University of Toronto

(FINANCIAL SERVICES DEPARTMENT, BUSINESS AFFAIRS)

TO: Audit Committee

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AGENDA ITEM:

ITEM IDENTIFICATION:

Pension Plans – Annual Financial Report for the Year Ended June 30, 2008

JURISDICTIONAL INFORMATION:

The Audit Committee is responsible for reviewing the annual financial report and for recommending the annual financial statements for the pension plans to the Business Board.

PREVIOUS ACTION TAKEN:

Annually the Audit Committee receives and reviews the pension annual financial report and recommends the pension plan financial statements to the Business Board, most recently for the year ended June 30, 2007. The pension contribution strategy was originally approved by the Business Board in January 2004. The pension master trust investment policy was most recently approved by the Business Board in December 2007.

HIGHLIGHTS:

This report provides the Audit Committee and the Business Board with an update of the pension liabilities and assets as well as an assessment of how well the University's pension investment and contribution strategies ensure pension financial health.

The University of Toronto provides pension benefits to current and future pensioners via three defined benefit pension plans: the registered University of Toronto Pension Plan (RPP), the registered University of Toronto (OISE) Pension Plan (RPP(OISE)), and the unregistered Supplemental Retirement Arrangement (SRA).

The actuarial results at July 1, 2008 are summarized by plan in the following table:

	RPP	RPP(OISE) (excludes partial wind-up)	SRA (1)
Accrued liabilities	$2,889.6 million	$104.2 million	$139.8 million
Market value of assets (1)	$2,724.2 million	$105.9 million	$174.2 million
Market surplus or (deficit)	(165.4 million)	$1.7 million	$ 34.4 million
Actuarial surplus or (deficit)	($92.4 million)	$4.6 million	

(1) For financial accounting purposes, the University from time to time appropriates funds which are set aside as "internally restricted funds" in respect of the obligations under the SRA. In accordance with an Advance Income Tax Ruling which the University has received, such assets do not constitute trust property, are available to satisfy University creditors, may be applied to any other purpose that the University may determine from time to time, are commingled with other assets of the University, and are not subject to the direct claim of any members.

The RPP had a solvency deficit of $217.2 million at July 1, 2008 compared to a solvency excess of $300.2 at July 1, 2007.

The RPP(OISE) had a solvency deficit of $3.3 million at July 1, 2008 compared to a solvency excess of $17.2 million at July 1, 2007, after taking the partial wind-up into account.

On October 1, 2007 the Financial Services Commission of Ontario (FSCO) approved the partial wind-up distribution to the members of the 1996 partial plan wind-up. The valuation results for RPP(OISE) at July 1, 2008 exclude the assets and liabilities related to the partial wind-up participants .

The results for the RPP and the RPP(OISE) plans reflect a one-year return for the pension master trust of -5.9%, net of fees and expenses. Fees and expenses for the year totaled $29.3 million, and amounted to 1.04% of master trust assets. The financial statements for the pension plans show the audited values of the assets available for benefits.

There were no changes to the assumptions in the July 1, 2008 actuarial reports.

Sensitivity Analysis:

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).

The liability depends on assumptions about the number of members in the pension plans, their length of service, their estimated salaries at retirement, the kinds of benefits they are receiving or will receive and future inflation. The liability represents the discounted net present value of pension benefits earned for service up to the valuation date, based on those assumptions. The discount rate at which the pension liabilities are discounted to their net present value has a significant impact on the surplus/deficit and on the current service cost contributions required to be paid into the plans.

A 4.0% real return plus CPI discount assumption has been in place for many years. At July 1, 2008, the discount rate is 6.5%, composed of 2.5% CPI and 4.0% real return, net of all fees. Changes in actuarial assumptions can have a significant impact on the employer current service cost and the surplus/deficit of the plans. For example, a 0.25% decrease in the discount rate would increase the employer current service cost by $5.4 million and would increase the market deficit by $94.2 million. A 2.0% reduction in the RPP real discount rate to 2.0% (4.0% interest rate including CPI) would increase the employer current service cost by $60.0 million (from $67.0 million to $129.0 million) and would increase the market deficit by $934.2 million. It is important to note that the intent of the sensitivity modeling around the discount rate is not to predict a range of investment outcomes. Rather, its intent is to illustrate the effect on contributions and the surplus/deficit of recognizing different proportions of risk premium (the additional investment return over the long-term from investments, such as equities, which are more risky than fixed-income investments) in advance of it being earned.

Current investment market conditions:

The University has a 10% standard deviation risk target and a 4% real investment return target, net of fees and expenses, over ten years. . The global financial crisis is driving a significant fall in market indices world wide during the latter half of 2008, and the pension plans are not immune to this. If the resulting poor investment returns the pension plans are currently experiencing in 2008-09 persist through to the end of the fiscal year, there would be a significant increase in the market deficit. The key reserving strategy is the annual base budget special payments allocation of $27 million required under the pension contribution strategy. This sum is sufficient to fund a market deficit of about $263 million amortized over 15 years. If a solvency deficit persists when the next filing is required to FSCO, it is possible a larger annual special payment allocation could be required.

Conclusion:

The RPP has changed from a market surplus to a market deficit position during 2008 reflecting a reversal of the gains achieved during 2007. There are also a number of issues that continue to cause concern, including the fall in market indices worldwide during the latter half of 2008 and expected volatility in investment returns over the coming years, the potential need to make payments into the RPP(OISE), and whether we will meet the long-term return expectations given financial market trends.

If there were a requirement to file the July 1, 2008 actuarial valuation with the FSCO, annual special payments of $38.6 million would be required over 5 years, in addition to the going concern special payments of $9.8 million which are being made, to amortize the solvency deficiency over 5 years (this is the statutory amortization period). In the absence of changes to pension benefits, the next required filing with FSCO is July 1, 2010.

We are continuing to monitor the impact of the financial crisis on the pension plans and, at this time, we are not proposing any changes to the current pension contribution strategy.

FINANCIAL AND/OR PLANNING IMPLICATIONS:

The pension contribution strategy continues to require 100% current service cost employer contributions and additional special payments of $27.2 million. Of this amount, $9.8 million will be contributed to the RPP, and the remainder will be contributed to the SRA. The pension deficit contributes to the employee future benefits costs recorded in the University's financial statements.

RECOMMENDATION:

It is recommended that the Audit Committee recommend to the Business Board:

1) that the audited financial statements for the University of Toronto Pension Plan, June 30, 2008, a copy of which is included in Appendix "A" hereto, be approved, and
2) that the audited financial statements for the University of Toronto (OISE) Pension Plan, June 30, 2008, a copy of which is included in Appendix "B" hereto, be approved