UNIVERSITY OF
TORONTO

Ensuring a Sustainable Pension Plan

for the

University of Toronto

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Executive Summary

The future of the University of Toronto depends, as always, on the caliber of the people it recruits to work and study here. However, over the next decade or more our institution will be heavily influenced by the wisdom of the decisions we make about the current shortfalls in funding our Pension Plan. These decisions will be made through collegial discussion, administrative action, and, where appropriate, Governance, as well as through negotiations with our Unions and Associations. Our shared goal must be to minimize any negative impact upon our academic programs, both in the short and longer run. This report sets out how we propose to accomplish that shared goal.

First, it should be understood that the University is not the only institution facing a pension problem. Almost without exception, Defined Benefit pension plans within the broad public sector in Canada and in the US have large deficits and employees and employers are being required to increase their contributions. In some plans benefit levels are also being reduced. Multiple factors led us to where we are today: some of those factors reflect decisions made 20 to 30 years ago; others are the result of the economic downturns that have occurred more recently and the continuing historically low interest rates. Continuing improvement in longevity is also a significant factor. What is important to note, however, is that most plans now face a problem of a similar kind regardless of the history of decision-making within each organization. This report accordingly outlines proposed strategies for dealing with two key issues: (i) addressing the deficit and (ii) enhancing the long-term sustainability of the plan.

The Solvency Deficit is approximately $1B. The Ontario Government has recently agreed that universities should be given some flexibility regarding Solvency Deficits. Provided that the University meets certain metrics, key among which is a negotiated agreement from employees to increase their contributions, the payment of the Solvency Deficit can be amortized over a longer period than five years. It is simply essential for the long term future health of this University that we meet the metrics specified by the Government. Being required to pay down the Solvency Deficit in a few years will put unacceptable fiscal pressures on the institution – with payments reaching as much as $200M per year. These pressures can be mitigated by a longer-term amortization if increases in contribution rates satisfy the provincial regulators. A longer-term horizon also means that we may benefit from improvements in investment returns and increases in interest rates. (A 2% increase in interest rates, tellingly, cuts the solvency deficit more or less in half.) It is, therefore essential, in the first instance, for the sustainability and fairness of our Pension Plan that member contributions bear a far closer relationship to the value of the pension benefit being earned. But such increases are also critical to enable the implementation of a rational amortization plan. Obviously, for these two positive outcomes to occur, we need the cooperation of the University's Unions and the Faculty Association.

Even amortizing $1B over a longer period than five years and even with an improvement in the financial markets, or changes in interest rates, the University will be required to make very significant payments to address the accumulated deficit. To avoid dramatic and adverse impacts on the academic mission, a variety of strategies must be devised to ensure that these payments are not drawn exclusively from the operating budget. For example, we can transfer into the plan the pension reserve; we can consider transferring some or all of the Supplemental Retirement Arrangement (SRA) assets that are on hand; we can take advantage of our credit ratings to borrow funds; we can issue letters of credit; we can sell or lease some of our assets that are not critical to the current operations of the University.

Over the next several months we will be bringing forward proposals to the Business Board and to the Pension Committee. At the same time we will be engaging in negotiations with UTFA and with several of our larger Unions, including USW, where the above-noted case for contribution increases will be a key item for discussion. We are committed to addressing the problem, to ensuring that the University remains an outstanding institution, and to offering our students access to strong academic programs offered by some of the best faculty anywhere.

Introduction

The University of Toronto registered pension plans are projected to have a large going concern deficit and a solvency deficiency as of July 1, 2011, the date of the next regulatory filing. The Province of Ontario has pending a regulation providing temporary solvency funding relief if certain conditions are met; in particular a requirement that employee contributions are increased to be more commensurate with the value of the pension benefit being earned. This paper outlines the magnitude of the deficit problem, and describes a range of approaches that may be employed to address it. The funding strategy that we ultimately adopt will depend upon the actual valuation results at July 1, 2011, the regulations that the Ontario Government releases, and our ability to meet any conditions set by the Government for acceptance into the temporary solvency funding relief program.

Background

The University of Toronto (the "University") provides pension benefits to current and future retired members via three defined benefit pension plans:

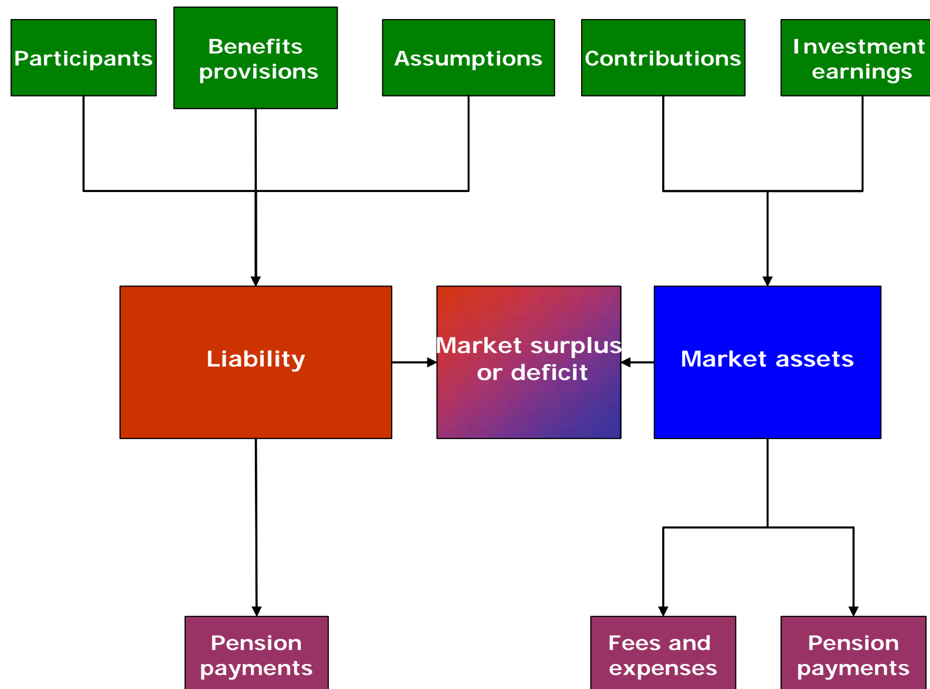
- the University of Toronto Registered Pension Plan (RPP).
- the University of Toronto (OISE) Registered Pension Plan (RPP (OISE)).
- the Supplemental Retirement Arrangement (SRA), an unregistered arrangement that provides pensions above the maximum pension benefit allowed under the Income Tax Act, up to a University specified maximum salary of $150,000.

A defined benefit pension plan provides pension benefits to each retiring member on the basis of defined percentages applied to salary and years of service. It is a challenge 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). Many actuarial assumptions go into calculating the liabilities, including assumptions around mortality; salary increases; inflation and investment returns. Many of these assumptions are interdependent. These assumptions are long-term in nature, are expected to meet actuarial standards of practice, and should ideally fall within the range used by other large pension funds. Actuarial assumptions have a powerful impact on the calculation of the liabilities. As an example, interest rates are currently at historic lows and this significantly affects the solvency calculation. A 2% increase in interest rates alone would reduce the solvency deficit by about half! The reduction in interest rates over a long period of time is a significant contributing factor to the current problem.

Funds must be set aside now to support payment of these pensions in the future (the assets). There are only two ways of funding a pension plan: contributions from employees and the employer; and investment returns. Contributions, plus investment earnings, minus the fees

and expenses incurred in administering the pension plans and managing the investments, minus the payments to retired members, result in the pension assets that are on hand and set aside to meet the pension liabilities.

The difference between the estimated net present value of current and future pensions (the liabilities), and the amount of funds actually on hand (the market assets) is the market surplus or deficit.



Helpful Definitions and Useful Context

Going Concern Deficit – the going concern valuation assumes that the pension plan continues to operate for the foreseeable future. A going concern deficit is the difference between 1) the plan liabilities calculated using actuarial assumptions that provide for continued operation of the plan, and 2) the market value of assets as at the valuation date. A going concern deficit may be amortized and eliminated over a fifteen-year period.

Solvency Deficit – the solvency valuation assumes that the plan will be wound up as at the valuation date. A solvency deficit is the difference between 1) the plan liabilities calculated using actuarial assumptions that provide for plan wind-up plus wind-up costs, and 2) the market value of assets as at the valuation date. The actuarial assumptions that must be used for this valuation are prescribed by legislation and actuarial standards. Solvency deficits must be amortized and eliminated over a five-year period.

Hypothetical Wind-up Deficit – the hypothetical wind-up valuation also assumes that the plan will be wound up at the valuation date, and that annuities will be purchased for plan members, at levels that provide for the 75% indexation benefit in the plan. A hypothetical wind-up deficit is the difference between 1) plan liabilities calculated using wind-up actuarial assumptions making provision for indexation, plus plan wind-up costs, and 2) the market value of assets as at the valuation date.

Solvency and hypothetical wind-up valuations assume the organization is ceasing to operate. A number of other provinces in Canada have acknowledged that within the University sector this is not likely to happen and do not apply the Solvency test to University pension plans. The Ontario government has not taken this position but has agreed to extend the amortization and payment period over a longer period than five years, provided certain conditions are met. Government officials have already signaled that a key condition for U of T is an increase in employee contributions.

Current service contributions - Contributions made by members and by the University to fund pension benefits earned in the current year are known as current service costs. The member share of those contributions is determined by formula, with the employer contribution representing the difference between the total current service contribution required (actuarially determined) and the portion paid by members.

For many years, the ratio of University to employee contributions has been about 2:1. This ratio has not changed even though the pension benefit has been enhanced significantly over that time period. Current employees are not contributing in proportion to the value of the benefit now being earned.

Special payments - Contributions in respect of pension deficits attributed to benefits earned in prior years are past service contributions and are normally referred to as special payments.

If the University of Toronto is unable to receive Government approval to extend the amortization period for financing the Solvency Deficit, the special payments will be in the range of $200 million per year – an amount that will severely impact our academic programs.

The Problem

The plans are currently in a significant deficit position as at July 1, 2010, with respect to both going concern and solvency valuation methodologies. At July 1, 2010, the going concern accrued liabilities and market value of assets for the University's pension plans were as follows (please see previous page for definitions of going concern deficit, solvency deficit and hypothetical wind-up deficit):

At July 1, 2010 (millions of dollars) [2]			
	Accrued Liabilities [1]	**Market Value of Assets**	**Market surplus (deficit)**
University of Toronto Pension Plan (RPP)			
Going concern actuarial valuation	3,126.0	2,093.9	(1,032.1)
Solvency actuarial valuation [3]	3,264.2	2,092.9	(1,171.3)
Hypothetical wind-up actuarial valuation [3]	4,244.6	2,092.9	(2,151.7)
University of Toronto (OISE) Pension Plan - RPP(OISE)			
Going concern actuarial valuation	109.0	72.8	(36.2)
Solvency actuarial valuation [3]	117.5	72.4	(45.1)
Hypothetical wind-up actuarial valuation [3]	150.3	72.4	(77.9)
Supplemental Retirement Arrangement (SRA)			
Going concern actuarial valuation	138.3	115.8	(22.5)
Pension Plan Reserve		24.9	24.9

[1] *For staff groups for whom salary increases had not been finalized at the date of the valuation, actual salaries at the valuation date were used. For Faculty and Librarians, salaries as of July 1, 2010 were estimated based on the arbitration award released on October 12, 2010.*

[2] *Going concern valuations assume that the plan is continuing to operate for the foreseeable future. Solvency and hypothetical wind-up valuations assume that the plan will be wound-up as at the valuation date*

[3] *The market value of assets are net of wind-up expenses which are estimated to be $1.0 million for the RPP and $0.4 million for the RPP(OISE).*

As a result, large special payments into the pension plans will be required over the next several years in accordance with Ontario pension legislation and regulation.

The cause of the problem is multi-factorial. During the times of significant surpluses, not only were plan sponsors precluded at times from making payments into the plan by the Income Tax Act, but the surplus was used to enhance benefits for active and retired members without a commensurate increase in contribution rates (we will return to this issue in the later section on *Addressing Ongoing Sustainability and the Importance of Increasing Member Contributions*). When investment returns returned to more normal levels, the plan moved into deficit. Another

key factor was the market crash of 2008-09 which resulted in investment losses of nearly 30% in the plans. All pension plans suffered significant losses at that time and, while we lost more money than most other Canadian universities in 2009, we had made more than most in 2007. However, neither fact is very relevant because our focus is long-term and on that longer-term basis we are tracking back towards our return target of a 4% real rate of return. (Over the 21-year period beginning July 1, 1989 and ending June 30, 2010, the **actual** average annual real investment return was 4.1%.) Investment returns have improved, but not enough to return the plan to a fully funded status. Moreover, funding to deal with this past service debt is not going to address the underlying problem that the current benefit levels require a higher level of contributions into the plan. The corollary is that current retirees and soon-to-be-retired members benefited from a bargain because they did not contribute at a level commensurate with the excellent pension that they are receiving or will receive.

At the same time, as noted earlier, interest rates have declined, a major factor contributing to the large solvency deficits that pension plans generally are now experiencing. To repeat and elaborate: a 2% increase in interest rates would reduce the solvency deficit by about half, but would not deal with the issue of long-term sustainability represented by the need to increase current service contributions.

Finally, members are living longer and collecting pensions longer – good news for our community, but another source of financial pressure on the plan!

The U of T is not the only university in Ontario facing this problem. Indeed, with very few exceptions, university defined benefit plans have significant deficits, as do defined benefit plans right across Canada and the U.S.A. The Province of Ontario has undertaken a comprehensive analysis of each university's pension plan as part of a general review of public and private pensions and has recently set out expectations for exactly what steps should be taken and what funds must be committed for each University's plan to be considered sustainable and solvent. The resulting pending regulations will put in place a two stage process that is intended to provide institutions in the broader public sector (which includes universities) with an opportunity to make net solvency payments over a longer period than would otherwise be required. Specifically, the Government expects institutions to negotiate with plan members and their representatives ways to enhance the long term sustainability of defined benefit pension plans. It is the government's view that employees, particularly within universities, are not paying a sufficiently high percentage of salary towards the retirement benefits they are earning and the Government expects those employee contributions to increase significantly to be more in line with the value of the benefit. In concrete terms, the Government is looking for employees and employers to share the cost of funding the pension benefit. The Government would also require that, during the funding relief period, and for a period of time following the relief period, contribution holidays would be restricted and any benefit improvements would require accelerated funding. The University fully

endorses the requirements for restrictions on contribution holidays and accepts the rationale for accelerated funding of benefit improvements.

The University must file a valuation report with the Financial Services Commission of Ontario (FSCO) as of July 1, 2011. It will need to submit a plan to the Ministry of Finance that identifies how we intend to address the sustainability issue and to share that plan with members and collective bargaining agents. That plan needs to be approved by the Ministry for us to enter Stage 1.

Stage 1 is a three-year period from July 1, 2011 to July 1, 2014 during which there would be a solvency funding exemption, subject to various tests, of which one would be making going concern special payments that at least cover interest on the solvency deficit. At the end of Stage 1, our plan would be assessed, based on technical measures, to determine whether sufficient progress in meeting the sustainability commitments has been made. If the assessment is that we have made sufficient progress then we are eligible to enter Stage 2 of the process.

Under Stage 2, the solvency deficit can be amortized over 10 years, that is, from July 1, 2014 to June 30, 2024, instead of the regular 5 year period. If we fail to enter Stage 2, we will be required to fund the solvency deficit over 5 years.

Even with temporary solvency relief, dealing with the pension funding issue will have a significant impact on the University. Without it, the consequences will be dire. The latter reality, in our view, renders moot all the ongoing debates about the history of the Pension Plan and the assumptions underpinning valuations within it. If contribution rates are not increased, both sides in the negotiations will bear the responsibility for damaging the fabric of a great Canadian institution. As a matter of fairness and sustainability, we believe negotiating increases to employee pension contributions is the right thing to do.

Projections for Dealing with the Deficit

As noted earlier, there are only two ways of funding a pension plan: contributions from members and the employer and investment earnings. The University is currently reviewing the pension investment risk and return targets and has been consulting with stakeholders. The Pension Committee is to consider them later in the year. While more work must be done, our preliminary conclusion is that we should not expect to solve our pension funding problem by increasing our investment targets and, therefore, our focus must be on the only other source of funds, that is, increased contributions.

Hewitt Associates has projected the going concern and solvency deficits and a sample funding and financing strategy, using the following key assumptions:

- The investment return target is a real investment return of 4.0% per annum over ten-year periods. Over the 21-year period beginning July 1, 1989 and ending June 30, 2010, the **actual** average annual real investment return was 4.1%.

- Actual investment returns are projected to be a 10% nominal return for the July 1, 2010 to June 30, 2011 period, and 6.5% (4.0% real return plus 2.5% inflation assumption) for each year thereafter.

- Prior to July 1, 2011 (the next required filing date), the University will make an estimated $150 million lump sum payment into the registered plans, to reduce the deficit.

- Once we have filed the actuarial valuation effective July 1, 2011 with FSCO (due March 31, 2012), we will not be required to file another actuarial valuation until July 1, 2014. This needs to be confirmed in the solvency relief regulation, which has not yet been released.

- There will be an annual recalculation of the deficit over the payment period taking actual payments into account.

- No change in interest rates is assumed, in line with our conservative approach to pension assumptions generally and to addressing this deficit problem. As noted earlier, a 2% increase in interest rates would reduce the solvency deficit by about half.

- Current actuarial assumptions are assumed. Actuarial assumptions are reviewed annually and must be approved by the Pension Committee. The assumptions around

mortality, inflation, and interest rates are currently under review and could change in the future, which could exacerbate the problem.

- Asset smoothing is used to determine the required contributions. This means that for the July 1, 2011 actuarial valuation, the going concern funding requirements are moderated by a deferral of some of the asset losses. Those asset losses would then be recognized in the next required actuarial valuation as of July 1, 2014 and amortized over 15 years from that date.

- We will qualify for both stages of temporary solvency relief. Obviously if we are not successful, the required payments would be accelerated, and the amount required to be paid each year would be much larger. Much more borrowing would be needed, with an associated much larger budget impact.

It is important to note the interdependency between the amounts required to be paid and the funding and financing strategy. Assuming we can recalculate annually, the more money the University puts into the plan and the sooner that is done, the smaller will be the subsequent payments that are required by regulation.

Under these assumptions, and after taking account of $150 million deposited to the plans prior to June 30, 2011, the going concern market deficit at July 1, 2011 is projected to be $890 million and the solvency market deficit is projected to be $1,046 million.

The breathing space provided by Stage 1, assuming the Government accepts our plan, would give us some time to develop broad strategies to generate large lump-sum amounts that could be put into the plans, rather than focusing solely on increasing annual appropriations from the operating budget over a long period of time. The rationale is that early large payments should generate positive growth in pension assets and help us protect the core mission of the University, relieving pressure on the operating budget by minimizing the need for cost containment. More specific information on potential short term and long term funding and financing sources is as follows:

Transfer Pension Reserve –The pension reserve is projected to be $37 million by June 30, 2011. The reserves have been held outside the registered pension plans for the purpose of funding the plans should the need arise. That need has now arisen.

The Supplemental Retirement Arrangement (SRA) Assets –The SRA is an unregistered pension plan. When the SRA was created in the late 1990’s, a funding strategy was put in place to set aside assets, which, in accordance with an Advance Tax Ruling, do not constitute trust property, are available to satisfy University creditors, are commingled with other assets of the

University, are not subject to the direct claim of any members, and may be applied to any other purpose that the University may determine from time to time. Over the past several years, due to legislated increases in the Income Tax Act maximum pension, liabilities previously anticipated to be included in the SRA have actually been moved back into the registered pension plans. And, as a result of those increases, it is projected that after 2014, all future pension liabilities would be included in the registered pension plans. Therefore the SRA will essentially be a closed plan, providing pension payments to those who had already retired. Annual SRA pensioner retirement payments are currently slightly less than $10 million per annum, decreasing slowly to zero in the future. However there has, to date, been no corresponding transfer of assets previously set aside for the SRA into the Registered Plans. We are actively considering whether it continues to be appropriate to maintain segregated/separately accounted for assets in support of the SRA, or whether a more prudent course of action is to contribute those assets to the registered plans. We will review this possibility with the Faculty Association. If indeed we do transfer some or all of the SRA Assets into the Pension Plans **it is important to stress that the pension promise associated with the SRA remains in full force and that individuals with entitlements under the SRA will continue to receive their benefits.** All that will change is the funding mechanism for these payments, with payments being made solely or mainly from the operating fund. All SRA entitlements will be honoured.

Increase Special Payments Budget –the annual special payments budget currently stands at $27.2 million per annum. It is projected that the University can allocate $30 million of new revenues to increase the special payments budget in base terms. While there are clear opportunity costs to this decision, this approach is preferable to waiting and facing large budget cuts downstream.

Borrow–and put the borrowed funds into the pension master trust. Interest rates would be based on market rates at that time. The resulting blended principal and interest payments would require an increase in the operating expense budget.

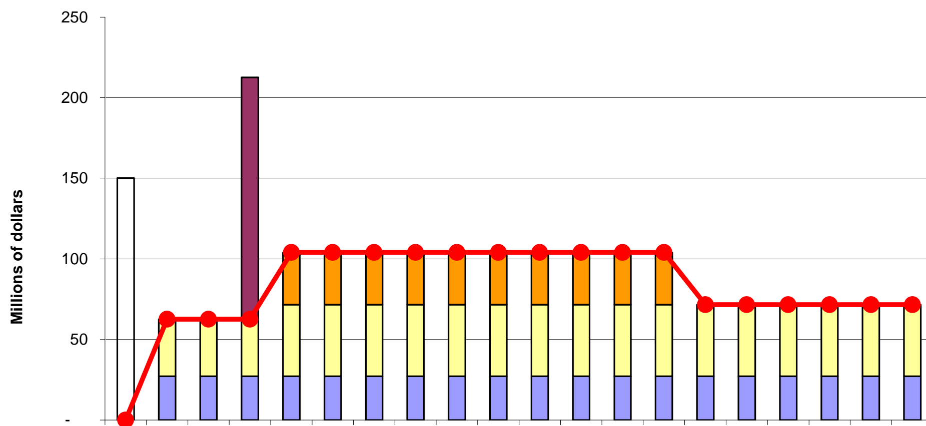
Sell or lease assets – while a direct transfer of physical assets owned by the University into the registered plans is not permitted under current legislation and regulation, the University could sell or lease surplus assets and transfer the net proceeds to the registered pension plans or lever resulting revenue streams to support borrowing that would enable large lump sum transfers into the plans. We are examining the possible ground lease of some lands and buildings that are not critical for the current operations of the University.

Issue letters of credit – New Ontario pension legislation permits the use of irrevocable letters of credit to meet the solvency special payment requirements, up to a maximum amount equal to 15% of the pension plan's solvency liabilities. It is important to note that letters of credit are not cash. They are designed to help deal with short-term volatility arising from investment returns and

interest rates. They are subject to bank fees which this modeling assumes would cost about 0.5% per annum, representing a cost-effective approach.

The key elements of the strategy are to put as much money into the plans as soon as possible to immediately enhance the financial health of pension plan and reduce interest charges on the deficit. To that end we are looking at making an estimated lump sum payment of $150 million into the plans before June 30, 2011 and making a second $150 million lump sum payment to the plans before June 30, 2014. We plan to increase the special payments budget and to utilize non-cash letters of credit where appropriate. We expect that the lump sum payments will arise from the pension reserve, from borrowing, from utilization of some or all of the assets supporting the SRA and from funds generated from sale or lease of existing capital assets. The following chart summarizes the funding and financing strategy and required special payments that are interdependent with it.

Funding and Financing of Required Special Payments
Stage 1 and Stage 2 Solvency Relief
Year beginning July 1



	Jul-10	Jul-11	Jul-12	Jul-13	Jul-14	Jul-15	Jul-16	Jul-17	Jul-18	Jul-19	Jul-20	Jul-21	Jul-22	Jul-23	Jul-24	Jul-25	Jul-26	Jul-27	Jul-28	Jul-29
Total funding and financing	150	63	63	213	104	104	104	104	104	104	104	104	104	104	71	71	71	71	71	71
Letter of credit					33	33	33	33	33	33	33	33	33	33						
Lumpsum payments	150			150																
Additional special payments budget		35	35	35	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44
Current special payments budget		27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27
Total special payment required	-	63	63	63	104	104	104	104	104	104	104	104	104	104	71	71	71	71	71	71

Data table amounts may not add precisely due to rounding.

As you can see from the chart, the total special payments required are $63 million per annum for the next three years, rising to $104 million per annum for the next ten years, and then declining to $71 million per annum in subsequent years. This stream of payments is actually dependent on the early large payments that are being made – the $150 million in 2010-11 and the second $150 million in 2013-14. Those early payments mitigate the subsequent required payments to the levels shown. Additionally, beginning in 2014-15, non-cash letters of credit are utilized to the level of $33 million per annum, which sum is not being deposited into the plans, so that actual payments into the plan during the ten year period from 2014 to 2023 are $104 million minus $33 million, equaling $71 million.

Therefore, the actual cash payments into the plans, in addition to the $300 million in lump sum payments, are projected to be $63 million per annum for the next three years, rising to $71 million per annum in subsequent years. As noted earlier, the current special payments base budget is $27 million per annum, leaving an additional $35 million per annum to be funded in the next three years in support of these payments, with another $9 million per annum to be added for the years beginning in 2014-15 with respect to these special payments.

In addition to the above funding required in support of the special payments, there are other related costs that must be funded.

- The RPP (OISE) plan is now in deficit and requires that current service costs of about $1 million per annum. In the past, those current service costs were paid from the surplus. (A partial wind-up of this plan, which was required under pension legislation, also distributed a significant amount of surplus existing at that time to certain plan members, exacerbating the problem with this plan).

- The Government requires plans with deficits to make contributions to the Pension Benefits Guarantee Fund (PBGF) and the size of our deficit dictates a payment of about $5 million per annum.

- To the extent we borrow funds we will incur repayment costs, and to the extent we charge the pension benefits payable under the SRA to the operating budget we will incur additional ongoing costs. These amounts are projected to be $10 million per annum beginning in 2011 and rising to $22 million per annum in 2014. Borrowing repayment is over an assumed term of 20 years.

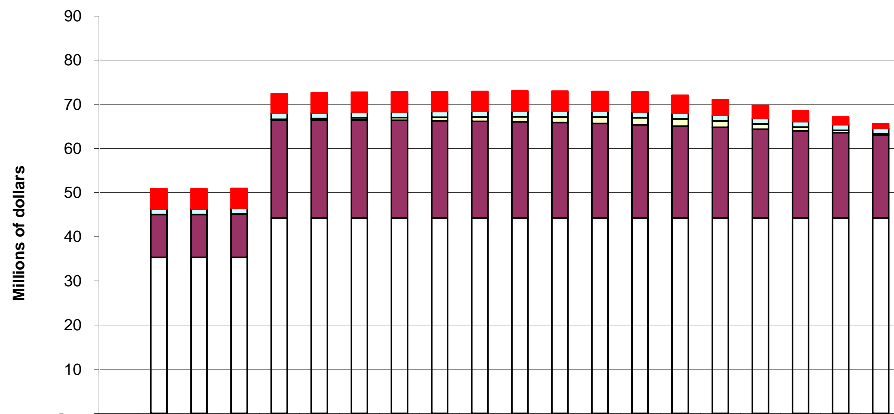
- Fees for letters of credit are assumed to cost about 0.5% per annum of the face value of the letters of credit, amounting to about $1 million per annum.

These costs amount to a further $16 million per annum for the next three years and rise to an additional $28 million per annum in 2014-15 once the borrowing repayment costs are added at that time. Therefore, total costs for which budget is not currently allocated in the operating fund are follows:

- Beginning July 1, 2011: $51 million per annum made up of $35 million for special payments plus $16 million for other related costs.

- Beginning July 1, 2014: that $51 million per annum rises to $72 million, made up of $44 million for special payments plus $28 million for other related costs. The following chart shows the required funding, for both the funding and financing strategy and the additional pension costs described above.

As noted earlier, a $30 million base budget is being allocated from new revenues anticipated next year, leaving $21 million per annum to be addressed for the 2011-14 period, and another $21 million per annum to be addressed by 2014-15. We are working hard to develop revenue streams to cover as much of this as possible to minimize the need for cost containment to deal with it.



	Jul-10	Jul-11	Jul-12	Jul-13	Jul-14	Jul-15	Jul-16	Jul-17	Jul-18	Jul-19	Jul-20	Jul-21	Jul-22	Jul-23	Jul-24	Jul-25	Jul-26	Jul-27	Jul-28	Jul-29
Additional budget impact		51	51	51	72	73	73	73	73	73	73	73	73	73	72	71	70	68	67	66
PBGF fee		5	5	5	5	5	5	5	5	5	5	5	5	5	4	4	3	2	2	1
OISE current service cost		1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Letter of credit fee at 0.5%					0	0	0	1	1	1	1	1	1	2	2	1	1	1	1	0
Budget cost of lumpsum payments		10	10	10	22	22	22	22	22	22	22	22	21	21	21	21	20	20	19	19
Additional special payments budget		35	35	35	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44	44

Data table amounts may not add precisely due to rounding.

Finally, it is important to stress that the above analysis is based on the assumptions described earlier, and that actual events will most likely be different. For example, this analysis assumes investment returns over the entire period at the 6.5% nominal return target rate. Better investment returns could improve this picture while, conversely, poorer investment returns would make it worse. The University is currently reviewing the investment risk and return targets and will be asking the Pension Committee to consider them later in the year. As a second example, this analysis assumes that interest rates will be unchanged over the period. As noted earlier, a 2% increase in interest rates would reduce the solvency deficit by about half.

Addressing Ongoing Sustainability and the Importance of Increasing Member Contributions

Looking back over the past 25 years (July 1, 1986 to June 30, 2011), University contributions are about $845 million, while member contributions are about $425 million. If we focus on current service contributions only, in 2010-11 the current ratio of $37.2 million in employee current service contributions (5.3% of payroll) and $78.3 million in employer current service contributions (11.1% of payroll) is a 2.1:1 ratio. For many periods during those 25 years our plan accumulated very large surpluses, largely owing to buoyant investment returns that substantially exceeded the target rate. Some $500 million of the surplus was used to enhance active and retiree benefits. In retrospect it would have been prudent a number of years ago to increase the percentage of salary that employees were contributing in order to ensure the long term sustainability of those enhanced benefits. However, given the magnitude of surplus in our plan this was not achievable through free collective bargaining or through arbitration.

As noted earlier the Ontario Government has been analyzing plans such as ours and is of the opinion that, given the value of the excellent benefits being earned, in general, employee current service contribution rates are simply too low for long-term sustainability. We agree that the contributions made by U of T employees are too low for the long term sustainability of our plans. In contrast, members of the Ontario Teachers' Pension Plan and the Ontario Colleges Plan contribute 11% of payroll with the employers also contributing 11% (a ratio of 1:1). The Ontario Healthcare Plan operates on a 1.26:1 ratio of employer to employee contributions. An examination[1] of publicly supported universities in the U.S. that had defined benefit plans in 2004-05 shows that the average contribution ratios for employers-to-employees was 1.5:1, lower than our ratio even before the recent fiscal crisis and associated solvency problems.

The Government believes that a more appropriate funding ratio going forward is a 1:1 current service contribution model with the employee and the employer each supplying half of the required current service contributions. In its view, this places increased responsibility on the shoulders of those who will enjoy the excellent benefits being earned, rather than on the shoulders of students and taxpayers who are, of course, the primary contributors, through tuition fees and government grants, to the University's operating budget. A move to a shared responsibility funding model, that is, a model in which the University and the plan members jointly share responsibility for ensuring the financial sustainability of the plan, with contributions more commensurate with the value of the benefit, would also set the stage for movement to full joint governance of the pension plans.

[1] Lahey, K.E. et al (2008) Retirement Plans for College Faculty at Public Institutions, Financial Services Review, 17, 323-341.

It is important to emphasize that increased employee current service contributions are not about clearing the deficit in the U of T plan or adding new entitlements. They are about ensuring the long-term sustainability of the pension plan by meeting the increasing costs of the excellent benefits that the plan already offers.

It is also important to note that if employee current service contributions are increased by an amount that is satisfactory to the government, then the financial viability of the pension fund gets steadily better over time – a far better outcome than the massive up-front penalties that will otherwise occur. In other words, not only do we create a positive mortgage effect through the addition of these increased contributions to our plan, but we also escape punitive solvency charges.

At this time, almost every defined benefit plan in the broader Canadian public sector is looking at increasing member current service contributions and/or contemplating reductions in future benefits, or has already done so. To name a few, this would include the University of Waterloo, Carleton University, the McMaster University Staff Plan, the Trent University Faculty plan, the UBC Staff plan, the Ontario Public Service Pension Plan, and the Alberta Universities Academic Pension Plan.

We are mindful that increased member current service contributions must be negotiated with the 10 unions participating in the pension plans as well as with UTFA. This will be a top priority for all negotiations from this point forward. The University's goal during negotiations over the next 2-3 years will be to increase member contributions to a level that meets a 1.5:1 ratio. Over future negotiations we will seek to move the ratio closer to 1:1. We anticipate that our Unions/Associations will wish to see commitments from the University regarding the University's current service contribution and this too will likely be the subject of negotiation.

To illustrate the impact of increased employee contributions, each 1% of salary in addition to the current 5.3% of payroll, (representing $37.2 million in 2010-11) would generate approximately $7 million per annum, assuming that all employee groups participated in the increase.

Finally, it cannot be emphasized enough that success in increasing member contributions will be a key criterion for obtaining Government permission to extend the net solvency payments over a longer period than five years. As noted, this is also an issue of fairness because those who receive the benefits will be paying a fairer share of the cost. If contributions are not increased, it will be the next generation of faculty, staff and students who bear the impact of the financial implications.

Recommendations

In conclusion, this paper illustrates how we might approach the pension funding problem and the assumptions that we are making as we plan for significantly increased pension contributions. While we are not asking for approval of a comprehensive funding strategy at this point, we do want to make a $150 million lump sum payment into the pension plan prior to July 1, 2011 to mitigate the payments required beginning July 1, 2011. This payment will likely be a combination of funds from the Pension Reserve and borrowing and we are, therefore, requesting approval for up to $150 million borrowing for deposit into the pension plans.

The current borrowing strategy approved by the Business Board provides for maximum external borrowing capacity of 40% of net assets averaged over five years, plus maximum internal borrowing capacity of $200 million.

The *Borrowing Strategy Review January 2011* (Business Board January 31, 2011) has identified an additional $150 million in EFIP that could prudently be invested long-term without impairing cash flows and would therefore be available for borrowing. We believe that, as discussed in that paper, it makes sense to designate this additional $150 million as a pension borrowing capacity, separate and apart from the borrowing capacity otherwise defined under the current Borrowing Strategy.

We are requesting that a $150 million pension borrowing capacity be established that is reserved for pension purposes, that it be separate and apart from the maximum borrowing capacity established under the current borrowing strategy, and that actual borrowing up to $150 million, to be used for pension purposes, may be made internally or externally at the discretion of the senior officer responsible for financial matters. As with the existing $200 million internal borrowing capacity, if this additional $150 million invested by EFIP were needed for short-term expenditures, the borrowing would have to be re-financed externally.