UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 163 OF THE BUSINESS BOARD

December 17, 2007

To the Governing Council,
University of Toronto.

Your Board reports that it met on Monday, December 17, 2007 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Mr. Richard Nunn, (In the Chair)
Mr. Geoffrey Matus, Vice-Chair
Ms Catherine J. Riggall, Vice-President, Business Affairs
Professor Angela Hildyard, Vice-President, Human Resources and Equity
Ms Mary Anne Elliott
Ms Susan Eng
Dr. Gerald Halbert
Mr. Alex Kenjeev
Ms Paulette L. Kennedy
Dr. Joel A. Kirsh
Dr. Stephan Mathias Larson
Mr. Jim Linley
Mr. Gary P. Mooney
Mr. David Oxtoby
Professor Arthur S. Ripstein
Mr. John Varghese
Ms B. Elizabeth Vosburgh
Mr. Larry Wasser

Professor Vivek Goel, Vice-President and Provost
Ms Judith Wolfson, Vice-President, University Relations
Professor R. Paul Young Vice-President, Research
Ms Sheila Brown, Chief Financial Officer
Ms Rivi Frankle, Chief Operating Officer, University Advancement, and Assistant Vice-President, Alumni Relations
Ms Christina Sass-Kortsak, Assistant Vice-President, Human Resources
Mr. Nadeem Shabbar, Chief Real Estate Officer
Professor Safwat Zaky, Vice-Provost, Planning and Budget

Mr. Neil Dobbs, Secretary

Regrets:

Mr. P. C. Choo
Mr. Gerald A. Lokash
Mr. George E. Myhal
Mr. Stephen C. Smith
Mr. Robert S. Weiss
Mr. Yang Weng
Mr. W. David Wilson

In Attendance:

Dr. Thomas H. Simpson, past Chair of the Governing Council and past Chair of the Business Board; Director, University of Toronto Asset Management Corporation (UTAM)
Dr. Tim McTiernan, Assistant Vice-President, Research, and Executive Director, Innovations Group
Mr. Robert Steiner, Assistant Vice-President, Strategic Communications

In Attendance (Cont'd)

Ms Deepa Jacob, Research and Policy Analyst, Office of the Vice-President, Business Affairs
Professor George Luste, President, University of Toronto Faculty Association
Mr. Dan Markovich, Hewitt Associates
Mr. Steve Moate, Senior Legal Counsel
Mr. Henry T. Mulhall, Assistant Secretary of the Governing Council
Ms Marny Scully, Director of Policy and Analysis, Office of the Assistant Vice-President, Government, Institutional and Community Relations
Mr. Allan Shapira, Hewitt Associates
Ms Meredith Strong, Director, Office of the Vice-President, University Relations
Ms Nancy Sutherland, Alumni College of Electors
Ms Linda Vranic, Director, Operations, Office of the Vice-President, Research

The Chair stated that the main theme of the meeting was the University's pension plans.

ALL ITEMS ARE REPORTED TO THE GOVERNING COUNCIL FOR INFORMATION.

1. Reports of the Previous Meetings

Report Number 161 (October 30, 2007, the report of the special meeting held *in camera* to consider two property acquisitions and a financial agreement) and Report Number 162 (November 19, 2007, the report of the regular November meeting) were approved.

2. Business Arising from the Reports of the Previous Meetings

Report Number 162, November 19, 2007. Item 3, University Relationship with the University of Toronto Asset Management Corporation (UTAM)

The Chair recalled that at the November meeting, the Board had reviewed initial drafts of proposed changes to the current Service Agreement with UTAM and to the Business Board's terms of reference dealing with investment matters. It was intended that revised documents would be bought to the current meeting for approval. Since that time, it had been decided to do some further work on those documents. Among other things, there would be further legal review. It was anticipated that the proposals would be on the agenda for February 4, 2008.

3. Capital Projects Background Information: Capital Projects Report as at November 30, 2007

The Board received for information the report on capital projects costing over $2-million as at November 30, 2007. Those projects included (a) $285.92-million of projects under construction, and (b) $336.77-million of projects that were now occupied but not officially closed.

4. Borrowing: Status Report to November 30, 2007

The Board received for information the status report on borrowing to November 30, 2007. Maximum borrowing capacity was $875.2 million. Borrowing allocated by Business Board was $825.0 million. Actual external borrowing was $556.7 million, and actual internal borrowing outstanding was $118.5 million.

5. Capital Project: Faculty of Law Expansion: Consultants' Fees

Mr. Shabbar said that the University would like to move forward with a Request for Proposals from architects for the design of the planned expansion of facilities for the Faculty of Law on the Flavelle House site, including the Bora Laskin Law Library. The completion of site investigations, planning, design, and preliminary engineering work would enable the preparation of a reliable estimate of the total cost of the project, which would be very important to facilitate fundraising in support of the project. He requested the Board's approval for spending not to exceed $2-million to engage consultants, with funding to be provided by the Faculty of Law.

In response to a question, Ms Riggall said that the Faculty of Law had been saving to meet this cost and had the funding required. Professor Goel added that, notwithstanding the request for approval of spending of up to $2-million, it was anticipated that less than $1-million would be required for consulting and design work at this stage.

On the recommendation of the Vice-President, Business Affairs,

YOUR BOARD APPROVED

THAT the Vice-President, Business Affairs be authorized to engage consultants to prepare a detailed Site and Phasing Master Plan, including a detailed construction cost estimate, for new facilities for the Faculty of Law, at a cost not to exceed $2-million, using funding to be provided by the Faculty of Law operating budget.

6. Capital Project: Lillian Massey Building: Renovation

Mr. Shabbar reported that the project to renovate a part of the Lillian Massey Building had begun early in 2007. The project had been approved under administrative authority by the Accommodation and Facilities Directorate at its original cost, which had been under $2-million. Because of a tender adjustment, however, it had been necessary to seek additional funding. That additional amount was less than 10% of the approved cost, and approval had again been effected under administrative authority. The total cost of the project was now $2,055,713, and it was anticipated that the project would be completed by year-end.

The Chair noted that the renovation was a leasehold improvement. The Lillian Massey Building was owned by Victoria University – one of the federated universities.

7. Pension Plans: Annual Financial Report for the Year ended June 30, 2007

Ms Kennedy reported that the Audit Committee, at its meeting of November 29, 2007, had completed a careful review of the annual financial report on the pension plans for the year ended June 30, 2007. The actuaries, the external auditor, and the Vice-President, Human Resources and Equity had been in attendance. Ms Brown had provided a complete report to the Audit Committee, and she would provide a substantial report to the Business Board. There had been positive developments from one year ago. The three pension plans were in a market surplus, with the July 1, 2007 market value of the assets in the main registered plan exceeding its accrued liability by $183.9-million. In addition, the actuarial deficit in the main registered plan had declined substantially. The format of the annual report had been improved, and the Audit Committee had been very complimentary with respect to the new format. The Chair noted that the financial statements of the two registered plans required the Board's approval for their submission to the Financial Services Commission of Ontario.

Ms Brown presented the highlights of the annual report. She noted that substantial work and effort had been required from a large team of people to prepare the annual actuarial reports, the financial statements and the annual report itself. She thanked all involved for producing a report that would meet regulatory requirements and that would provide clarity to members of the Board and other readers. The format of the report was a new one, aiming to provide a clear explanation of how defined-benefit pension plans worked in general and how the University's plans worked specifically.

- **How a defined benefit plan worked**. The University made a pension promise to its faculty and staff that it would provide pensions to them upon retirement that would be based, according to a predefined formula, on salary and the number of years' service. To assess the health of the defined-benefit plans, the University estimated the net present value of all pensions to be paid over time (the liabilities) and valued the amount of assets on hand to support payment of those pensions in the future (the assets). That estimate of the liabilities depended on: assumptions about the number of members of the plan, about the length of their service and their salaries at retirement (and therefore about the benefits they would be receiving), and about future inflation. The benefits had to be projected far into the future and then discounted to determine their present value. The present value of the liability then had to be compared with the value of the assets available to meet the pension promise. Those assets could come from only two sources: (a) contributions by employees and by the University, and (b) investment earnings on those contributions. It was necessary to make estimates of how much would be required from contributions and how much could be earned from investments to pay both pensions and the costs of the pension plan. The accrued liability and the fair value of the assets were then compared to determine whether the plan enjoyed a surplus or was in a deficit position.

7. Pension Plans: Annual Financial Report for the Year ended June 30, 2007 (Cont'd)

In determining the position of the plan, the accrued liability could be compared to the market value of the assets in the plan on the date of the report. It was also possible to compare the accrued liability with the actuarial valuation of the assets, which smoothed the effects of varying investment returns out over a number of years. The focus of the report now before the Board was the market value, which in Ms Brown's view represented the best way to assess the financial health of the plan.

- **Tools for the assessment of the pension plans**. The valuation of the assets in the plan at their fair market value was reported in the financial statements and audited by the external auditors. There were several ways to determine the valuation of the pension plans' funding. The most common was the going-concern valuation, which was the focus of this report. The report also included, however, the solvency valuation, showing the ability of the pension funds' assets to cover the accrued liability in the event of the wind-up of the plan and the payment of pensions without indexing. It also included a wind-up valuation showing the ability of the pension funds' assets to cover their accrued liability in the event of the wind-up of the plan and the payment of pensions including indexing. A final tool was the accounting valuation, completed for the University's financial statements as at the April 30 end of each fiscal year. The accounting valuation did not permit recognition of the possibility of investment returns beyond those on long-term bonds and it therefore required that the accrued liability of the plan be discounted at the current interest rate for long-term bonds. The accounting valuation also took into account the University's full liability for pensions including the Supplemental Retirement Arrangement (S.R.A.), but it did not take into account the assets set aside to meet that liability. (The S.R.A. was the plan by which the University provided pensions above the maximum benefit allowed under the Income Tax Act, up to those based on a University-specified maximum salary of $150,000 per year.) The outcome of the accounting valuation on the University's financial statements was therefore often quite different from the valuations in the current report.

- **Pension status at July 1, 2007**. Ms Brown noted that the report showed the going-concern liabilities, the assets and the overall position of the three plans together as well as separately. Nonetheless, the registered plans were highly regulated, and the assets in one registered plan could not be used to fund the pensions in the other or in the S.R.A., although the money set aside by the University to meet its obligations under the S.R.A was University money and it could be used for employer contributions to the registered plans.

  The market surplus of the three plans was equal to 7% of their liabilities. That was a definite improvement over the status at July 1, 2006, which was a market deficit of 1% of the liabilities. The current surplus was, however, a modest one.

7. Pension Plans: Annual Financial Report for the Year ended June 30, 2007 (Cont'd)

- **Liabilities**. The going-concern liabilities of the plans were just over $3-billion. That was the present value of the stream of future payments required to pay pensions earned for service to July 1, 2007. That represented an increase from the $2.771-billion of going concern liabilities as at July 1, 2006. That increase was the outcome of: growth in the number of participants, the augmentation of benefits to full indexation for retired faulty members and librarians, and a change in two assumptions. The assumed mortality rate had been changed to reflect the fact that people were living longer. The assumed retirement age of faculty and librarians had also been changed with the abolition of mandatory retirement.

- **Assets**. The market value of the assets in the plans had grown from $2.739-billion to $3.231-billion. While the liabilities of the plans changed in a reasonably regular manner, the market value of the assets was much more variable, depending on the performance of the investment markets. The increase in the assets was the outcome of a 20% return on investments in the plan over 2006-07, an increase from the 7% return in the previous year. The returns were net of all fees and expenses and excluded the returns on private investment interests. In addition, $117-million had been contributed to the plans. That amount included $89.1-million of current-service contributions by plan members and by the University as well as $28-million in special payments under the Pension Funding Strategy and in payments for the cost of the Voluntary Early Academic Retirement Program. Payments to pensioners had amounted to $132.1-million, an increase from $123.8-million the previous year. Fees and expenses had amounted to 0.8% of assets compared to 0.64% in 2005-06. That increase had been the outcome of significant increases in investments in private-equity funds and hedge funds, which had higher management fees but also had the potential for significantly higher returns.

- **Market surplus**. The market surplus in the main registered pension plan as at July 1, 2007 was $183.9-million. The surplus in the registered plan for the faculty and staff of the Ontario Institute for Studies in Education was $16.3-million (including partial windup). The surplus of the funds set aside to meet the University's obligations under the Supplemental Retirement Arrangement was $24.6-million. Ms Brown stressed that those surpluses were welcome but modest. If the investment return in 2007-08 were to be zero, the surpluses would disappear.

- **Changes to the main registered plan from 2002 – 07**. Over the past five years, liabilities had increased by 48% to $2.746-billion. The increase was the result of benefits earned over the period, the build-up of the interest cost required to discount the liabilities to their present value, experience losses relative to plan assumptions (for example, the lower mortality rates), the cost of benefit improvements, the increase in the maximum pension permitted under the *Income Tax Act*, and changes in assumptions, less the amount of benefits actually paid out. The assets had grown over the five years by 51% to $2.930-billion. That increase had come about through the addition of investment returns net of fees and the addition of contributions and transfers into the pension fund, less the amount paid out in benefits.

7. Pension Plans: Annual Financial Report for the Year ended June 30, 2007 (Cont'd)

- **Sensitivity analysis: discount rate for liabilities**. Ms Brown stressed that the assumptions used in the valuation of the plan were important. The interest rate used to discount the future flow of pension payments to their present value reflected the expected future investment return. That rate was currently a 4% real (after inflation) return plus 2.5% inflation. The outcome was the $183.9-million surplus in the main registered plan. If that real discount rate were reduced from 4% to 3.75%, the surplus would decline to $93.2-million. If the real discount rate were reduced to 2.25%, a rate reflecting no premium for investments more risky than bonds, the plan would fall into a deficit of $577.7-million. Because the amounts involved were very large, the outcome of a change in the assumptions was also large. The assumption used for many years had been a 4% discount rate.

  Any change in the discount rate would have a similarly large impact on the University's contributions to the plan. Because the pension plans had only two sources of funding - investment earnings and contributions - the outcome of lower investment earnings would be the need for higher contributions. Because employee contributions were fixed as a proportion of salary, the higher contributions would have to be paid by the University. With the 4% real discount rate, employer contributions to the main registered plan were $64.7-million per year. A reduction to a real discount rate of 3.75% would require increased employer contributions amounting to $69.9-million per year. A 2.25% discount rate would require employer contributions of $112.3-million per year.

- **Conclusions about the financial health of the pension plans**. A good investment return along with the University's Pension Contribution Strategy had brought about a surplus amounting to 7% of liabilities, which represented an improvement over the past several years. The surplus was, however, a modest one, which could be eliminated by investment earnings of zero for 2008. The surplus or deficit position of the plans was highly sensitive to the rate used to discount the plans' liabilities to their present value, and it was also highly sensitive to the other actuarial assumptions. The University's Pension Contribution Strategy called upon the University to make its full current-service contribution to the plan even if it was in a surplus position and also to set aside additional reserves amounting to $27-million per year to provide for years of poor investment returns. That Strategy was currently being reviewed to determine the appropriate funding levels and reserves going forward. Investment return targets and investment risk tolerance were to be considered by the Board next on the agenda in its review of the University's Pension Fund Master Trust Investment Policy.

- **Questions to be considered by the Board**. Ms Brown suggested that the Board consider four questions. The administration assumed that the answers would be affirmative in all cases. First, were the pension plans financially healthy? Second, were the University's

7. Pension Plans: Annual Financial Report for the Year ended June 30, 2007 (Cont'd)

policies and strategies adequate to ensure sufficient assets to pay current and future pensions? Third, would the requirement to provide pensions be achieved without exposing the University to undue financial risk? Finally, had the auditors confirmed that the pension fund financial statements showed the fair value of the pension funds' assets?

The Chair invited Professor Luste to address the Board. Professor Luste distributed a memorandum to the Board and spoke to it. He commended the administration for a major improvement in the discussion of some issues in the annual report. The pension plan represented a major and very large "I.O.U." to faculty and staff, and Professor Luste expressed his view that there were a number of extremely important shortcomings in the management of the assets to back that I.O.U. Given the time he could speak, Professor Luste would address only certain major issues in his memorandum.

- **Investment risk** had been expressed solely in terms of standard deviation. The risk tolerance was stated as a maximum standard deviation of 10% averaged over ten years. Professor Luste did not, however, agree that standard deviation was a good measure of investment risk. He cited various authorities, including Warren Buffet, who had stated that past volatility did not measure the risk of current investments. Buffet had said that "risk comes from the nature of being in certain kinds of businesses and from not knowing what you're doing." Professor Luste had expressed his serious concern about the level of risk in the pension fund portfolio at a previous meeting of the Board, and he was discouraged that the matter had not been addressed in the current report. He referred to a list of several types of investment risks on page 3 of his document. He said that those risks had not been addressed. He then referred to a table of returns and standard deviations for various asset classes from 1970 – 2006. That table illustrated his view that there was no relationship between levels of volatility and investment returns in the past that could reliably be projected into the future to determine an "efficient frontier." That purported efficient frontier had, however, been used to determine the target return and limit on volatility. A graphing of efficient frontiers, shown in Professor Luste's memorandum, demonstrated that there was extreme variability from one period to the next. Yet a limit on average volatility over ten years appeared to be the sole approach used in the proposed Pension Funds Master Trust Investment Policy to control risk.

- **Effect of past pension contribution holidays**. Professor Luste referred to data in his memorandum which showed that the University had made either no current-service contribution to the pension plan (fourteen years) or only a partial current-service contribution to the pension plan (five years) between 1986-87 and 2003-04*. He said that those holidays had a significant effect on the financial health of the pension plan at this

* There had been full employee contribution holidays for five years and partial holidays for three years in this same period.

7. Pension Plans: Annual Financial Report for the Year ended June 30, 2007 (Cont'd)

time. The holidays had been made possible by aggressive increases in the interest-rate assumption for the pension fund: i.e. the assumed real (after inflation) rate of return on the investments of the pension fund. That assumed rate of real return had increased from 2.5% to 3.0% beginning in 1990-91, then to 3.5% beginning in 1996-97, and finally to the current 4.0% beginning in 1998-99. He said that the effect of the three increases in the interest rate assumption had been to create and grow the apparent surplus being reported in the pension plans.

Professor Luste urged members to review the data in his memorandum concerning the increase in fees and expenses for the main registered plan from $15.6-million in 2005-06 to $23.1-million in 2006-07. He also drew the Board's attention to a resolution passed by the Faculty Association's Executive requesting additional information about the pension fund's investments in hedge funds, private equities, real assets, derivative-related receivables, and other non-long instruments such as foreign currency forward contracts and equity and commodity index future contracts.[*]

Among the matters that arose in questions and discussion were the following:

(a) Financial health of the pension plans. A member observed that the surplus in the main registered plan was a relatively small one and that achieving it had required additional annual payments. In those circumstances, would it in fact be safe for the Board to assume that the plan was financially healthy? Ms Brown replied that the surplus of $183-million had been the outcome of 2006-07 investment earnings of $497-million and a special payment of $27-million. The original projections in the Pension Contribution Strategy had the objective of ending the deficit in the plan in 2016. However, the good investment earnings had resulted in the achievement of that goal many years earlier. The additional payments had played a much lesser role in the achievement of the plan's financial health.

(b) Faculty Association concern. A member said that the pension plan was a defined-benefit plan, in which the University was obligated to pay pensions according to the formula based on salary and years' service. Therefore, the pensions paid would be independent of investment returns. In the light of that situation, why was the Faculty Association concerned about the investment performance of the pension fund? Professor Luste replied that the University was a not-for-profit institution and its revenues were controlled by Government decisions. Therefore the only way the University could pay the promised pensions in a situation of poor investment performance was to reduce the other major area of spending, which was salaries. That would mean fewer faculty, higher faculty/student ratios and a greater workload for faculty.

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[*] Ms Riggall responded to Professor Luste's written document in a letter dated December 20, 2007, a copy of which was provided to all members of the Business Board.

7. Pension Plans: Annual Financial Report for the Year ended June 30, 2007 (Cont'd)

Ms Brown said that University was legally required to pay the pensions it had promised. That requirement was independent of investment returns. She noted that while there were years of stronger and years of poorer investment returns, the annual contributions to the pension plan were quite close to the current annual pension payments. It was true that the cost of making additional payments into the pension plans would have an impact on the University's ability to spend in other areas. There were, however, other larger lines in the expenditure budget which often required spending increases in excess of funding increases. That was the case in particular with salary settlements, which generally required adjustments in other areas of spending. Salaries currently cost very close to $1-billion per year, and salary settlements could have a significant impact. It was therefore necessary to consider all lines in the expenditure budget and their inter-relations.

(c) Possibility of a defined-contribution plan. A member asked whether the faculty had been offered a defined-contribution plan. Professor Hildyard replied that there had been some discussion of that possibility in 2000-01, but the administration and the Faculty Association had been unable to agree on the structure of such a plan.

(d) Effect of increase in the maximum pension benefit under the Income Tax Act. A member observed that the Supplemental Retirement Arrangement (S.R.A.) provided pensions to eligible retirees above the maximum pension permitted by the *Income Tax Act* for registered pension plans, and below that reflecting a maximum salary of $150,000 per year. Because the maximum pension permissible for registered plans was now increasing, the S.R.A. was declining. Did the University plan to increase the maximum salary to compensate? Professor Hildyard replied that the matter was one for negotiation with the Faculty Association. There were some other employees who would also be involved. There had to this date been no agreement to make any change. Invited to comment, Mr. Shapira stressed that any change would affect only future retirees. Any change would have no effect on current pensioners and on the liability on account of them.

On the recommendation of the Audit Committee,

YOUR BOARD APPROVED

(a) The audited financial statements of the University of Toronto Pension Plan, June 30th, 2007; and

(b) The audited financial statements of the University of Toronto (OISE) Pension Plan, June 30th, 2007.

8. Pension Fund Master Trust Investment Policy

Ms Riggall recalled that Professor Luste had in his list of investment risks included "not knowing what you are doing" risk. That was precisely the reason for the expert Board and staff of the University of Toronto Asset Management Corporation (UTAM). The proposed Policy included a return target and a risk tolerance expressed in terms of an average standard deviation over ten years. Ms Riggall assured the Board that UTAM considered the risk of various investments in a much more elaborate way than that presented in the paper now before the Business Board.

Ms Brown presented the proposed Policy, which focused on the asset side of the pension plans. Pension plans were funded from only two sources: contributions to the plan and investment earnings. The proposed Policy dealt with investment earnings: how much the University wished to earn and what level of risk it was prepared to accept to achieve those earnings. Because investment earnings affected the surplus / deficit position of the plan, they also affected the level of contributions required into the plan.

Ms Brown recalled that the University had in 2003 undertaken an analysis of the trade-offs between investment-return expectations and the level of risk required for a reasonable expectation of achieving various levels of investment return. That study had originally focused on the endowment fund. Its outcome had been presented in detail and discussed at an off-line session of the Business Board held in 2003. The outcome had been the decision to seek a return that would allow both the maintenance of the real value of the endowment against erosion by inflation and a 4% annual payout. A payout of 4% would require accepting a 9% risk of a shortfall of more than $10-million of investment returns in any single year, which translated into a 4% real return target and a 10% annual standard deviation, both averaged over ten years. That decision had been made after a period of poor investment returns. Having completed the study for the endowment fund, the University had then looked at the appropriate level of return expectation and risk tolerance for the pension fund. The review had followed a similar pattern, and the University had concluded that the target and risk tolerance should be the same for both the endowment fund and the pension fund. Both were long-term funds, but ones that also had immediate cash requirements. Therefore the 10% annual risk tolerance and 4% real-return expectation over ten years were appropriate for both funds.

Ms Brown explained the meaning of the risk and return targets. With annual inflation of 2.5%, it could be expected that nominal (before inflation) returns two thirds of the time would vary between a gain of 16.5% and a loss of 3.5%. The actual return on the pension fund for 2007 was one of the outliers, with a gain of 20%. In terms of dollar earnings on a $3-billion fund, a target return of 6.5% (2.5.% inflation plus a real return of 4%) would provide $195-million. A return of 16.5% would provide $495-million. A loss of $3.5% would have a cost of $105-million. The hope over the longer term was to earn at least the $195-million per year required to keep the assets and liabilities of the plan in balance. The actual investment returns on the registered pension fund had over the past nine years been up and down, with the most negative return

8. Pension Fund Master Trust Investment Policy (Cont'd)

coming in 2001 with a loss of $105-million and the most positive outcome coming in 2007 with earnings of $498-million. The outcome of those investment earnings, combined with the effects of special payments and plan changes, had been the plan's reaching its current surplus position.

Ms Brown stressed that the achievement of the surplus had not been a coincidence. As a result of the 2003 study, the real-return target had been reduced from 5% to 4%, and the budget for the annual special payment – a reserving mechanism - had been initiated. Having a mechanism for reserving (currently $27-million per year) was very important to the stability of the University's funding because investment returns always varied substantially around any target. The special payment permitted the University to deal with this volatility.

Ms Brown reported that the actuaries had conducted a new asset / liability study in the spring of 2007, dealing solely with the registered pension plans. (The fund set aside to deal with the liabilities of the S.R.A. did not form a part of the assets of the pension plan; they were University assets.) The study was based on efficient-frontier analysis, with the objective of using global historical data to identify optimal portfolios with various mixes of assets that would provide the best possible return for particular levels of risk. Those asset mixes included alternative asset classes, particularly absolute-return hedge funds, real estate and private equity. The alternative asset classes had been shown to enhance the returns provided by traditional asset classes (stocks and bonds) for a given level of risk. Possible outcomes of those asset mixes had been tested in over 5,000 simulations because any asset mix could perform in a variety of ways under different market conditions. The study had concluded that the pension fund could aim for a real return of 4.8% within an annual risk tolerance of 10%, both over ten years. Or the pension fund could continue to aim for a real return of 4% with a lower level of risk – an annual standard deviation of 7.2% over ten years. A key consideration was the risk of requiring special contributions of more than the current $27-million per year (which were made in addition to the current service cost). The study had shown that there was about a one-third chance of needing additional special contributions with the various asset mixes. There was one exception; a pure bond portfolio, because of its low return, would almost certainly require additional payments. Because any deficits could be dealt with over time, that one-third risk of needing additional special payments was an acceptable one.

Ms Brown stressed that the modeling in the asset / liability study should be regarded only as a tool. It was based on data from the past and it could not include all possible future outcomes and future risks. Therefore, the outcome of the study had to be interpreted. The staff and Board of UTAM considered all kinds of risk. The extensive analysis at UTAM included consideration of the risks and potential rewards of investment in each asset class. It was, in addition, necessary to consider the future behaviour of the markets. While it was possible to complete modeling for periods of five to ten years, markets changed. Therefore, the modeling exercise was repeated every four or five years, taking into account the most recent market data. Indeed, more frequent modeling would be completed if required by market changes. The proposed Policy factored in current market conditions.

8. Pension Fund Master Trust Investment Policy (Cont'd)

Ms Brown said that the proposed Policy sought especially to avoid downside risk, notwithstanding the extensive reserving included in the Pension Contribution Strategy. The administration had considered the impact of a minimum-risk portfolio, with a real-return target of 2%. Such a portfolio would still require a risk tolerance of an annual standard deviation of 5% over ten years. More importantly, it would require very large pension-plan contributions. After significant discussion, the administration felt comfortable maintaining the risk tolerance of an average standard deviation of 10% over ten years. The proposed Policy did, however, specify that the risk tolerance was a maximum. It also contained a new statement stressing that UTAM should not seek a return beyond the 4% real-return target if that would require taking on risk beyond the 10% average risk tolerance.* Ms Brown stressed that it would not be realistic to attempt to limit risk by a greater degree; matching the liabilities of the plan by an all-bond portfolio would require very costly contributions. The administration planned to review the return and risk parameters regularly. At this time, it was clear that the appropriate policy objectives should be to limit risk to a 10% standard deviation averaged over ten years and to achieve an average real return of at least 4% per year, while avoiding substantial periods of negative returns.

In response to the Chair's question, Ms Brown said that the administration had discussed the proposed Policy with UTAM management before, during and after its drafting to be sure that UTAM felt comfortable that it could realistically implement the Policy. UTAM used very sophisticated risk-management measures, taking into account the potential volatility of investments as well as other kinds of risk.

Among the matters that arose in questions and discussion were the following.

(a) Financial effect of surplus / deficit position to the University. A member asked whether the University would enjoy any financial benefit arising from the plans' being in a surplus position. Ms Brown replied that all contributions, by law, remained in the plan. Substantial deficits had to be dealt with by increases in the University's contributions. The member observed that it would, therefore, be to the University's benefit to reduce risk. Ms Brown replied that the objective of the proposed Policy was to permit some moderate risk. With a very low risk policy of investing only in very safe, fixed-income securities - primarily in real-return bonds - there would certainly be a need to increase contributions by a substantial amount.

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* Part 2.2 of the proposed Policy reads as follows. "To keep risk at a reasonable level, the risk objective is an annual standard deviation of 10.0% or less in nominal terms over 10 year periods. The University has less appetite for downside risk than for upside risk and prefers that risk be managed to minimize the downside, and particularly to avoid returns less than 0% where ever possible. In order to meet the planned payments of pensions to pensioners, the return objective is at least a 4.0% real inflation-adjusted return over a 10 year period, net of all investment fees and expenses, plus CPI, but with the target real return to be no greater than that which is achievable within the 10% allowable risk objective."

8. Pension Fund Master Trust Investment Policy (Cont'd)

A member asked about the rules governing contribution holidays. Ms Brown replied that the *Income Tax Act* required the suspension of employer contributions when the plan surplus exceeded 10% of the accrued liability.* There was no regulation governing employee contributions.

(b) Conservatism of the proposed Policy. A member asked whether the proposed Policy could be characterized as more or less conservative than others for similar pension plans. Invited to reply, Mr. Shapira said that most pension investment policies in universities and in the broader public sector did provide for significant equity investments. About 60% equities and 40% bonds represented a typical mix of traditional assets, which were combined with alternative investments in order to improve returns and moderate volatility. It was not possible to make broad comparisons without reference to the liability structures of the various plans. The Chair asked whether the proposed Policy was a reasonable one or an exceptionally risky one that "took the University way out on a limb." Ms Brown replied that the policy was, in its conservatism, reasonably comparable to other plans. The most important factor to consider was the inter-relation of risk, return, reserving and funding contributions. Mr. Shapira added that the real-return objectives of comparable plans ranged between 3.7% and 5%.

A member recalled that the plan had suffered because of an aggressive policy and very poor returns early in the decade. The current Policy, like the proposed Policy, stipulated only the real-return objective and the risk tolerance, and it did not include the permissible asset mix. While the Board was not, therefore, responsible for the asset-mix decision, it would most certainly still be held to account in the event of another period of very poor returns, imperiling the financial health of the University. She noted that the University would benefit from returns arising from a less conservative policy that could build up a substantial surplus in the plan, permitting and indeed requiring an employer contribution holiday. She therefore asked for specific assurance from the administration that the proposed Policy did provide for the correct level of risk and that acceptance of that level of risk would, to the extent reasonably possible, shelter the University from unacceptable losses. Ms Riggall replied that the current Policy, approved in 2003, stipulated the same real-return objective and risk tolerance, but without the proposed addition of qualifications to further limit risk. That Policy had served the University well, and Ms Riggall was confident that the targets as stipulated in the current Policy would continue to do so.

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* The objective of the regulation was to prevent for-profit employers from sheltering income from taxation through excessive pension-plan contributions.

8. Pension Fund Master Trust Investment Policy (Cont'd)

On the recommendation of the Vice-President, Business Affairs,

> Subject to Governing Council approval of a forthcoming proposal to revise section 5.1 of the Business Board Terms of Reference,*
>
> YOUR BOARD APPROVED
>
> The proposed University of Toronto Pension Fund Master Trust Investment Policy, a copy of which is attached hereto as Appendix "A".

9. Vice-President, University Relations: Annual Report, 2006-07

Ms Wolfson, using powerpoint slides, presented the first annual report of the University Relations portfolio.

- **Stakeholders and impact**. The University's footprint was a very large one, with internal, local, provincial, national and international stakeholders. The job of the University Relations portfolio was to steward those relationships. In addition to its educational impact, the University (with over 11,000 employees) was one of the largest employers in the Greater Toronto area (G.T.A.) In addition, with its $900-million of capital projects, the University was one of the G.T.A.'s largest property developers. The University was also an important centre for the arts and culture in the G.T.A., participating in its Doors Open and Nuit Blanche programs and offering theatrical productions and concerts. It also provided services to members of the community through such means as its legal aid and dental clinics for those not able to purchase those services.

- **Government, Institutional and Community Relations**. The Government, Institutional and Community Relations group worked to develop a coordinated approach to the federal, provincial and municipal governments. It was essential that there be clear voices speaking for the University as a whole. Because many academic divisions had relationships with various branches of Government, it was also important to coordinate those voices and to enhance relationships with institutional partners in joint work with

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* The "subject to . . ." condition on the motion is required because the current Business Board terms of reference stipulate that the Policy contain certain additional elements. Under the proposed new terms of reference, those elements would not be required but would clearly be the responsibility of UTAM. Should the new terms of reference not be approved by the Governing Council, the Vice-President, Business Affairs would bring the UTAM policy to the Business Board and she would recommend the Board's assent to the inclusion of the UTAM policy in the University's Statement of Investment Policies and Priorities. That process has been followed in recent previous years.

9. Vice-President, University Relations: Annual Report, 2006-07 (Cont'd)

governments. Good relationships with governments were essential in light of the fact that they provided almost half of the University's revenue. The Government of Ontario also regulated tuition fees, and government funding plus tuition fees accounted for 68% of revenue.

- **International Relations**. The University operated in a rich international environment, with many productive relationships. It was important to build on those relationships and to benefit from them. That required the development of a strategic focus: sorting out priorities for international relations and developing those that would bring the University the greatest measure of support for its activities. The International Relations group sought to coordinate activities among internal departments with a significant role in the internationalization of the University and to encourage information sharing among them. Specific central activities included hosting incoming delegations, hosting outgoing delegations and assisting in the negotiation of formal agreements to establish valuable collaborations with international partners.

- **Strategic communications**. The Strategic Communications area comprised three teams. The first was issues management and media relations. It worked to protect and enhance the University's reputation, providing counsel to the senior administration on issues that presented a risk to the University's reputation. It also worked to improve the perception of the University's brand. It did that by promoting stories to the media to increase the profile of the University's students, faculty, staff, programs and initiatives.

  The second team was responsible for faculty and staff communications. With so large a University family, it was important to ensure excellent internal communications. In addition to the *Bulletin* newspaper, the University had established a twice-weekly *eBulletin*, responding to the way members of the University community now obtained and consumed information.

  The third team was responsible for University marketing – communicating the University's vision and messages to those outside the University community and improving the University's brand. Paid advertising was employed to take advantage of specific opportunities.

- **New visual identity**. The University had developed and implemented two new compatible versions of its signature, including a common design for its coat of arms / crest and its wordmark (the words "University of Toronto"). The objective was to establish a strong sense of visual cohesion – a consistent look and feel. That should not only provide a sense of visual clarity but should also lead to efficiencies and cost savings through standardization of design for stationery and other University materials.

9. Vice-President, University Relations: Annual Report, 2006-07 (Cont'd)

- **Looking forward: Government, Institutional and Community Relations**. The key objective of government, institutional and community-relations activities was to increase financial support for the University. That would require a focus on strengthening of the relations with the Province of Ontario, and also with Government of Canada, with the City of Toronto and with the City of Mississauga. It would be important to work on the relationships with the cities to capitalize on the benefits brought to the cities by the operations of the University and to seek an appropriate quid pro quo. It would be important that the University reposition itself in the perceptions of the Government in order to achieve improvements in the funding model. To do so, the University would have to convince governments of the importance of investing in the quality of the education and research that was being provided by the University of Toronto. There would be need to deal with a number of key issues: promoting understanding of the importance of investing in quality; dealing with demand for University places from students in the growing Greater Toronto area; providing facilities to meet the special demand for more places for graduate students; providing adequate capital funding to deal with deferred maintenance needs; promoting improvements in tuition and ancillary fee policy; promoting support for research and innovation in key research sectors; meeting the Province's needs for health professionals; supporting accountability and performance measurement; and promoting internationalization and the increased enrolment of international students.

- **Looking forward: International Relations**. The main objective would be the development of an overarching strategy for internationalization – a key focus in the planning exercise *Towards 2030*. The development of a strategy would include: assessing the current relations with numerous international partners, determining geographic and thematic strategies, and building upon previous contacts – focusing on and improving the most important ones. The international strategy would include: defining and advancing key national and international priorities of interest to the University; identifying niche areas for strategic cooperation; and facilitating work to coordinate and implement the strategy. For example, it would be important not to have two different groups from the University visiting the same place, not cooperating and perhaps not even being aware of the presence of the other.

- **Looking forward: Strategic Communications**. In the area of issues management and media relations, the group would seek to enhance the University's profile in the media. It would adopt a strategic and thematic approach to story pitching, seeking to enhance the imprint of the University and to earn its fair share of media coverage and perhaps more. This effort would require expansion of the University's domestic and international media contacts.

9. Vice-President, University Relations: Annual Report, 2006-07 (Cont'd)

With respect to faculty and staff communications, it was important to remember that it was not possible to over-communicate. The University would seek to redevelop its web presence, which was not as robust and interesting as it could be. Work would continue to refine the *Bulletin* and the *eBulletin*. In addition, the central Strategic Communications group would provide support for publications across the University to facilitate its speaking with a powerful voice.

Marketing efforts would include the continued implementation of the new visual identity. In January, the University would undertake qualitative and quantitative market research, looking at the perception of the University by its stakeholders. Advertising efforts would continue to raise the public profile of the University and to improve its broad positioning.

10. Health and Safety Requirements: Report on Compliance with Legal Requirements

The Chair reminded members that they could be held personally liable for any Board failure to carry out due diligence to ensure conformity with health and safety requirements. Therefore, this regular report was of considerable importance.

Professor Hildyard recalled her oral, *in camera* report to the May meeting of the Board concerning a gap in the University's reporting to the Ministry of Labour on employee's hours of work with asbestos. The Office of Environmental Health and Safety had worked with the Facilities and Services Department, the union, and the relevant Joint Health and Safety Committee to collect the necessary information. It would be submitted to the Ministry in January, following the confirmation of the information with the individual employees.

Professor Hildyard reported that the University of Toronto, along with all other Ontario universities, had been placed on a "last chance" list by the Ministry of Labour on the basis of ranking in the 10% of employers in a particular group with the worst safety records, as measured by accidents reported to the Workplace Safety and Insurance Board. The origin of the problem was that the universities' safety record was being compared with that of 1,400 organizations including elementary and secondary schools. Unlike most of the organizations with which it was being compared, the University was a very large institution with many buildings and with a wide array of complex activities. The universities, through the Council of Ontario Universities, had decided to form their own safety association in order to enable more appropriate comparisons, and Professor Hildyard was confident that the University of Toronto would come off the "last chance" list. The University would continue to pursue the goal of eliminating workplace accidents or reducing them to the lowest possible level. In response to a member's question, Professor Hildyard said that she anticipated Ministry acceptance of the changes that would provide for more appropriate comparisons of the safety records of the universities.

11. Reports of the Administrative Assessors

Insurance Program

Ms Riggall recalled that she had reported the University's decision to terminate its participation in the Canadian Universities Reciprocal Insurance Exchange (CURIE). That step had been implemented, and the University had secured similar or better insurance coverages through commercial insurers and had secured significant cost savings in so doing.

12. Date of Next Meeting

The Chair reminded members that the next regular meeting was scheduled for Monday, February 4, 2008 at 5:00 p.m.

THE BOARD MOVED INTO CLOSED SESSION

8. Gifts and Pledges over $250,000, Quarterly Report, August 1 to October 31, 2007

The Board received, for information, the Report on Gifts and Pledges over $250,000 for the period August 1 to October 31, 2007.

THE BOARD RETURNED TO OPEN SESSION.

The meeting adjourned at 6:40 p.m.

Secretary Chair

January 23, 2008

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