University of Toronto

(OFFICE OF THE VICE-PRESIDENT, BUSINESS AFFAIRS – FINANCIAL SERVICES DEPARTMENT

TO: Business Board

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AGENDA ITEM: 6

ITEM IDENTIFICATION:

Pension Strategy

JURISDICTIONAL INFORMATION:

The Business Board approves policies with respect to financial programs and transactions, and approves individual programs and transactions as required by those policies.

PREVIOUS ACTION TAKEN:

In October 1997, Business Board approved the funding strategy for the registered University Pension Plan (RPP) and the unregistered Supplemental Retirement Arrangement (SRA).

HIGHLIGHTS:

In 1997, the University had a registered pension plan in surplus, to which it was not permitted to make contributions, and had just established the SRA. The strategy that was adopted in 1997 was to utilize pension budget, established at 75% of employer current service cost, to fund the SRA unfunded liability over 5 years, and for other University purposes.

At July 1, 2003, the RPP was in deficit. The SRA, while also in deficit, had assets of $91.2 million, exceeding the original funding commitment, and liabilities are moving back and forth between the SRA and RPP in accordance with the rate of increase in the Income Tax Act maximum pension over time. The RPP deficit requires payment of full current service pension contributions and special payments in respect of unfunded past service.

The proposed pension strategy going forward is to consider the RPP and SRA together, to put in place a funding mechanism that amortizes deficits in both plans over the 15 year period permitted under pension regulations and to do so using a smoothed approach that is both prudent and predictable. Here are the specific recommendations:

1. Employees make their regular annual contributions.

2. For the 2003-04 fiscal year, the University contributes $26.8 million to the RPP and $9.5 million to the SRA.

3. Beginning May 1, 2004, the University contributes 100% of the required employer current service cost for the RPP and SRA. This will require restoration of the operating budget pension budget to 100% of the RPP current service cost.

4. Beginning May 1, 2004, the SRA is put on the same basis as the RPP with respect to deficits. With the achievement of full funding of the original past service liability occurring at the time the SRA was established in 1997 and because a portion of the liabilities will move back and forth between the SRA and the RPP in accordance with the Income Tax Act maximum pension over time, future SRA deficits should now be treated like those of the RPP and funded over 15 years.

5. Beginning May 1, 2004, the University makes special payments of no less than $26.4 million annually to deal with the RPP and SRA deficits by way of a smoothed budget allocation over about 15 years. This smoothed approach provides for higher payments than required in the earlier years, thus holding off any possible solvency issues and providing for predictability.

6. The OISE plan is a closed plan (no new members) and is still in a surplus position. It is unlikely that the university will have to make a current service cost contribution to this plan in the near future and therefore no budget is proposed for this.

7. Steadfastly make a special payment of no less than $26.4 million annually in respect of the RPP and the SRA even if investment returns reduce plan deficits. By doing this, the University will be making provision for future periods of poor investment returns.

8. Continue to set these funds aside, regardless of Income Tax Act restrictions. If not permitted to make contributions to the RPP, reserves should be set aside outside the RPP.

9. Make provision for funding any future augmentations that might occur by setting aside the corresponding amount from pension surpluses existing at the time.

FINANCIAL AND/OR PLANNING IMPLICATIONS:

To implement this strategy, the University's operating budget allocation for pensions must rise from $31.2 million for fiscal year 2003-04 to $65.9 million for 2004-05, $75.5 million for 2005-06, $77.8 million in 2006-07, $80.3 million in 2007-08, $82.7 million in 2008-09 and $85.0 million in 2009-10.

With these contributions and if the assumptions contained in the projections with respect to investment returns, participation, etc. would be achieved, the RPP deficit would increase to about $236 million in 2004-05 and then gradually decline over time. The SRA deficit would remain approximately at current levels even though liabilities are projected to rise. There is considerable variability expected in these liabilities since they will be influenced by the rate of increase in the Income Tax Act maximum pension, which is pegged to the increase in the industrial wage starting in 2006.

The impact on the financial statements is expected to be an increase in pension expense on the income statement from $39.7 million in 2002-03 to about $90 million annually. Pension liability on the balance sheet is expected to rise to about $131 million by 2007-08 and then begin to fall as the deficit is reduced over time.

RECOMMENDATION:

That the Business Board approves the funding strategy contained in the nine recommendations provided above.