UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 10 OF

THE PENSION COMMITTEE

December 12, 2012

To the Governing Council,
University of Toronto.

Your Committee reports that it held a meeting on Wednesday, December 12, 2012 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Professor George Luste, In the Chair
Professor C. David Naylor, President of the University
Mr. Jeff Collins
Professor Ettore Vincenzo Damiano
Ms Nancy Edwards
Professor Jennifer Jenkins
Ms Paulette Kennedy
Mr. Alex McKinnon
Mr. Philip Murton
Ms Jane Pepino
Ms Melinda Rogers
Mr. Keith Thomas
Ms Helen Rosenthal
Mr. Andrew Ward
Mr. W. David Wilson

Non-Voting Assessors:

Ms Sheila Brown, Chief Financial Officer
Professor Angela Hildyard, Vice-President, Human Resources and Equity
Professor Scott Mabury, Vice-President, University Operations

Mr. Louis R. Charpentier,
Secretary of the Governing Council

Secretariat:

Ms Cristina Oke, Acting Secretary

Regrets:
Professor Laurence Booth
Ms Shirley Hoy
Mr. Gary Mooney
Mr. Howard Shearer
Mr. W. John Switzer
Ms Rita Tsang

In Attendance:
Mr. Francis Low, Plan Auditor, Ernst & Young
Mr. William Moriarty, President and Chief Executive Officer, University of Toronto Asset Management Corporation (UTAM)
Mr. Pierre Piché, Controller & Director Financial Services, University of Toronto
Mr. Allan Shapira, Plan Actuary, AON Hewitt
Mr. Weeman Wong, Ernst & Young

The Chair welcomed members and guests to the meeting.

1. Report of the Previous Meeting

Report Number 9 (September 27, 2012) of the Pension Committee was approved.

2. Business Arising from the Report of the Previous Meeting

a) Report on *Facilitating Pooled Asset Management for Ontario's Public-Sector Institutions*

President Naylor gave a brief summary of the Report written by Mr. Bill Morneau on the consolidation of the assets of public-sector institutions. [1] The Report's recommendations are listed in Appendix 1.

The President noted that, while the Report recommended that the government should legislate the participation of public-sector pension funds that were expected to realize appreciable benefits from pooled asset management, pooled asset managers must permit participating institutions to retain fiduciary responsibility and control over asset allocation decisions. At least $50 billion of pooled assets were required to support the development of cost-effective internal investment management teams and to attract world-class investment leaders. The amount of savings that would result from pooled asset management was estimated to be from $70 million to $100 million annually.

Matters that needed clarification included in what way and in what time period would the proposed savings be achieved; what would the indemnification arrangements be; and how would universities be safeguarded when assets were being pooled.

The timeline set out in the Report assumed that the Corporation would be established January 1, 2014. Given the current political situation in Ontario, it might not be possible to pass the necessary legislation by that date.

A member asked whether there would be any additional consultation on the proposal. The President replied that consultation would likely focus on the implementation of the proposal rather than on the proposal itself.

A member asked Mr. Shapira for his views on the Report. Mr. Shapira replied that the Report reflected what Mr. Morneau had heard during his consultations. Clarification was needed on the implementation of the recommendations and the transition to the consolidation of pooled assets.

A member asked what kind of governance the new corporation would have. The President replied that the general outline of governance included in the report emphasized the need for external experts. Mr. Shapira added that the 11 directors of the board were expected to be independent experts who would be at arm's length from the government. Two of the directors would be appointed by plan members and three of the directors would be nominated and appointed by clients.

The Chair thanked the President for his comments on the Morneau Report.

[1] http://www.fin.gov.on.ca/en/consultations/pension/recommendations-report.pdf

3. University of Toronto Pension Plans: Actuarial Reports as at July 1, 2012

Mr. Shapira summarized the highlights of the Actuarial Reports of the University of Toronto Pension Plans.

- The going concern market deficit of the University of Toronto Registered Pension Plan at July 1, 2012 was $1,115.2 million, an increase of $158 million over the going concern market deficit of $957.2 million at July 1, 2011. The increased deficit was mainly due to investment returns being less than the target return.
- The solvency deficit of the University of Toronto Registered Pension Plan at July 1, 2012 was $1,747.9 million, an increase of $736.4 million over the solvency deficit of $1,011.5 million at July 1, 2011 mainly due to a drop in interest rates from 4.20% to 3.05%.
- The number of total participants in the University of Toronto Registered Pension Plan had increased by 417 since July 1, 2011.

The President noted that at the present time, the amount paid out in pensions and the current service contributions made into the Registered Pension Plan almost balanced, and asked what drove the going concern deficit. Mr. Shapira replied that the intent of funding was to have enough money in the plan at any point in time to pay for the benefits that have been earned to that date. Since the number of retirees is growing over time, in the future the amount paid out in pensions will be greater than the current service contributions made by employees and the University.

The President commented that a cash flow analysis would be useful to determine the pressure points of the funding of the pension plans. Mr. Shapira committed to prepare the cash flow analysis. The Chair suggested that an 'off-line' discussion on the topic be arranged.

A member noted that higher investment rates and/or more contributions were necessary to improve the funding of the pension plans. A member stated that she understood that it was unlikely that the nominal investment target of 6.25% would be achieved over the next few years and asked whether some money would be set aside to cover increased liabilities of the pension plan. Ms. Brown noted that no one knew what future investment returns would be, but that for this pension year, for the first four months of the year, actual returns were higher than target. She noted that the going concern special payments under the current pension contribution strategy, which had been estimated at $76 million per annum effective July 1, 2014, and payable beginning July 1, 2015, would need to be increased by about $9 million per annum to address the increase in the going concern deficit from July 1, 2011 to July 1, 2012, everything else remaining the same.

A member asked what additional return was needed to recover the necessary assets as an alternative to increasing contributions. Mr. Shapira replied that an additional return of approximately 3.5% per year for the next two years in excess of the target return was necessary otherwise the special payments would increase.

On motion duly made, seconded and carried

It was Resolved

a) That the actuarial report for the University of Toronto Pension Plan as at July 1, 2012, attached to the Memorandum from the Chief Financial Officer dated December 3, 2012 as Appendix A, be approved.

b) That the actuarial report for the University of Toronto (OISE) Pension Plan as at July 1, 2012, attached to the Memorandum from the Chief Financial Officer dated December 3, 2012 as Appendix B be approved; and

c) That the actuarial report for the Supplemental Retirement Arrangement as at July 1, 2012, attached to the Memorandum from the Chief Financial Officer dated December 3, 2012 as Appendix C, be approved.

4. University of Toronto Pension Plans: Annual Financial Report for the year ended June 30, 2012

a) Audited Financial Statements

Ms Paulette Kennedy, Chair of the Audit Committee, reminded members that the Audit Committee had responsibility for reviewing the audited financial statements of the pension plans, and for recommending the financial statements to the Pension Committee for approval.

At its meeting on December 4, 2012, Audit Committee members had been given a brief oral overview by Ms Brown as well as a brief oral summary of the report by Mr. Francis Low from Ernst & Young, who was responsible for the pension audit.

On motion duly made, seconded and carried

It was Resolved

a) That the audited financial statements for the University of Toronto Pension Plan for the year ended June 30, 2012, a copy of which is included in Appendix "4a" of the document entitled *University of Toronto Pension Plans Annual Financial Report For the Year Ended June 30, 2012* be approved; and

b) That the audited financial statements for the University of Toronto (OISE) Pension Plan for the year ended June 30, 2012, a copy of which is included in Appendix "4b" of the document entitled *University of Toronto Pension Plans Annual Financial Report For the Year Ended June 30, 2012*; be approved.

b) Annual Financial Report

On motion duly made, seconded and carried

It was Resolved

That the University of Toronto Pension Plans Annual Financial Report For the Year Ended June 30, 2012 be approved.

5. Report on Pension Fees and Expenses for the period from 1989 to 2012

Ms Brown explained that the Report provided a historical summary of fees and expenses specifically allocated to the pension plan since 1989, excluding the Supplementary Retirement Arrangement (SRA).

A member asked whether the complexity of managing the investments had increased over the past 10 years. Another member suggested updating the table on page 6 of the Report with more recent data.

A member commented that it was the job of the Committee to look at the relationship between return and costs, and suggested that information on expenses and fees for 2012-13 be monitored by the Committee.

A member asked why there had been a substantial increase in expenses in 2006-07. Ms Brown explained that, in 2007, transaction fees were separated for the first time. Mr. Moriarty noted that private equity investments, which had higher fees, had increased, and leverage within the portfolio was introduced. He also pointed out that the University's private equity investments had substantially outperformed passive public equity markets investments in the period since 2007.

6. Report on Pension Fees and Expenses for the period from 1989 to 2012 (cont'd)

A member asked if the University had a policy on socially responsible investing. Ms Brown replied that the University had a Policy on Social and Political Issues with Respect to University Divestment and a Responsible Investing Committee that was advisory to her. The Committee included representatives of alumni, administrative staff, students and faculty, and provided a forum for discussion of principles related to responsible investing .

Mr. Moriarty noted that UTAM was a member of the Canadian Coalition for Good Governance.

7. Educational Opportunities: Suggested Topics

The Chair reminded members that the Terms of Reference of the Committee provided for information sessions to be organized for members. He invited members to suggest topics for at least one information session to be held in January or February.

8. Assessors' Reports

There were no reports from the assessors.

9. Date of the Next Meeting: Wednesday, March 20, 2013

Members were informed that the next regular meeting of the Pension Committee was scheduled for Wednesday, March 20, 2013 at 5:00 p.m.

10. Other Business

a) Working Group on Report Formats

Ms Brown informed members that some investing report templates had been developed by UTAM. A Working Group to review the templates had been formed at a previous Committee meeting, and the Chair, Vice-Chair, Professor Damiano and Mr. Thomas had volunteered to serve on the group. A meeting of the group would be scheduled in January. In response to an invitation for additional members, Mr. Ward volunteered to serve on the Working Group.

The meeting adjourned at 6:45 p.m.

Acting Secretary Chair

December 18, 2012

Appendix 1

Facilitating Pooled Asset Management for Ontario's Public-Sector Institutions (Morneau Report)

Recommendations

2.1 Pooled asset management should only be undertaken it if achieves sufficient scale to support the development of cost-effective internal investment management teams and to attract and retain world-class leadership. The threshold would have to be at least $50 billion.

3.1 The Province should introduce legislation to establish a new pooled asset manager to facilitate pooled asset management for Ontario's smaller public-sector institutions – the Ontario Investment Management Corporation (Corporation).

3.2 The government should legislate the participation of public-sector pension funds that are expected to realize appreciable benefits from pooled asset management.

3.3 The government should include provisions in legislation that would indemnify current fiduciaries from any fiduciary liability arising from the legislated transfer of investment management responsibility to the Corporation.

3.4 All public-sector institutions with pension funds of less than $40 billion in assets under management should be compelled to pool their assets with the Corporation, subject to limited exceptions.

3.5 The Ontario Nuclear Funds, the Workplace Safety and Insurance Board investment funds, and the Agricorp Production Insurance fund should be compelled to participate in the pooling framework.

3.6 All public-sector institutions whose assets are not mandated to be managed by the Corporation should be permitted to voluntarily access the services and individual asset classes available through the Corporation, subject to reasonable terms and conditions, and on a 'cost-recovery' pricing basis (ie. Voluntary participants would experience pricing on the same basis as mandated participants).

3.7 Broader public-sector institutions should be permitted to voluntarily access the services available through the Corporation for endowment funds and supplemental employee retirement plan funds, subject to reasonable terms and conditions, and on a "cost-recovery" pricing basis. The Corporation should be equipped to accommodate these types of funds immediately upon its establishment.

3.8 Any public-sector pension plan that can negotiate an agreement-in-principle to transition its assets to an existing large Ontario asset management entity (eg. the Ontario Teachers' Pension Plan [Teachers'], the Ontario Municipal Employees Retirement System [OMERS] Pension Plan, or the Healthcare of Ontario Pension Plan [HOOPP]) with a signed memorandum of understanding prior to the establishment of the Corporation should not be compelled to pool its assets with the Corporation.

3.9 The Corporation should be structured to facilitate the management of defined-contribution assets. Defined-contribution funds would be permitted to pool assets with the Corporation on a voluntary basis, but only at such time as the capacity of the Corporation permits.

3.10 The Corporation should develop the capacity to offer cost-effective advice on asset allocation decisions to participating institutions.

3.11 The legislation establishing the Corporation should clearly define the relationship between the Government and the Corporation, limiting control and influence to specific areas, including accountability and transparency through reporting requirements. The legislation should include a mandate clarifying that the Board has a duty to serve and act in the best interests of its clients.

3.12 The board of directors should have 11 representatives including a chair. Three directors should be nominated by client groups and two directors should be nominated by plan members. Six, including the chair, should be selected solely based on professional qualifications and appointed by the board.

3.13 All candidates for the board would be screened by the nominating committee to ensure they meet minimum qualification standards for eligibility before appointment, and selected based on the decision of the nominating committee as to fit for the Corporation board.

4.1 The government should commit to ensuring that in the first three years of the Corporation's operation, participating institutions would not face increased total investment management costs, except in cases where an institution changes its asset allocation. Beyond this three-year period, investment costs should be charged to participating institutions on the basis of asset-allocation decisions and the direct costs of investment.

4.2 Once the Corporation is established, anticipated within approximately six months following the passage of legislation, it should have arrangements in place to transfer the internal investment teams from participating institutions to support the early stages of implementation.

4.3 Like existing large pension plans, the Corporation should not be subject to the compensation bands of traditional public-sector entities. Compensation for directors should be comparable to other like pension funds and compensation for management should be competitive to external benchmarks. Furthermore, management compensation arrangements and perquisites should be overseen by a board compensation committee.

4.4 The Corporation would need to employ a unitized fund structure, providing the flexibility to accommodate the distinct asset-allocation decisions of each participating institution.

4.5 The Corporation, immediately after establishment, would develop and adhere to a clearly stated investment philosophy, robust risk management framework, transparent procurement policy and ethical governance and management guidelines.

4.6 After a cooling-off period, participating institutions should be free to withdraw from the pooling framework, as directed by their trustees or governors. This cooling-off period would give the Corporation time to negotiate lower investment management costs, rationalize external investment managers, and develop internal investment expertise. It should also allow for a significant period of full operation and a more accurate assessment of the Corporation's performance.