

UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 24 OF THE PENSION COMMITTEE

June 8, 2016

To the Governing Council,
University of Toronto.

Your Committee reports that it held a meeting on Wednesday, June 8, 2016 at 4:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Ms Claire Kennedy, In the Chair
Mr. Alex McKinnon, Vice-Chair
Mr. Harvey Botting
Mr. David Bowden*
Ms Colleen Burke
Mr. Jeff Collins
Professor Paul Downes
Ms Janet L. Ecker*
Mr. Brian D. Lawson*
Ms Leanne MacMillan
Mr. John Paul Morgan*
Professor Emeritus Arthur Rubinoff
Mr. Andrew Szende**
Mr. Bruce Winter

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

Secretariat:

Mr. David Walders, Committee Secretary
Mr. Anwar Kazimi, Deputy Secretary of the
Governing Council

Regrets:

Professor Ettore Vincenzo Damiano
Professor Jennifer Jenkins
Mr. Mark Krembil
Ms Kim McLean
Dr. Gary P. Mooney
Dr. Andreas Motsch

**Participated by Telephone*

***Absent for vote on Item 2*

In Attendance:

Ms Elizabeth Brown, Hicks, Morley
Mr. Geoff Matus, Co-Chair, Investment Committee
Mr. Steve Moate, Senior Legal Counsel, University of Toronto
Dr. Pierre Piché, Controller and Director of Financial Services
Mr. Allan Shapira, Hewitt Associates LLC
Mr. Daren Smith, Managing Director, Manager Selection & Portfolio Construction,
University of Toronto Asset Management Corporation (UTAM)
Mr. John Switzer, Chair, UTAM Board

The Chair provided introductory remarks and welcomed members and guests, offering a special welcome to a new member, Professor Emeritus Arthur Rubinoff. She also extended a special thank you to Mr. Bill Moriarty, who had announced his retirement as President and CEO of the UTAM Corporation, for his leadership of UTAM over the past 8 years.

1. Investment Committee Terms of Reference and Investments: *Who Does What?*

Ms Brown provided an update for members regarding the Investment Committee (IC). She noted that the IC would replace the Investment Advisory Committee (IAC) and would work with the UTAM Board and UTAM management staff directly on behalf of the President. The IC membership, which had been drawn from membership of the IAC, was constituted so as to have significant expertise to provide direct input to UTAM staff in the fulfillment of their duties.

Mr. Switzer, Chair of the UTAM Board, added that the newly created IC would have a close working connection with the UTAM Board. He noted that the UTAM Board would still need to approve the role of the IC to interact with the UTAM Board, and as required with the management staff of UTAM on behalf of the President of U of T, and that the Board would consider this matter at its meeting on June 14, 2016.

Mr. Matus, Co-Chair of the IC, commented that the creation of the IC had represented an important step in strengthening and clarifying the relationship between UTAM and those responsible for providing investment guidance to the University.

In reply to a question from a member, the Chair replied that reporting to the Pension Committee following the creation of the IC would remain virtually unchanged. The Pension Committee would continue to receive regular updates from UTAM senior management, and Mr. Matus or Mr. Denison (the other co-chair of the IC) would attend the Pension Committee on an as-needed basis to provide updates to members.

2. Pension Fund Master Trust Statement of Investment Policies and Procedures (SIP&P)

Ms Brown provided brief introductory remarks and proceeded to offer a presentation on the 2016 SIP&P, focussing on proposed changes. Her presentation addressed the following five topics: the merger of the OISE Pension Plan with the University Pension Plan (RPP); proposed changes to the Reference Portfolio; proposed changes to the Active Risk limit; proposed changes to the table in the Portfolio Diversification section; and the addition of a section on Environmental, Social and Governance (ESG) factors. Members were encouraged to ask questions during the presentation.

OISE Merger

Ms Brown reported that the application to effectuate the merger was made in March, 2015 and received approval from the Superintendent in March, 2016, with an effective date of July 1, 2014. It was expected that the transfer of the assets in the OISE Pension Plan would be transferred to the RPP by the end of June, 2016.

Proposed Changes to the Reference Portfolio

Ms Brown reminded the Committee that the existing reference portfolio had been established in 2011-2012 and was reviewed annually. Mr. Smith described the proposed changes to the reference portfolio, including;

- A reduction of Canadian equities from 16% to 10%;
- Introduction of a Global Equity segment with a weight of 5%;
- An increase of 2% to the weight of US equities taking it to 20%;
- A decrease of 1% to the weight of EAFE equities taking it to 15%;
- A reduction in the currency hedging ratio from 65% of US and EAFE equities to 50%. No currency hedging in the new Global Equity segment; and,
- Modest changes to the width of the allowable range of exposures around the Reference Portfolio target weights (i.e. the “bands”), including a new symmetrical band for credit, (allowing for a maximum underweight and overweight of 10%) and a plus or minus 5% band around the new Global Equity segment target weight of 5%.

Mr. Smith noted that the Canadian equity market was dominated by companies in the financials, energy, and materials sectors. By reducing Canadian equities and reallocating to other equity markets, the new Reference Portfolio would be more diversified than the existing Reference Portfolio. As a result of the changes to the equity weights in the Reference Portfolio and the reduced hedging ratio, the new Reference Portfolio was expected to be marginally more efficient than the existing Reference Portfolio (i.e. higher expected return for a given amount of risk).

In reply to a member’s question regarding whether anyone had considered adding an allowable duration band in the Government segment, Mr. Smith replied that since UTAM had a mandate to achieve a real investment return of 4%, and the University had not asked UTAM to pursue a liability-driven strategy – duration bands were not considered to be needed.

In reply to a member’s question regarding hedging the US dollar exposure in the portfolio, Mr. Smith and Mr. Matus replied that a decrease in hedging historically had the effect of reducing volatility in the portfolio. This approach of not fully hedging US dollar exposure had been pursued by UTAM for some time and the current proposal was to further reduce US dollar hedging.

Proposed Changes to the Active Risk Limit

Mr. Smith noted that the current Active Risk framework had consisted of only one number, the maximum allowed Active Risk of 75 bps. The proposed framework involved moving to a “traffic light” system with various zones and a modest increase of 25 bps to the upper end of the “normal” operating zone (i.e. from 75 bps to 100 bps). This system would include the following: a “normal” range of Active Risk from -50 bps to 100 bps, which was considered the normal operating zone; a “watch” zone between 100-125 bps, which would trigger reporting obligations to the IC and possible steps to mitigate the risk; an “alert” zone where risk was above 125bps, which would trigger immediate reporting obligations to the IC and immediate actions to de-risk.

In reply to questions from members, the Chair along with Ms Brown informed the Committee that while the IC would receive an immediate update if the risk limit was exceeded (as stipulated in the traffic light system), the Pension Committee would not receive an immediate update but instead would continue to receive regular reports from UTAM, which would include a section that addressed risk and volatility in the portfolio.

Proposed Portfolio Diversification

Mr. Smith noted that modest changes had been made to the table that described asset and investments strategies, and that further work was currently being undertaken in this regard. He noted that further refinements to enhance to clarity of this section would be brought forward at a future meeting. Changes had also been made to the wording to provide greater clarity regarding the use of derivatives.

Environmental, Social and Governance Factors (ESG)

Ms Brown informed the Committee that the addition of the section on ESG factors had been driven by two main factors. The first driver was a regulatory requirement that, effective January 1, 2016, under the Pension Benefits Act, a plan's SIP&P was required to include information as to whether ESG factors were incorporated into the plan and, if so, how those factors were incorporated. The second was the report by the President, which represented the administrative response to the *Report of the President's Advisory Committee on Divestment from Fossil Fuels*, which provided the rationale, including a discussion of fiduciary duty, and recommended that ESG factors be integrated in investment decision making for pension funds.

The wording in the section was sufficiently broad to allow the University to focus in the short term on examining direct investments and, over the longer term, to focus on indirect (pooled) investments as well.

Members asked several questions and raised concerns that the language contained in the ESG section was vague, cautious and could be construed as misleading.

The following are more granular concerns that were raised:

- The distinction between direct and indirect investing was not made clear. Since the initial approach of the University would be to focus on an examination of ESG factors concerning direct investments, and since direct equity investments make up less than 10% of the investment portfolio, it could be interpreted that the University's current plan was to examine both direct and indirect investments at this time.
- The *Administrative Response to the Report of the President's Advisory Committee on Divestment from Fossil-Fuels* was not fully captured in the ESG language. Specifically, the ESG language did not include details of the ways in which the directives in the Response would be operationalized.
- Concern over potential public perception that the ESG language did not reflect a strong commitment by the University to meaningfully consider ESG factors when investing.

The following responses were provided:

- Ms Brown responded that the language in the section was carefully drafted so as to provide necessary flexibility to implement a phased approach whereby the initial focus would be on direct investments, with the goal to address indirect investments as soon as practicable. Due to the fiduciary duty obligation to pension plan members, it would be inadvisable to include language in the SIP&P which would force the sale of assets at inopportune times. Mr. Moate concurred, noting that the language was intended to provide a principled approach to be followed by those making decisions regarding investment.
- Ms Brown responded that the recommendations contained in the *Administrative Response* were captured in the ESG section, and that the President had expressed unequivocal support for the proposed ESG language in the SIP&P. She also reported that the function of the SIP&P, as a policy document, was designed to outline whether the University would consider ESG factors, and was not intended as a prescription for how to achieve these goals.
- The Chair along with Ms Brown reminded the Committee that the fiduciary obligation of the Pension Committee was to pension plan members and not to the University community as a whole. As such, and following both the *Administrative Response* and the Provincial directive, the Committee had a fiduciary obligation not only to indicate whether ESG factors were considered in investment decision-making in the SIP&P but also to ensure that the language contained in the ESG section did not force imprudent investment practices that would negatively impact investment returns.
- Ms Brown responded that the University's strong commitment to consider ESG factors in its investments was reflected in the language contained in the ESG section. Ms Elizabeth Brown informed the Committee that, when drafting the ESG wording in the SIP&P, the ESG wording in comparator SIP&Ps (CPPIB and other Universities) was reviewed, and the language contained in the University's SIP&P was, in many cases, more detailed.

The following motion was duly moved and seconded:

THAT the Pension Committee approve the Pension Fund Master Trust Statement of Investment Policies and Procedures, attached as Appendix A, replacing the Statement of Investment Policies and Procedures, attached as Appendix C, which had been approved by the Pension Committee on June 1, 2015.

THE MOTION FAILED.

Ms Brown informed the Committee that, in light of this result, the 2015 SIP&P would remain in effect.

CONSENT AGENDA

On motion duly moved, seconded, and carried

YOUR COMMITTEE APPROVED

THAT the consent agenda be adopted and the items approved.

3. Report of the Previous Meeting: Report Number 23, March 16, 2016

The report of the previous meeting was approved.

4. Business Arising from the Report of the Previous Meeting

There was no business arising from the report of the previous meeting.

5. Date of Next Meeting: Friday, September 16, 2016 at 12:00 p.m.

6. Reports of the Assessors

There were no reports.

7. Other Business

There were no items of other Business.

*Pursuant to section 33 of By-Law Number 2,
consideration of item 8 took place in camera*

The Committee Moved *In Camera*

8. Update: Government Pension Initiatives and Jointly Sponsored Pension Plan Initiatives

Professor Hildyard provided an update to the Committee on recent Provincial statements regarding jointly sponsored pension plans.

The Committee returned to closed session

The Chair thanked the Committee members and the assessors for their commitment and contributions during the year and especially noted Professor Angela Hildyard who would be retiring and was making her last regularly scheduled appearance before the committee.

The meeting adjourned at 6:27 p.m.

Committee Secretary

Chair

June 14, 2016