Appendix "C"
Business Board, Report #197
May 3, 2012

UNIVERSITY OF
TORONTO

Pension Contribution Strategy

Recommended

to the

Business Board

May 3, 2012

Table of Contents

Introduction……………………………………………………………………………………………………..3

Background……………………………………………………………………………………………………..3

The Problem…………………………………………………………………………………………………….7

Projections for Dealing with the Deficit………………………………………………………..…….….….9

Addressing Ongoing Sustainability and the Importance of Increasing Member Contributions………..….15

Revised Pension Contribution Strategy……………………………………………………………………17

Summary of Proposed Pension Contribution Strategy…………………………………….……………..21

Appendix 1 - Pension Contribution Strategy approved January 19, 2004

Appendix 2 – Comparison of Special Payments Budget and Projected Costs

May 1, 2011 to June 30, 2016.

Introduction

The University of Toronto registered pension plans have a large going concern deficit of $997.3 million and a solvency deficiency of $1.058 billion as of July 1, 2011. The Province of Ontario has established a regulation providing temporary solvency funding relief if certain conditions are met and, in its budget of March 27, 2012, has signalled other measures that may potentially enhance that relief, again provided that certain conditions are met. This paper outlines the magnitude of the deficit problem, reflects the University's acceptance to Stage 1 of the solvency funding relief regime and assumes that the University will be accepted to Stage 2 of the regime. It considers the January 2004 pension contribution strategy that is still in force and updates the January 2011 paper[1] on this subject that considered a range of approaches for dealing with the deficit. It does not reflect any possible further changes the government might make, but does discuss their implications in appropriate places in the document. It proposes a revised pension contribution strategy going forward to ensure that the plans can continue to meet their obligations to provide pensions to current and future pensioners and can meet the government's regulatory requirements.[2]

Background

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

- Two registered pension plans:
  - The University of Toronto Pension Plan ("RPP");
  - The University of Toronto (OISE) Pension Plan ("RPP(OISE)")
- One unregistered pension plan:

---

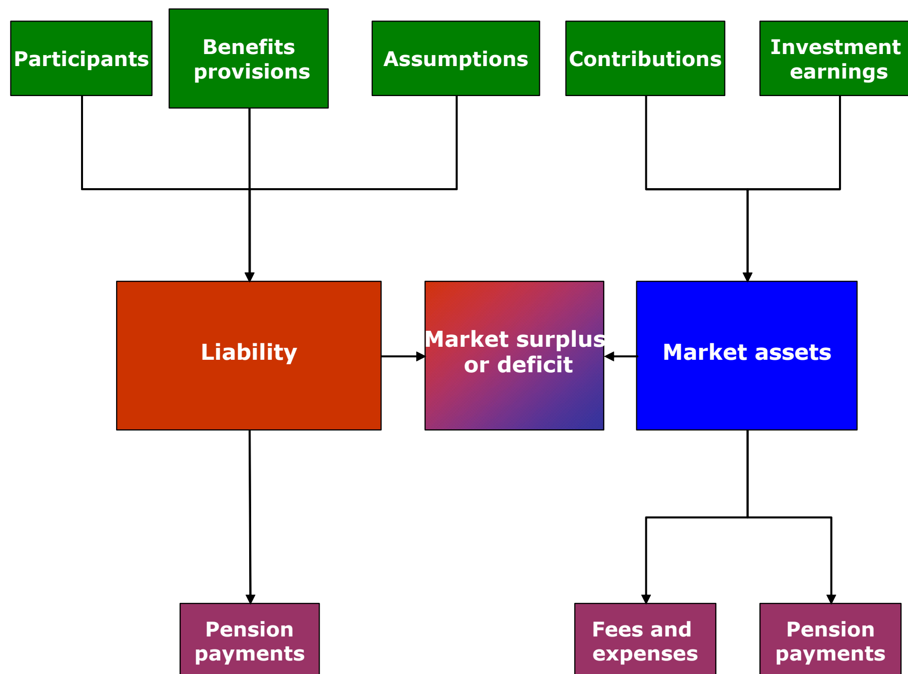
[1] Ensuring a Sustainable Pension Plan for the University of Toronto, Business Board, January 31, 2011. See http://www.governingcouncil.utoronto.ca/AssetFactory.aspx?did=7486

[2] It is important to note that this analysis assumes the continuation of the current legislative and regulatory environment. Future changes to that environment, at either the federal or provincial levels, could require future changes to the contribution strategy that is proposed here for approval. It is also important to note that this analysis includes future projections that are based on numerous assumptions, including assumptions about future investment returns and interest rates. Any material deviation in actual future results from those assumptions would also likely require future changes to this proposed strategy.

- The Supplemental Retirement Arrangement ("SRA"), which provides pensions above the maximum pension benefit allowed under the Income Tax Act, up to a University specified maximum pensionable salary of $150,000 per annum.

A defined benefit pension plan provides pension benefits to each retiring member on the basis of defined percentages applied to salary and years of pensionable service. The main objective of managing a defined benefit pension plan is to ensure that there are sufficient resources to pay for the current pensions of retired members and to ensure that there will be sufficient funds to pay for the pensions of members who will retire in the future.

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), as illustrated by the following diagram.



There are only two sources of funding to set aside the money needed to support these pension payments: contributions (from members and from the University) and investment earnings. 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.

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 at the valuation date. A going concern deficit must be amortized and eliminated over a period no longer than fifteen-years.

Solvency Deficit – the solvency valuation assumes that the plan will be wound up as at the valuation date. It assumes that benefits will be settled through purchase of annuities or payment of lump sum values. However, indexation (inflation) after termination or retirement is excluded from the liability calculation. 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 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 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 this is not likely to happen in the University sector and do not apply the Solvency test to university pension plans. The Ontario Government has not taken this position but has agreed to provide temporary solvency funding relief by extending the amortization and payment period over a longer period than five years, provided certain conditions are met.

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

Special Payments – are contributions in respect of pension deficits attributed to benefits earned in prior years. (They are sometimes referred to as past service payments).

The Ontario Government has indicated that a key condition for agreeing to provide temporary solvency funding relief would be either a reduction to future benefits or an increase in member current service contributions to make them more commensurate with the benefit being provided to plan members.

The University has negotiated increases to member contributions with most employee groups and is continuing to work towards this objective with other employee groups. **If the University is not accepted to Stage 2 of the temporary solvency funding relief programme and is therefore not permitted to extend the amortization period for financing the Solvency Deficit to a period longer than five years, the required special payments beginning July 1, 2015 will likely approach $200 million per annum – an amount that will severely impact our academic programs.**

The Problem

The plans are currently in a significant deficit position as at July 1, 2011, with respect to both going concern and solvency valuation methodologies. At July 1, 2011, the accrued liabilities and market value of assets for the University's pension plans were as follows (please see previous pages for definitions of going concern deficit, solvency deficit and hypothetical wind-up deficit):

At July 1, 2011 (millions of dollars)			
	Accrued Liabilities [1]	**Market Value of Assets**	**Market surplus (deficit)**
University of Toronto Pension Plan (RPP)			
Going concern actuarial valuation, current assumptions	3,274.1	2,486.3	(787.8)
Going concern actuarial valuation, new assumptions	3,443.5	2,486.3	(957.2)
Solvency actuarial valuation [2]	3,496.8	2,485.3	(1,011.5)
Hypothetical wind-up actuarial valuation [2]	4,754.6	2,485.3	(2,269.3)
University of Toronto (OISE) Pension Plan - RPP(OISE)			
Going concern actuarial valuation, current assumptions	111.6	76.1	(35.5)
Going concern actuarial valuation, new assumptions	116.1	76.1	(40.0)
Solvency actuarial valuation [2]	121.8	75.7	(46.1)
Hypothetical wind-up actuarial valuation [2]	161.7	75.7	(86.0)
Supplemental Retirement Arrangement (SRA)			
Going concern actuarial valuation, current assumptions	135.5	120.8	(14.7)
Going concern actuarial valuation, new assumptions	140.4	120.8	(19.6)

[1] *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.*

[2] *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 past-service benefits for active and retired members. 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. At the same time, interest rates have declined, a major factor contributing to the large solvency deficits that pension plans generally are now experiencing. To elaborate: a 1% increase in interest rates would reduce the solvency liabilities by about $500 million,

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 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. 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. The Government also requires that, during the funding relief period, and for a significant period of time following the relief period, contribution holidays would be restricted and any benefit improvements would require accelerated funding.

The University is implementing member current service contribution increases with most employee groups and is continuing to work towards this objective with other employee groups. The University fully endorses the requirements for restrictions on contribution holidays and accepts the rationale for accelerated funding of benefit improvements, both of which are required for plans falling under temporary solvency relief.

In December 2011, the University filed a plan with the Ministry of Finance that identified how we intend to address the sustainability issue, and shared that plan with members and collective bargaining agents. The Ministry of Finance responded on February 16, 2012 and confirmed that the U of T pension plans have been approved to enter Stage 1 of the temporary solvency funding relief programme. With that approval, the special payments for the period July 1, 2011 through June 30, 2015 are now known, absent any plan changes that would require that actuarial valuations be filed with the Financial Services Commission of Ontario during the intervening period.

Projections for Dealing with the Deficit

It is important to note that this analysis assumes the continuation of the current legislative and regulatory environment. Future changes to that environment, at either the federal or provincial levels, could require future changes to the contribution strategy that is proposed here for approval. It is also important to note that this analysis includes future projections that are based on numerous assumptions, including assumptions about future investment returns and interest rates. Any material deviation in actual future results from those assumptions would also likely require future changes to this proposed strategy.

Aon Hewitt has projected the going concern and solvency deficits using the following key assumptions:

- The real investment return target of 4.0% per annum.
- After filing the July 1, 2011 actuarial valuation with FSCO, we will not be required to file another actuarial valuation until July 1, 2014 (due March 31, 2015).
- There will be an annual recalculation of the deficit over the payment period taking actual payments into account.
- No change in market interest rates is assumed.
- Actuarial assumptions at July 1, 2011 are assumed to be unchanged over the projection period. Actuarial assumptions are reviewed annually and must be approved by the Pension Committee.
- 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.
- We will qualify for Stage 2 of temporary solvency funding 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 higher. This projection assumes a 10 year net solvency payment period. In its budget announcement of March 27, 2012, the Government signalled possible adjustments to the solvency relief regime, provided certain conditions were met. It is assumed that such adjustments could extend the net solvency payment period to a period longer than 10 years, but in the absence of any firm information, such an extension is not shown here.

It is important to note the interdependency between the amounts required to be paid and the timing of contributions. 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. The short-term and long-term funding and financing sources that have been identified are as follows:

Utilize Pension Reserve – the pension reserve was $37.4 million for 2010-11, reserved for the purpose of funding the registered pension plans should the need arise. (This reserve balance was transferred to the RPP in February 2011).

Borrow – and put the borrowed funds into the pension master trust. (On January 31, 2011, the Business Board approved internal borrowing of up to $150 million for pensions.)

Increase Operating Fund Special Payments Budget – at April 30, 2011, the annual special payments budget was $27.2 million per annum. It is projected that the University will need to allocate an additional $70 million per annum to this budget line by 2015-16, to pay required special payments and other related costs.

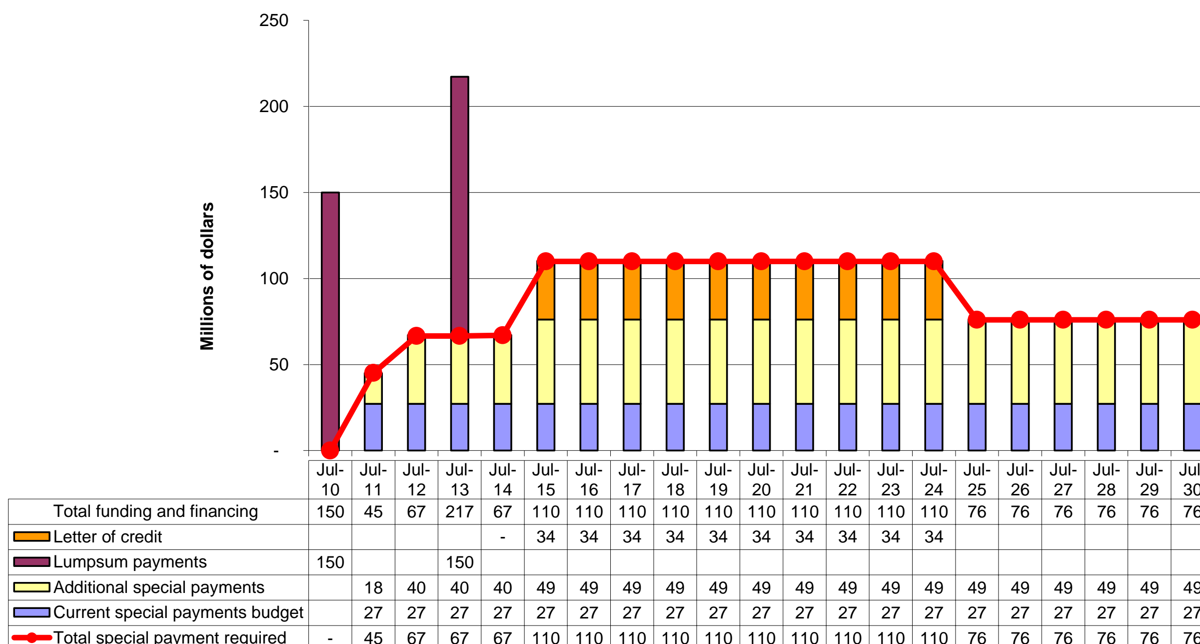
Utilize Supplemental Retirement Arrangement (SRA) Assets – the SRA is an unregistered pension plan. When it was created in the late 1990's, a funding strategy was put in place to set aside assets, which, in accordance with an Advance Tax Ruling, do not constitute trust property, are available to satisfy 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. Due to legislated increases in the Income Tax Act maximum pension, 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 have already retired. Annual SRA pensioner payments are currently slightly less than $10 million per annum, decreasing slowly to zero in the future. At June 30, 2011, SRA assets totalled $120.8 million. We are planning to contribute those assets to the registered 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.

Issue Letters of Credit –use irrevocable letters of credit to meet the solvency special payment requirements to the extent permitted by regulation, assumed to be 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 element of this strategy is to put as much money into the plans as soon as possible to immediately enhance the financial health of the pension plans and reduce the interest charges on the deficit. A $150 million lump sum payment was made into the plan prior to the July 1, 2011 actuarial valuation and a second $150 million lump sum payment is planned before June 30, 2014. The special

payments budget is increasing from $27.2 million per annum in 2010-11 to a planned $97.2 million per annum by 2015-16. We plan to utilize non-cash letters of credit where permitted for any net solvency special payments.

The first lump sum payment was composed of $37.4 million from the Pension Reserve and $112.6 million of internal borrowing. The second lump sum payment is planned to be sourced from the SRA assets ($120.8 million at June 30, 2011) and up to $37.4 million of internal borrowing. The following chart summarizes the contribution strategy for the required special payments.



	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	Jul-30
Total funding and financing	150	45	67	217	67	110	110	110	110	110	110	110	110	110	110	76	76	76	76	76	76
Letter of credit					-	34	34	34	34	34	34	34	34	34	34						
Lumpsum payments	150			150																	
Additional special payments		18	40	40	40	49	49	49	49	49	49	49	49	49	49	49	49	49	49	49	49
Current special payments budget		27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27	27
Total special payment required	-	45	67	67	67	110	110	110	110	110	110	110	110	110	110	76	76	76	76	76	76

Data table amounts may not add precisely due to rounding.

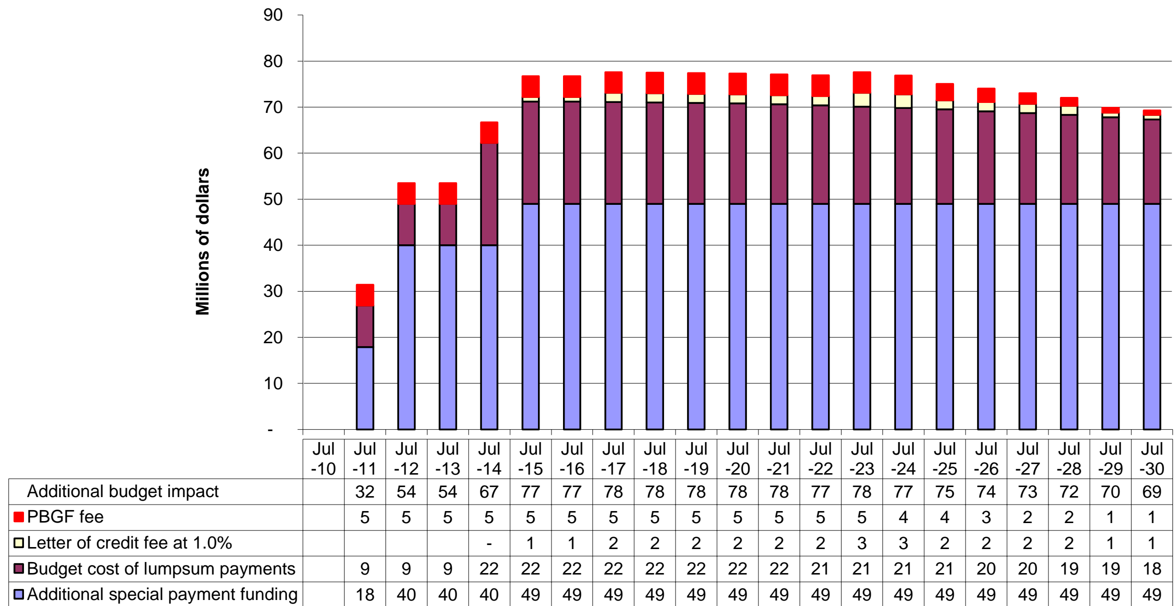
As you can see from the chart, in addition to $300 million in lump sum payments, the annual total special payments required are $45 million for 2011-12 and $67 million per annum for 2012-13, 2013-14 and 2014-15, rising to $110 million per annum for the next ten years, and then declining to $76 million per annum in subsequent years. This stream of payments is dependent on the two early large lump sum payments, which mitigate the subsequent required payments to the levels shown. This stream of payments also reflects a one-year deferral of special payments as permitted under regulation. Additionally, beginning in 2015-16, non-cash letters of credit are utilized to the level of $34 million per annum for net solvency payments, which sum is not being deposited into the plans. Therefore, actual payments into the plan during the ten year period from 2015 to 2024 are $110 million minus $34 million, equalling $76 million per annum.

Therefore, in summary, the actual cash payments into the plans in respect of special payments, in addition to the $300 million in lump sum payments and taking account of the letters of credit, will be $45.1 million per annum for 2011-12, $66.6 million per annum for each of 2012-13, 2013-14 and 2014-15, and are projected to rise to approximately $76 million per annum in subsequent years.

In addition to the required special payments into the registered pension plans, there are some other related costs that must be funded as part of this strategy. They are as follows:

- The Ontario Government requires that pension plans with deficits make contributions to the Pension Benefits Guarantee Fund (PBGF) and the size or our deficit dictates a payment of about $5 million per annum.
- To the extent we borrow funds, we incur repayment costs, and to the extent we charge the pension benefits payable under the SRA to the operating fund we will incur additional operating costs. These amounts are expected to be $8.9 million per annum beginning in 2011 and rising to $22 million per annum in 2014. Borrowing repayment is over a term of 20 years, with interest. SRA payments to pensioners are expected to continue for many years, eventually declining to zero.
- 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 to $2 million per annum.

These related costs amount to $14 million per annum beginning in 2011 and are projected to rise to $28 million per annum in 2015. The following chart shows the additional budget impact for both the required annual special payments into the pension plans and the additional related costs described above.



	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	Jul -30
Additional budget impact		32	54	54	67	77	77	78	78	78	78	78	77	78	77	75	74	73	72	70	69
PBGF fee		5	5	5	5	5	5	5	5	5	5	5	5	5	4	4	3	2	2	1	1
Letter of credit fee at 1.0%					-	1	1	2	2	2	2	2	2	3	3	2	2	2	2	1	1
Budget cost of lumpsum payments		9	9	9	22	22	22	22	22	22	22	22	21	21	21	21	20	20	19	19	18
Additional special payment funding		18	40	40	40	49	49	49	49	49	49	49	49	49	49	49	49	49	49	49	49

Data table amounts may not add precisely due to rounding.

. As you can see from the above chart, total costs for which additional budget must be allocated in the operating fund are as follows:

- $32 million for 2011-12, made up of $18 million for special payments plus $14 million for other related costs.
- Beginning July 1, 2012: the $32 million rises to $54 million per annum, made up of $40 million for special payments plus $14 million for other related costs.
- Beginning July 1, 2014, the $54 million rises to $67 million, made up of $40 million for special payments plus $27 million for other related costs.
- Beginning July 1, 2015: the $67 million is projected to rise to $77 million per annum, made up of $49 million for special payments plus $28 million for other related costs

As noted earlier, the annual special payments budget was increased from $27.2 million in 2010-11 to $77.2 million by 2012-13. Further annual increases of $10 million in 2013-14, $5 million in 2014-15 and $5 million in 2015-16 are planned to bring it to $97.2 million per annum by 2015-16.

Please see Appendix 2 for a comparison between the planned annual special payments budget and the required pension and other related costs over the next several years. While this planned budget

increase does not exactly match the currently projected requirement, 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 4.0% real return target rate (approved by the Pension Committee on October 18, 2011) plus 2.5% CPI, for a nominal return target rate of 6.5% over the period. Better investment returns could improve this picture while, conversely, poorer investment returns would make it worse. As a second example, this analysis assumes that interest rates will be unchanged over the period.

These projections will be reviewed regularly and the planned contribution strategy will be adjusted as appropriate in the future.

Addressing Ongoing Sustainability and the Importance of Increasing Member Contributions

The Ontario Government has analyzed defined benefit plans within the Broader Public Sector, 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. In its March 27, 2012 budget, the Government signalled that it expected single-employer public-sector pension plans to move to a 1:1 cost sharing ratio within five years. Over the last number of years, the ratio of the University current service costs to the member contributions has been approximately 2 to 1, with member contributions at approximately 5.2% of capped salary. We agree that the contributions made by members are too low for the long-term sustainability of our plans and if the recent changes that have been negotiated/implemented for a number of employee groups are extended to all members of our plans, the member contributions would increase to approximately 7.2% of capped salary. With no decrease being made in University current service costs, the ratio to member contributions would be approximately 1.5:1. 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[3] 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, even before the fiscal crisis and associated solvency problems.

The Ontario 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. This view has been reiterated and emphasized in the March 27, 2012 Provincial budget and additional incentives to achieve this are signalled for the temporary solvency relief programme. In the Government's 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.

[3] [3] 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. The University is committed to dealing with the going concern market deficit existing at July 1, 2011 through this contribution strategy. 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 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 contributions and/or contemplating reductions in future benefits, or has already done so. This includes the University of Waterloo, Carleton University, McMaster University, the Trent University Faculty Plan, Queen's University, Wilfrid Laurier University, Ryerson University, the University of Manitoba, the UBC Staff plan and the Alberta Universities Academic Pension Plan.

As of the writing of this report, we have reached agreement with most employee groups to increase member contributions over the next 2-3 years to a level that meets a 1.5:1 ratio. and are continuing to work towards this objective with other employee groups. Over future negotiations we will seek to move the ratio closer to 1:1. In return, the University has made a commitment that the University's RPP current service contribution would not fall below the level of the July 1, 2008 valuation, in percentage terms that is, 10.77% of the capped participant salary base. If the anticipated increase to 1.5:1 were fully implemented for all employee groups participating in the pension plans, this would represent increased member current service contributions of about $15 million per annum and would represent a net increase of $13.5 million per annum to the pension plans after the termination provision and cost sharing rule are taken into account.

Finally, it cannot be emphasized enough that success in increasing member contributions will be a key criterion for obtaining Government permission to enter Stage 2 and thus extend the net solvency payments over a longer period than five years. As noted, this is also an issue of fairness because those who will receive the benefit 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.

Revised Pension Contribution Strategy

The pension contribution strategy (see Appendix 1) approved by the Business Board in January 2004 was established to ensure that full current service contributions were paid for pensions by both employees and the University, to put the SRA on the same basis as the registered pension plans with respect to funding, to establish a special payments budget to address a going concern deficit that existed at that time, and to provide a reserving mechanism to help with possible future deficits.

The reserving mechanism was in the form of an annual operating fund special payments budget of no less than $26.4 million (now $27.2 million) in respect of the RPP and the SRA to deal with the then-deficit. There was a provision that these funds would continue to be set aside, outside the registered pension plans on an ongoing basis for about 15 years.

While some elements of the 2004 strategy should be maintained, others need to be updated to reflect changes over the intervening 8 years as well as the current pension deficit.

Current Service Contributions:

The 2004 strategy established what was essentially a "no pension current service contribution holiday' rule for both employee and employer contributions for the RPP and the SRA. It required that plan members make employee contributions in accordance with the contribution formula and that the University make the full employer current service contribution required. It required that if University current service contributions could not be made into the registered pension plans that they be reserved for pensions outside the registered pension plans. It did not make provision for any university current service contributions to the RPP (OISE) since the plan had a large surplus at the time; however, by 2011-12, current service contributions to OISE were required, and budgeted in the University's operating budget. Also by 2011-12, the anticipated transition of the SRA to a closed plan status and the proposed transfer of SRA assets into the registered pension plans suggest that the currently budgeted current service contributions of $0.1 million per annum should be discontinued. In 2011-2012, the University also made a commitment that the University's RPP current service contribution would not fall below the level of the July 1, 2008 valuation, in percentage terms, that is, 10.77% of the capped participant salary base.

On a go forward basis, it is proposed that full employee and employer current service contributions be required for the RPP and for RPP (OISE) but not for the SRA; that the RPP minimum university current service contribution of 10.77% of the capped participant salary base be maintained; and that University current service contributions not permitted to be deposited to the registered pension plans should continue to be reserved for pensions outside the registered pension plans.

Deficit Funding:

The 2004 strategy devised a mechanism for funding required special payments by designating an annual budget allocation (which amounted to $27.2 million per annum by April 30, 2011), along with a requirement that these funds would continue to be set aside for pensions, regardless of Income Tax restrictions. If not permitted to be used to make contributions to the RPP, the strategy indicated that funds should be reserved outside the plan.

In 2009 a Pension Reserve was established to hold budgeted special payments that were not deposited into the registered pension plans. This reserve was fully transferred to the registered pension plans in February 2011. Going forward, the proposed strategy maintains the annual special payments budget of $27.2 million per annum and the requirement for reserving outside the registered pension plans if funding cannot be made into the plans remain a valid requirement. The Pension Reserve structure that was established continues to be useful and should be continued.

However, as the previous sections of this paper show, much more is needed to address the current pension deficit and the proposed strategy adds to the 2004 provisions as described below.

Lump sum payments:

As noted earlier, going forward, a key element of the strategy is to put as much money into the plans as soon as possible to immediately enhance the financial health of the pension plans and reduce the interest charges on the deficit. The 2004 pension contribution strategy did not make any provision for lump sum payments.

On a go forward basis, this proposed strategy proposes a second large lump sum payment of $150 million prior to June 30, 2014.

The source of funding for this second $150 million payment is planned to be a combination of SRA assets and internal borrowing, both of which are discussed further under the relevant headings below.

Borrowing:

The 2004 strategy did not provide for any borrowing in respect of pension plans since the current service and special payments requirements identified at that time were addressed through the other elements contained in that strategy.

At its meeting of January 31, 2011, the Business Board approved internal borrowing of up to $150 million, to be added to the registered pension plans. The repayment costs associated with this borrowing are addressed as part of this proposed strategy.

Supplemental Retirement Arrangement:

The 2004 strategy amended an earlier funding strategy for the SRA that had been put in place in 1997 that had required that the SRA liabilities be funded over 5 years. The 2004 strategy put the SRA funding strategy on the same basis as the normal going concern funding strategy for the registered pension plans, that is, over 15 years. At June 30, 2011, SRA assets totalled $120.8 million. On a go forward basis, it is proposed that the revised strategy:

- Makes no further current service contributions to the SRA.
- Ends the requirement for 15 year funding of any SRA plan deficits and requires no further special payment contributions to the SRA.
- Transfers all SRA assets on hand to the registered pension plans on or before June 30, 2014.
- Provides for pension payments to current and future SRA pensioners to be made by the University beginning when the transfer of SRA assets into the registered pension plans has been completed. The pensioner payments represent a cost that is addressed as part of this 2012 strategy.

Letters of Credit:

The 2004 strategy did not provide for use of letters of credit. On a go forward basis, it is proposed that letters of credit be used to the extent permitted by legislation and regulation for the purpose of funding the net solvency payments (the amount by which required solvency special payments exceed required going concern special payments). The cost associated with maintaining the letters of credit is a pension-related cost that is addressed as part of this proposed strategy.

Operating Fund Special Payments Budget:

The 2004 pension contribution strategy established an annual operating fund special payments budget. The purpose of this budget was to extinguish a then-existing deficit and to provide reserving against future deficits. When it was established, the intent was that it would remain in place for about 15 years, that is, for the entire period over which going concern deficits are addressed, even if the deficit that existed in 2003 was extinguished earlier. The 2003 deficit was extinguished by 2007; however, the special payments budget of $27.2 million per annum remained in place and forms the basis for the ongoing operating budget funding that is now proposed.

In the 2011-12 and 2012-13 budgets, this special payments budget was increased by $50.0 million per annum to $77.2 million per annum, in anticipation of the requirement to fund the pension deficit. Additional budget increases were signalled. On a go forward basis, this proposed strategy provides for additional budget increases of $20 million to be added to the $77.2 million over the three year period from

2013-14 to 2015-16 to bring this budget to $97.2 million per annum[4]. This special payments budget is to be used to pay for the following components of the strategy:

- Special payments into the registered pension plans.
- Principal and interest payments on internal borrowing of up to $150 million.
- Pensioner payments to current and future SRA pensioners.
- Costs associated with the letters of credit that are planned to address the net solvency payments.
- Pension Benefits Guarantee Fund required payments.
- Other pension or pension related costs that may arise that support the strategy to fund the pension deficit over time.

If any portion of the annual special payments budget is not required for the purposes listed above in a particular year it is to be reserved in the Pension Reserve to be used for these purposes in a future year. This budget is to be maintained until the pension deficit has been extinguished. Once that has happened, the annual budget can be lowered to the $27.2 million per annum that was previously in place and used to fund the remaining costs related to this strategy. Once the deficit has been dealt with, those remaining costs are expected to comprise the SRA payments to pensioners and the borrowing repayment costs. Once those obligations have been extinguished, the $27.2 million per annum budget is to be maintained on an ongoing basis as a provision against future adverse markets.

[4] An additional $50 million was approved as part of the Operating Budget Reports for 2011-12 and 2012-13. A further $20 million is planned over the three year period from 2013-14 to 2015-16. See Appendix 2 for a comparison between the special payments budget and the projected costs, for the period from May 1, 2011 to June 30, 2016, by University fiscal year and pension year.

Summary of the Proposed Pension Contribution Strategy

The previous section provided a comparison between the 2004 pension contribution strategy and the proposed strategy going forward. The key elements of the proposed pension contribution strategy are:

1. **Current Service Contributions:**

   a. Members and the University make 100% of required current service contributions into the RPP and RPP (OISE) each year, i.e. no current service contribution holidays.

   b. University RPP current service contributions are to be no less than 10.77% (i.e. the July 1, 2008 level) of the capped participant salary base.

   c. In the event that legislation or regulation prohibits the deposit of some or all of University current service contributions into the registered pension plans, those contributions will be reserved for pensions outside the registered pension plans.

2. **Deficit Funding:**

   a. Lump sum payments: that a second lump sum payment in the amount of $150 million be made into the registered pension plans before July 1, 2014, utilizing SRA assets and internal borrowing as required.

   b. Supplemental Retirement Arrangement (SRA):

      i. No further current service or special payment contributions will be made into the SRA.
      ii. Deposit the balance of the SRA assets into the registered pension plan(s) by June 30, 2014.
      iii. Payments to current and future pensioners will be made by the University beginning when the SRA assets are transferred into the registered pension plans.

   c. Borrowing: up to $150 million internal borrowing for pensions. (Note: Business Board approved internal borrowing for pensions of up to $150 million on January 31, 2011. Inclusion of this item again here is for completeness).

d. Letters of Credit will be utilized to address the net solvency special payments to the fullest extent permitted by legislation and regulation.

e. Operating Fund Special Payments Budget:

    i. Increase this budget line to an amount deemed sufficient to meet the plan's special payment funding requirements, currently estimated to be $97.2 million per annum. (Governing Council approved the first $50 million of this estimated increase as part of its approval of the Budget Reports for 2011-12 and 2012-13).
    ii. Utilize this budget to fund special payments into the registered pension plans and to fund other costs related to this pension contribution strategy such as borrowing repayment costs and SRA pension payments for pensioners.
    iii. Maintain that higher budget, currently estimated at $97.2 million, until the pension deficit is extinguished.
    iv. Do not decrease the annual special payments budget below $27.2 million per annum, even after the deficit and other costs related to this strategy have been extinguished. If funds designated to be paid into the registered pension plans are not required for, and/or permitted to be added to the registered pension plans, reserve outside the registered plans.
    v. Maintain the Pension Reserve structure for current service or special payments that in future would not be permitted to be made into the registered pension plans.