University of Toronto

(FINANCIAL SERVICES DEPARTMENT, BUSINESS AFFAIRS)

TO: Business Board

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AGENDA ITEM: **3**

ITEM IDENTIFICATION:

Pension Plans – Annual Financial Report for the Year Ended June 30, 2007

JURISDICTIONAL INFORMATION:

Pursuant to section 5.1(b) of its terms of reference, the Business Board is responsible for "review of regular reports on matters affecting the finances of the University." The Board is asked to review and, on the recommendation of its Audit Committee, approve the audited financial statements for the registered pension plans

PREVIOUS ACTION TAKEN:

At its meeting of November 29, 2007, the Audit Committee reviewed the pension plans annual financial report and recommended the pension plan financial statements to the Business Board for approval. The pension contribution strategy was originally approved by the Business Board in January 2004. The pension master trust investment policy was most recently approved by the Business Board in June 2007. A proposed revised policy is on the agenda of the December 17 meeting.

HIGHLIGHTS:

This report provides the Audit Committee and the Business Board with an update of the pension liabilities and assets as well as an assessment of how well the University's pension investment and contribution strategies ensure pension financial health.

The University of Toronto provides pension benefits to current and future pensioners via three defined benefit pension plans: the registered University of Toronto Pension Plan (RPP), the registered University of Toronto (OISE) Pension Plan (RPP(OISE)), and the unregistered Supplemental Retirement Arrangement (SRA).

The actuarial results at July 1, 2007 are summarized by plan in the following table.

	RPP	RPP(OISE) (includes partial wind-up)	SRA (1)
Accrued liabilities	$2,745.8 million	$115.3 million	$145.4 million
Market value of assets (1)	$2,929.7 million	$131.6 million	$170.0 million
Market surplus	183.9 million	$16.3 million	$ 24.6 million
Actuarial surplus or (deficit)	($55.8 million)	$7.0 million	

(1) For financial accounting purposes, the University from time to time appropriates funds which are set aside as "internally restricted funds" in respect of the obligations under the SRA. In accordance with an Advance Income Tax Ruling which the University has received, such assets do not constitute trust property, are available to satisfy University creditors, may be applied to any other purpose that the University may determine from time to time, are commingled with other assets of the University, and are not subject to the direct claim of any members.

The RPP solvency ratio, which is a measure of the assets' market value as compared to the solvency liability of the plan (before indexing), was 1.11 at July 1, 2007. It has increased from 1.00 at July 1, 2006. On a wind-up basis (after indexing and incorporating early retirement windows) the deficit is $512.9 million.

The RPP(OISE) solvency ratio was 1.15 at July 1, 2007, taking the partial wind-up into account. At July 1, 2006 it was 1.05 after taking the partial wind-up into account. On a windup basis (after indexing and incorporating early retirement windows) the deficit is $11.7 million.

The RPP(OISE) plan results include the assets and accrued liabilities related to the members of the 1996 partial plan wind-up. The amount of assets allocable to the partial plan wind-up members as at June 30, 2007 is $14.6 million. These assets will be used to provide for settlement of pension entitlements and surplus allocation for partial plan wind-up members and expenses associated with the partial plan wind-up and surplus distribution.

The results for the RPP and the RPP(OISE) plans reflect a one-year return for the pension master trust of 20.0%, net of fees and expenses and excluding returns on private investment interests. Fees and expenses for the year totaled $24.5 million, and amounted to 0.8% of master trust assets. The financial statements for the pension plans show the audited values of the assets available for benefits.

The July 1, 2007 actuarial reports also reflect the following:

- A change to the mortality table to reflect the fact that plan participants are living longer.
- A change to the retirement assumption to reflect the end of mandatory retirement and the Agreement on Retirement Matters with the University of Toronto Faculty Association.
- Augmentation from 75% of CPI to 100% of CPI at July 1, 2007 and July 1, 2008, for retired faculty and librarians.

Sensitivity Analysis:

The challenge for defined benefit pension plans is to find a way to reasonably estimate the current net present value of what pensions will be paid to retired members over time (the liabilities) and to set aside money now to support payment of those pensions in future (the assets).

The liability depends on assumptions about the number of members in the pension plans, their length of service, their estimated salaries at retirement, the kinds of benefits they are receiving or will receive and future inflation. The liability represents the discounted net present value of pension benefits earned for service up to the valuation date, based on those assumptions. The discount rate at which the pension liabilities are discounted to their net present value has a significant impact on the surplus/deficit and on the current service cost contributions required to be paid into the plans.

A 4.0% real return plus CPI discount assumption has been in place for many years. At July 1, 2007, the discount rate is 6.5%, composed of 2.5% CPI and 4.0% real return, net of all fees. Changes in actuarial assumptions can have a significant impact on the employer current service cost and the surplus/deficit of the plans. For example, a 1.75% reduction in the RPP real discount rate to 2.25% (4.75% interest rate including CPI) would increase the employer current service cost by $47.6 million and would decrease the market surplus by $761.6 million. A 0.25% decrease in the discount rate would increase the employer current service cost by $5.2 million and would decrease the market surplus by $90.7 million. It is important to note that the intent of the sensitivity modeling around the discount rate is not to predict a range of investment outcomes. Rather, its intent is to illustrate the effect on contributions and the surplus/deficit of recognizing different proportions of risk premium (the additional investment return over the long-term from investments, such as equities, which are more risky than fixed-income investments) in advance of it being earned.

It is also important to note that a zero percent return in 2007-08 would be sufficient to eliminate the current market surplus of $183.9 million in the RPP.

Conclusion:

The unfunded position has clearly improved. However, while there is a small surplus, there are still a number of issues that continue to cause concern, including the potential need to make payments into the RPP(OISE), expected volatility in investment returns, whether we will meet the long-term return expectations given financial market trends, and the University’s very large unfunded post-retirement benefits liabilities which we need to manage and control.

We are continuing to review the pension contribution strategy and will provide additional analysis at a meeting in the near future.

FINANCIAL AND/OR PLANNING IMPLICATIONS:

The pension contribution strategy continues to require 100% current service cost employer contributions and additional special payments of $27.2 million. The pension deficit contributes to the employee future benefits costs recorded in the University’s financial statements.

RECOMMENDATION:

It is recommended by the Audit Committee:

1) that the audited financial statements for the University of Toronto Pension Plan, June 30, 2007, a copy of which is included in Appendix “A” hereto, be approved, and

2) that the audited financial statements for the University of Toronto (OISE) Pension Plan, June 30, 2007, a copy of which is included in Appendix “B” hereto, be approved.