emissions from University-owned vehicles. Scope 2 included emissions associated with purchases of electricity, heat and steam. Scope 3 included emissions from faculty, staff and student commuting, other travel, and solid waste disposal (including recycling). Similar studies had been completed for the Mississauga and Scarborough campuses.

Mr. Swail outlined a number of sustainability projects planned for the future. They included achieving over a half-million dollars of savings on building operations, often at little or no cost; extensive real-time metering of the use of water, electricity and heating/cooling; re-commissioning of the building at 246 Bloor Street West (housing, among other units, the Factor-Inwentash School of Social Work); a number of water conservation projects; moving to highly fuel-efficient vehicles for police, grounds and mail operations (hybrid vehicles were used, and the first full electric vehicle was expected in June 2011); revised, more energy-efficient design standards for construction projects (with the Mining Building and the Munk School of Global Affairs Building seeking to achieve LEED certification). Deferred maintenance projects would also seek to achieve energy efficiencies.

As the University moved forward with its *Towards 2030* plan, there would be new challenges. The St. George Campus already had 3-million square feet of the space less than it

7. Sustainability: Annual Report, 2010 (Cont'd)

should have for its enrolment - a 20% deficiency - according to Council of Ontario Universities space standards. In addition, the University was planning to increase graduate enrolment on the St. George Campus and to increase its funded research. All of those plans would require more space and more intensive energy use, generating more greenhouse gases.

Mr. Swail concluded that the University had a very strong culture of sustainability that could be traced back almost four decades. Facilities and services would continue to make every effort to enhance the triple bottom line: providing a better physical environment while conserving utility use and reducing operating costs. The University was a recognized sustainability leader, but its current academic plan would challenge its ability to reduce its overall greenhouse gas inventory.

Members of the Board, by their applause, congratulated Mr. Swail and his colleagues on the considerable successes recorded in this report.

8. Capital Projects Report as at February 28, 2011

The Board received for information the Report on Capital Projects Under Construction as at February 28, 2011, providing information on projects with a total budgeted cost of $379.14-million.

9. Borrowing: Status Report to March 31, 2011

The Board received for information the Borrowing Status Report as at March 31, 2011. That Report showed a maximum borrowing capacity of $971.5-million pursuant to the University's borrowing strategy. $936.41-million of borrowing had been allocated, net of repayments that could be reallocated. The allocated amounts were required only as projects proceeded; therefore not all of the allocated borrowing had been executed. Actual external borrowing amounted to $525.9-million. Internal borrowing outstanding was $212.2-million. Additional borrowing capacity of $150-million had been approved for the purpose of pension-plan funding; no additional loan for that purpose had been made to date.

10. Reports of the Administrative Assessors

Ms Riggall recalled that Mr. Nadeem Shabbar had left the University to take up a new position. The University had engaged on a temporary basis a highly experienced individual to review the University's entire real-estate and capital project processes. Because the University's needs for the next decade were likely to be very different from those of the previous decade, there might well be opportunities to improve the organization of the real-estate and capital projects operation.

Ms Riggall recalled that two major projects had been undertaken to construct instructional buildings at the Mississauga and Scarborough campuses, funded by the Federal / Provincial Knowledge Infrastructure Program. The program was designed to provide economic stimulus to

10. Reports of the Administrative Assessors (Cont'd)

combat the recent economic downturn, and therefore all projects were to be undertaken in a timely manner and to be substantially completed by March 31, 2011. Of the twenty-three university projects funded nation-wide by the Program, only the two at the University of Toronto were completed on time. They were also completed on budget. In spite of the short time for the projects, the buildings in both cases had been exceptionally well designed and built. Members of the Board, by their applause, congratulated Ms Riggall and her colleagues in the Real Estate Department and at UTM and UTSC on this success.

11. Date of Next Meeting

The Chair observed that the Board's next regular meeting was originally scheduled for Monday, May 2, 2011, which was the date of the forthcoming federal election. The Secretary was instructed to establish an alternative date. The date that was later arranged was **Wednesday, May 4, 2011**. That meeting would consider, among other matters, the annual reports of the Vice-President, Human Resources and Equity and the Vice-President, Research.

THE BOARD MOVED IN CAMERA.

12. Striking Committee: Appointment

On motion duly made, seconded and carried, it was RESOLVED

> THAT, pursuant to section 33(i) of By-Law Number 2, the Board consider the proposal for appointment of the Striking Committee *in camera*.

On motion duly made, seconded and carried, it was RESOLVED

> THAT the following be appointed to the Business Board Striking Committee to recommend appointments for 2011-12:
>
> Mr. W. David Wilson (Chair)
> Ms Shirley Hoy (Lieutenant-Governor-in-Council appointee; Vice-Chair)
> Mr. P. C. Choo (administrative staff)
> Mr. Olivier Sorin (student)
> Professor Janice Stein (teaching staff)
> Ms Elizabeth Vosburgh (alumna)

REPORT NUMBER 188 OF THE BUSINESS BOARD – April 4, 2011

THE BOARD RETURNED TO OPEN SESSION

The meeting adjourned at 7:00 p.m.

Secretary Chair

April 27, 2011

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