UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 6 OF

THE PENSION COMMITTEE

Wednesday, December 14, 2011

To the Governing Council,
University of Toronto.

Your Committee reports that it held a meeting on Wednesday, December 14, 2011 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Mr. W. John Switzer, In the Chair
Professor George Luste, Vice-Chair
Mr. Richard B. Nunn, Chair of the Governing Council
Mr. Donald Andrew
Professor Ettore Vincenzo Damiano
Ms Nancy Edwards
Ms Shirley Hoy
Mr. Alex McKinnon
Mr. Gary Mooney
Mr. Philip Murton
Ms Jane Pepino
Ms Helen Rosenthal
Mr. Howard Shearer
Mr. Andrew Ward
Mr. W. David Wilson

Non-Voting Assessors:

Ms Sheila Brown, Chief Financial Officer
Ms Catherine Riggall, Vice-President, Business Affairs

Mr. Louis R. Charpentier,
Secretary of the Governing Council

Secretariat:

Ms Cristina Oke, Acting Secretary

Regrets:
Professor Laurence Booth
Mr. Thomas Finlay
Mr. Steve (Suresh) K. Gupta
Ms Melinda Rogers
Mr. Keith Thomas
Ms Rita Tsang

In Attendance:
Mr. Francis Low, Plan Auditor, Ernst & Young
Mr. William W. Moriarty, President and Chief Executive Officer, UTAM
Mr. Pierre Piché, Controller and Director of Financial Services
Mr. Allan Shapira, Plan Actuary, AON Hewitt
Mr. Weeman Wong, Ernst & Young

1. Reports of the Previous Meetings

Report Numbers 4 (September 28, 2011) and 5 (October 18, 2011) of the Pension Committee were approved.

2. Business Arising from the Reports of the Previous Meetings

There was no business arising from the Reports of the previous meetings..

3. University of Toronto Registered Pension Plans: Audited Annual Statements for the Year ended June 30, 2011

a) Background

Ms Brown explained the relationship among the various items affecting the Pension Plans.

Pension Committee Responsibilities

Audited Financial Statements

- The Pension Committee was responsible for approving the audited financial statements of the Pension Plans prior to the submission of the statements to the Financial Services Commission of Ontario (FSCO) by December 31, 2011.

Actuarial Assumptions and Results

- The Pension Committee approved the Actuarial Assumptions of the Pension Plans on October 18, 2011.
- The Pension Committee was responsible for approving the Actuarial Results of the Pension Plans.

Application for Solvency Relief

- The application for solvency relief, including the approved actuarial results, had to be filed with the Ministry of Finance by December 30, 2011.
- The response from the Ministry of Finance was expected by mid-February 2012.

Actuarial Report

- The Pension Committee was responsible for approving the Actuarial Report that had to be submitted to FSCO by March 31, 2012
  - The Report would reflect the decision made by the Ministry of Finance on the University's application for solvency relief.

Investment Target Return and Statement of Investment Policies and Procedures (SIP&P)

- The Pension Committee approved the target return for investments at its meeting of October 18, 2011.
- The Committee was responsible for approving the Statement of Investment Policies and Procedures, including the asset mix.

Business Board Responsibilities

- The Business Board approved the pension contribution strategy in January 2004.
- The Business Board reviewed a preliminary funding and financing strategy to address the pension deficit in January 2011.
- The Business Board would consider a revised funding strategy for the pension plans once the actuarial report had been finalized and approved by the Pension Committee.

b) Introduction

The Chair welcomed Mr. Low, Mr. Wong and Mr. Piché to the meeting.

On behalf of the Chair of the Audit Committee, Ms Brown reported that the Audit Committee had reviewed the audited financial statements for the University of Toronto Pension Plan as at June 30, 2011. After a thorough discussion, the Audit Committee recommended that the audited financial statements be approved by the Pension Committee.

3. University of Toronto Registered Pension Plans: Audited Annual Statements for the Year ended June 30, 2011 (cont'd)

b) Introduction (cont'd)

The Chair noted that it was unusual for a recommendation from a Committee to be presented by a member of the administration, but neither the Chair nor the Vice-Chair of the Audit Committee had been able to attend the meeting of the Pension Committee.

c) Discussion

The Chair drew the attention of members to the document placed on the table that contained answers to questions that had been raised by Professor Luste. Professor Luste commented that he had not had time to review the answers, and would raise any additional questions that he had under Business Arising at the March meeting of the Committee. The Chair encouraged Professor Luste to direct any follow-on or additional questions to Mr. Piché as soon as he had read the responses that had been tabled.

A member asked how long Ernst and Young had been the auditors of the University. Ms Brown replied that the firm had served as the University's auditors for many years. The audit partner who dealt with the University was rotated regularly, and had changed two years ago.

The member commented that it might be possible for the relationship between an audit firm and the University to become too close if the firm was not changed. Ms Brown replied that the University followed the guidance of the U.S. National Association of College and University Business Officers (NACUBO) that had conducted a thorough review of the matter at the time of implementation of the Sarbanes/Oxley Act in the United States. NACUBO had examined its advice again a few years after Sarbanes/Oxley and concluded that the university sector was a unique one for which only a few accounting firms could provide the specialized audit services required. Given that fact, universities should consider, at appropriate intervals of perhaps seven years, rotation in the partner responsible for the audit in order to ensure independence.

A member commented that he had raised the issue of changing auditors at the meeting of the Business Board held on June 16, 2011. The Chair indicated that the Audit Committee would be considering the issue as part of the process of recommending the appointment of external auditors for 2012-13. The member suggested that the Audit Committee conduct a formal review of the costs and benefits of changing auditing firms versus retaining the same firm.

On motion duly made, seconded and carried

It was Resolved

a) THAT the audited financial statements for the University of Toronto Pension Plan June 30, 2011, a copy of which is included as Appendix "A" to the memorandum from the Vice-President, Business Affairs dated November 10, 2011, be approved; and

b) THAT the audited financial statements for the University of Toronto (OISE) Pension Plan June 30, 2011, a copy of which is included as Appendix "B" to the memorandum from the Vice-President, Business Affairs dated November 10, 2011, be approved.

4. University of Toronto Pension Plans: Summary of Actuarial Valuation Results as of July 1, 2011

a) Introduction

Mr. Shapira presented the highlights of the summary of the actuarial valuation results of the Pension Plans.

- Based on the New Asset Valuation Method and the New Actuarial Assumptions, the going concern market deficit as of July 1, 2011 was $997 million for the two registered pension plans, which was close to the amount that had been projected.
- The current service costs did not include the changes in contribution rates that had been agreed upon to date.
- The solvency deficiency of $1.1 billion was similar to the amount recorded last year.
- The number of members in the University of Toronto Pension Plan had increased by almost 400 since July 1, 2010, reflecting, in part, the fact that new hires were now more likely to join the plan immediately upon being hired.

Mr. Shapira indicated that the summary of the actuarial valuation results would accompany the University's application for solvency relief.

b) Discussion

A member asked what would be the probability of success of the application for solvency relief. Mr. Shapira replied that he was cautiously optimistic that the application would be approved. He noted that all University applications during the first round in 2010 had been approved.
A member asked whether any conditions had been imposed on applications by the provincial government. Mr. Shapira replied that the application had to include information on agreements that were in place concerning employee and employer pension contributions and the process that was in place to achieve the savings target identified in the application. A member asked whether further conditions could be placed on approvals after the application had been received. Mr. Shapira replied that the regulations concerning solvency relief contained certain conditions but that no new conditions could be added without another regulation. Once the application had been approved, the terms could not be changed.

A member asked whether the components of the solvency deficit could be reported. Mr. Shapira indicated that a reconciliation for the solvency deficit would be included in the final report of the actuarial valuation presented in March.

A member noted that a annual nominal return of 6.25% was necessary over the long-term to fund the current service cost of the Pension Plan, and asked if the current service cost included the interest on the pension deficit. Mr. Shapira replied that the annual special payments, and not the current service cost, were calculated to address the pension deficit, including interest on the deficit. He noted that the annual going concern special payment of $66 million included repayment of principal and interest. He agreed to create a chart for the March meeting of the Committee that showed the interest and principle repayment charges.

4. University of Toronto Pension Plans: Summary of Actuarial Valuation Results as of July 1, 2011 (cont'd)

b) Discussion (cont'd)

On motion duly made, seconded and carried

It was Resolved

THAT the Pension Committee approve the actuarial valuation results for the University of Toronto Pension Plan, the University of Toronto (OISE) Pension Plan, and the Supplemental Retirement Arrangement, attached as Appendix A to the memorandum from the Vice-President, Business Affairs dated December 2, 2011, on the understanding that, if the application for Stage 1 temporary solvency funding relief is not granted, the actuarial valuation results will be revised for purposes of the actuarial valuation reports as at July 1, 2011 to reflect the five year solvency deficit payment requirement.

5. University of Toronto Registered Pension Plans: Application for Temporary Solvency Funding Relief

Members received for information the application for temporary solvency relief that was being submitted by the University to the Ministry of Finance. Mr. Shapira explained that the application was structured to meet the requirements of the provincial government.

6. Assessors' Reports

There were no reports from the assessors.

The Chair noted that this was the final meeting for which Ms Riggall would be Senior Assessor to the Committee. He thanked her for her important contributions in planning for the Committee, in establishing it, and in supporting its success since it had begun its work.

7. Date of the Next Meeting

Members were reminded that the next regular meeting of the Pension Committee was scheduled for Wednesday, March 28, 2012 at 5:00 p.m.

8. Other Business

a) Request for Clarification of Fiduciary Responsibilities for Pension Committee

A member requested that the administration prepare a statement articulating the fiduciary responsibilities of members of the Pension Committee. He explained that, at the recent meeting of the Business Board, he had requested such a statement for the fiduciary responsibilities related to the endowment. Ms Riggall replied that she had drafted a response to the request made at the Business Board, and would also provide a statement for the Pension Committee.

8. Other Business (cont'd)

b) Motion from a Member of the Committee

The Chair explained that Section 9.3 of the Committee's Terms of Reference stated that 'Any member of the Committee may suggest an agenda item through the Chair'. Professor Luste had requested that a motion be placed on the Agenda of the meeting, and had provided documentation for the motion.

a) Introduction

Professor Luste introduced the motion by means of a Powerpoint presentation that included the following slides:

- A table illustrating the 'maturing' of the University of Toronto Pension Plan and the real return assumption problem.
- A chart of the aggregate solvency of defined-benefit pension funds in Canada at October 2011.
- Issues of pension plan investment risks that should concern members of the Pension Committee.
- Total annual expenses of the University of Toronto Pension Plan from 1987 to 2007.
- Pension plan and comparator returns – UTAM years (2000 – 2010) vs pre-UTAM years (1985 – 1999).
- Performance Comparison of Asset growth from 2000 to 2010.
- Complexity of current asset allocation.

It was moved and seconded

i) The Pension Committee requests a report from UTAM that provides a timetable that could achieve an investment allocation whereby a minimum of 90% of all assets could be in publicly traded stocks and bonds. (This reflects one of the six key conclusions in the Jackman report of February, 2010, namely: "In short, we believe that the pension and endowment funds should be invested primarily in publicly traded stocks and bonds.");

ii) The Pension Committee requests a report from UTAM that provides a possible timetable for reallocating a minimum of 80% of its investments assets to low cost, passive index funds or ETFs;

iii) The Pension Committee requests UTAM prepare a report providing timetables and the associated implications for reducing its total investment expenses to each of the following three levels: (i) to 60 basis points (bp) – or 0.60%, (ii) to 40 bp and (iii) to 25 bp. [100bp equals 1%] ; and

iv) The above three reports be made available to UTFA by March 1, 2012 or, if that is not possible, that an alternative date be set by UTAM.

8. Other Business (cont'd)

b) Discussion

A member commented that members of the Pension Committee were not managers, and that requesting a specific timetable would be a broad expansion of fiduciary responsibilities. Another member agreed that the request as presented might be beyond the scope of the Committee.

At the request of the Chair, Mr. Moriarty commented that the Investment Advisory Group had agreed that simple passive management of the investment portfolio would likely result in a 2.5% real return. Some modification to the passive management of the investment portfolio would likely result in a return of 3 to 3.5%. A return of more than 4% would require active management of a portfolio that included alternative assets.

The President remarked that the Investment Advisory Committee had endorsed a reference portfolio that was low-cost and passively managed. In his view, it was appropriate for the Pension Committee to take a broader view than that reflected in the motion that was being discussed.

A member expressed her concern with the level of detail included in the motion, and suggested that the detail was more appropriately considered by the UTAM Board and the Investment Advisory Committee. By focusing on such detail, the Pension Committee would be duplicating the work of other groups.

Professor Luste expressed his belief that members of the Committee needed to know the investments of the Pension Plans. In his view, the motion was a good first step in moving ahead.

A member suggested referring the motion back to Professor Luste for rewording. The Chair reminded members that the Committee would be discussing the Statement of Investment Policies and Procedures at the March meeting. He believed that it would be helpful if members of the Investment Advisory Committee were present at the March meeting of the Pension Committee.

The President expressed his concern at the timetable that was included in the current motion, but agreed that it was reasonable to request information from UTAM on the implications of the costs and expected return from a simpler, less costly portfolio.

A member asked if it would be possible for the Committee to have an orientation session with the Investment Advisory Committee prior to the March meeting. The Chair replied that it was an excellent suggestion that was provided for in the Terms of Reference of the Committee, and that an information session would be scheduled. Professor Luste requested that the orientation session include individuals who supported a passive approach to investment management.

A friendly amendment to the motion was proposed and accepted by the mover and seconder.

8. Other Business (cont'd)

b) Discussion (cont'd)

On motion duly made, seconded and carried

It Was Resolved

THAT, in preparation for an information session to be held prior to the next meeting of the Pension Committee with the Pension Committee, the President's Investment Advisory Committee, and any experts that the University of Toronto Faculty Association (UTFA) or other committee members wish to invite, the University of Toronto Asset Management Corporation (UTAM) be asked to prepare an information report for a range of scenarios regarding:

i) the expected return and cost advantages and or disadvantages of moving to a much simpler, less costly investment portfolio with varying degrees of reliance on passive management rather than active management;

and

ii) the potential transition costs and realistic timetables that would be involved in moving to such portfolios.

The meeting adjourned at 6:30 p.m.

Secretary

Chair

December 21, 2011