AMENDED

UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 196 OF THE BUSINESS BOARD

April 2, 2012

To the Governing Council,
University of Toronto

Your Board reports that it met on Monday, April 2, 2012 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Mr. W. David Wilson (In the Chair)
Ms Shirley Hoy, (Vice-Chair)
Professor Scott Mabury, Vice-President, University Operations
Ms Sheila Brown, Chief Financial Officer
Professor Angela Hildyard, Vice-President, Human Resources and Equity
Mr. Richard Nunn, Chair of the Governing Council
Mr. Jeff Collins
Professor Edward Iacobucci
Ms Paulette L. Kennedy
Professor Michael R. Marrus
Ms N. Jane Pepino
Mr. Manveen Puri
Ms Catherine Riddell
Ms Penny Somerville
Mr. W. John Switzer
Mr. W. Keith Thomas
Ms Rita Tsang
Ms B. Elizabeth Vosburgh

Mr. David Palmer, Vice-President, Advancement

Professor Judith Wolfson, Vice-President University Relations
Mr. Andrew Arifuzzaman, Chief Strategy Officer and Interim Chief Administrative Officer, University of Toronto Scarborough
Mr. Louis R. Charpentier, Secretary of the Governing Council
Mr. Paul Donoghue, Chief Administrative Officer, University of Toronto Mississauga
Ms Sally Garner, Executive Director, Planning and Budget
Ms Anne E. MacDonald, Director, Ancillary Services
Ms Gail Milgrom, Acting Assistant Vice-President, Campus and Facilities Planning
Ms Christina Sass-Kortsak, Assistant Vice-President, Human Resources
Mr. Ron Swail, Assistant Vice-President, Facilities and Services

Mr. Neil Dobbs, Secretary

Regrets:

Ms Celina Rayonne Caesar-Chavannes
Mr. P. C. Choo
Ms Mary Anne Elliott
Mr. J. Mark Gardhouse
Mr. Steve (Suresh) Gupta
Mr. Gary P. Mooney
Mr. Jorge J. Prieto
Mr. Howard Shearer
Mr. Chris Thatcher
Dr. Sarita Verma

In Attendance:

Ms Gillian Morrison, Assistant Vice-President, Divisional Relations and Campaigns
Ms Lisa Becker, Director, Operational Due Diligence and Chief Compliance Officer, University of Toronto Asset Management Corporation
Mr. Mark Britt, Director, Internal Audit
Mr. W. G. Tad Brown, Counsel, Business Affairs and Advancement
Mr. Jim Delaney, Director, Office of the Vice-Provost, Students
Mr. John Hsu, Chief Operating Officer, University of Toronto Asset Management Corporation
Mr. Adrian Hussey, Director, Portfolio and Risk Analysis, University of Toronto Asset Management Corporation
Mr. Michel Malo, Managing Director, Asset Allocation and Portfolio Strategy, University of Toronto Asset Management Corporation
Ms Tory Mathers, Senior Labour Relations Officer
Mr. Steve Moate, Senior Legal Counsel
Mr. William W. Moriarty, President and Chief Executive Officer, University of Toronto Asset Management Corporation
Mr. Pierre Piché, Controller and Director of Financial Services
Mr. Daren Smith, Managing Director, Manager Selection and Portfolio Construction, University of Toronto Asset Management Corporation

ALL ITEMS ARE REPORTED TO THE GOVERNING COUNCIL FOR INFORMATION.

1. Business Arising from the Previous Meeting

Item 5 - Cost-Recovery Ancillary Fees and Administrative User Fees and Fines (fees reported for information), 2012-13

Professor Mabury recalled that a representative of the Graduate Students' Union had raised a number of concerns about the academic incidental fees charged to students in the Master's and Doctoral programs in Clinical Engineering offered by the Institute of Biomaterials and Biomedical Engineering. Those concerns had included lack of clarity and timely communication to students about the fees and apparent lack of compliance of certain fees with Ministry of Training, Colleges and Universities policy. The administration had undertaken to consult with students and with the Ministry and had arrived at the following decisions, which had been endorsed by the Ministry.

- Because of insufficient communication to students, three 2011-12 fees would be refunded: the course material fee, the career network services fee, and the internship placement fee.

- The supplementary application fee had already been waived for 2011-12 owing to lack of timely communication to students.

- The course field trip fee had been determined not to meet policy requirements, would be refunded tor 2011-12, and would not be charged in the future. The fee could be charged only

1. Business Arising from the Previous Meeting (Cont'd)

Item 5 - Cost-Recovery Ancillary Fees and Administrative User Fees and Fines (fees reported for information), 2012-13 (Cont'd)

"for the reasonable direct costs of travel and accommodation of students on compulsory field trips." Because the fee as proposed by the program included indirect administrative costs to arrange field trips, it was deemed not to meet the terms of the policy.

- The records and documents fee, labeled as the accreditation fee, met policy requirements, had been communicated in a timely fashion and had been charged through the University-wide system. It would remain in effect.

- For 2012-13, the Institute had made a commitment to ensuring that its website included clear, detailed information about the ancillary fees, to informing students about them prior to their registration, and to charging the fees through the University-wide system. Therefore, all incidental fees, apart from the field-trip fee, would be charged for 2012-13.

- The internship placement fee would be charged to cover the costs of administrative support to facilitate and administer placements. That support would be provided in cases where the Institute had identified the placement site and in cases where students themselves identified a location where they would like to complete their internship. Because administrative support was required in both cases, the fee would be charged.

Professor Mabury stated that the administration would conduct a review of all compulsory academic incidental fees to ensure (a) that they met both Ministry and University policy requirements and (b) that appropriate notification to students was given. It would also establish a process for University-level review and approval of all new academic incidental fees to ensure that the criteria were met.

2. Senior Appointments and Compensation Committee: Annual Report

The Board received for information the annual report of the Senior Appointments and Compensation Committee for 2010-11. Mr. Nunn said that the Committee provided governance oversight of senior appointments and executive compensation. It had over the past year worked through a number of policies and processes. Its work over the past year with respect to senior salaries had been limited by the Province's compensation-restraint legislation. A significant emphasis during the current year, which would be reflected in the next annual report, was on the oversight of succession, with a particular focus of the forthcoming Presidential succession.

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011

The Board received for information the annual report (including the audited financial statements) of the University of Toronto Asset Management Corporation (UTAM) for 2011.

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011 (Cont'd)

Ms Brown reminded members of the role of the Board in oversight of investment matters relative to that of the Pension Committee, the Investment Advisory Committee, and the University administration.

- **Return targets and risk tolerance** were recommended by the University administration following consultation with the Investment Advisory Committee. Those targets for University funds were approved by the Business Board and for the pension funds by the Pension Committee.

- **The Reference Portfolio asset allocation** was recommended by UTAM in consultation with the Investment Advisory Committee. In the case of University funds, the asset allocation was approved by the President of the University. In the case of the Pension Fund Master Trust, the asset allocation was recommended by the University administration to the Pension Committee for its approval.

The role of the Business Board was not only to approve the return target and risk-tolerance target for University funds but also to exercise oversight over the general financial health of the University. As a result, it reviewed this annual report on the investment performance of both University funds and the pension fund. It also reviewed a semi-annual report made in September and any other reports that might be deemed appropriate. The role of the Pension Committee was (a) to consider and approve the Statement of Investment Policies and Goals for the pension fund master trust, which included both the return and risk-tolerance targets, the asset allocation and other policy elements, and (b) to review reports on the investment performance of the pension funds.

Mr. Moriarty presented the UTAM Portfolio Performance Review. Among the highlights of his presentation were the following.

- **UTAM role**. UTAM managed about $5.3-billion of investments on behalf of the University. That included $2.5-billion in the Pension Fund Master Trust, $1.8-billion in the Long-Term Capital Appreciation Pool (primarily the endowment funds[*]), and about $1-billion in the Expendable Funds Investment Pool (the University's working capital pool, which was invested in short- and mid-term fixed-income investments).

- **Investment returns compared to objectives**. The University had established a target return for the Pension Fund Master Trust (the "pension fund") and the Long-Term Capital

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[*] In addition to the endowment funds, the Long-Term Capital Appreciation Pool contained (a) the assets set aside by the University to meet a part of its obligation under the Supplementary Retirement Arrangement, and (b) the assets of the Long-Term Borrowing Pool, consisting of repayments from the divisions set aside to repay the University's borrowing through its several debenture issues.

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011 (Cont'd)

Appreciation Pool (the "endowment fund"). That target return was inflation (as measured by the Canadian Consumer Price Index) plus 4%. That target reflected the long-term needs of the funds, but it was a very difficult one to achieve in a year of poor equity markets, such as 2011. The return on both the pension fund and the endowment fund for 2011 had been 1.2%, which fell short of the target of 6.3% (4% plus inflation of 2.3%).

Because the target return was not reflective of market conditions in any one year, the University had also established a Reference Portfolio – a simple, investable but hypothetical portfolio consisting of various securities indices. For 2011 and earlier years, the Reference Portfolio had consisted of: 30% Canadian equities, 15% U.S. equities, 15% other international equities, 35% fixed-income investments and 5% real-return bonds. One half of foreign currency exposure was hedged back to the Canadian dollar. (An earlier "benchmark portfolio" had also been established, reflecting UTAM's actual asset mix, but that measure was now rarely used.) For 2011, the actual return of 1.2% had outperformed the Reference Portfolio return of 0.2% by 1%. For the two years 2010 and 2011, the actual return on the long-term portfolios had been 5.1% per year for the endowment fund and 5.2% per year for the pension fund, which approximated the return of the reference portfolio. For the four year period 2008-2011, the actual return on the pension fund had been a negative 4.7% per year and for the endowment fund a negative 4.6%, compared to the Reference Portfolio return of a positive 1.4% per year. The poor actual returns reflected the more risky nature of the portfolio in 2008. The encouraging feature was the steady improvement of returns relative to the Reference Portfolio over time.

For 2011, the outperformance of the actual portfolio compared to the Reference Portfolio had been the outcome of a number of factors. The actual portfolio's asset mix had accounted for 19 basis points of outperformance (one basis point = 1/100 of 1%). Manager selection had added 71 basis points – particularly selection of managers for hedge funds and Canadian equities. Unhedged foreign investments had added 18 basis points.

- **Investment returns by asset class**. For the 2011 year, the Standard and Poor's Toronto Stock Exchange Composite Index of Canadian equities had declined by 8.7%. The decline of the Canadian equities in the University's portfolio had been 78 basis points less – primarily as the result of a higher level of investments with managers of smaller–company stocks. U.S. equities in the University's portfolio had performed roughly in line with the market, gaining about 1% for the year. International equities had incurred a loss of 13.1%, which was 94 basis points more than the loss of the Morgan Stanley Europe/Australasia/Far East (EAFE) index. That underperformance was disappointing, and UTAM was in the process of restructuring that part of its portfolio. Fixed-income investments had gained 9.2%, about 45 basis points less than the Dex Canadian Universe bond index. That had been the outcome of relative over-exposure to corporate debentures and relative under-exposure to government bonds. UTAM was, however, maintaining that strategy, expecting that corporate credits would outperform government bonds going forward.

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011 (Cont'd)

- **Investment returns: alternative assets**. The alternative asset classes had provided excellent performance – an important fact to bear in mind in the light of a great deal of misunderstanding about the return on those investments. For 2011, hedge-fund investments had earned 2.1% - which was 5.79% better than the return of the benchmark index – the Hedge Fund Research Inc. Conservative Fund-of-Funds Index. Private-market investments (primarily in private-equity limited partnerships) had earned 12.9% for the pension fund and 14.8% for the endowment fund. Investments in real-asset funds (real-estate, infrastructure and commodity limited-partnerships) had earned a return of 9.9% for the pension fund and 9.0% for the endowment fund. The alternative investments had generally outperformed the public equity market indices when measured over the past four years. Some had performed less well than fixed-income investments over that period.

- **New Reference Portfolio.** The original hypothetical Reference Portfolio had, between 1970 and 2009, achieved an outcome in keeping with the University's objectives. It had a real return of about 4½%, with a standard deviation of returns of about 9.3%. It had, however, been developed solely as an instrument for comparison to actual performance and not as a guide to actual investments. Therefore, the Investment Advisory Committee, working with UTAM, had developed a new Reference Portfolio to guide UTAM investments as well as to use as a measure to compare UTAM performance. The original Reference Portfolio, developed in 2008, was no longer an appropriate guide for investments. It was highly concentrated regionally and by sector. 30% of the Reference Portfolio consisted of Canadian equities, which represented less than 4% of the global equity market. And, 70% of the value of the Canadian equity market was concentrated in three sectors: materials, energy and financial companies. The result was a potentially risky portfolio. Moreover, the Reference Portfolio lacked significant exposure to the emerging markets, which were the world's fastest growing and the most inefficient markets, the latter factor enabling gains from good stock selection. Given current interest rates and valuations, the old Reference Portfolio was projected to deliver a real (after inflation) return of only 2.8%.

  The new Reference Portfolio, consisting of securities indices, was projected to deliver a real (after inflation) return of 3.5%. With an additional ½% of return from active management – a reasonable goal – a portfolio based on the Reference Portfolio should be able to deliver the required real return of 4% per year. The new Reference Portfolio consisted of:

Canadian equities	16%
U.S. equities	18%
Other developed country equities	16%
Emerging market equities	10%
Canadian investment-grade corporate bonds	20%
Canadian government bonds	20%

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011 (Cont'd)

Unhedged foreign currency exposure would amount to 18.5% of the portfolio – a bit more than the old Reference Portfolio – with the majority in the emerging markets (whose currencies were very costly to hedge and would therefore be left unhedged). The investments in the alternative asset classes – hedge funds and private-market investments – would be included in the appropriate equity or bond categories, reflecting their characteristics and their risk.

- **Portfolio risk**. While there was no single measure to characterize the risk in an investment portfolio, the University had historically used average portfolio volatility over a ten-year period. The actual portfolio and the Reference Portfolio had, using that measure, been generally in line and within the policy risk-tolerance of a standard deviation of 10% over the ten years. Volatility was, however, a backward-looking measure. UTAM had completed a great deal of work on measuring and controlling risk, and it would propose additional benchmarks or indicators to limit risk.

Mr. Moriarty concluded that UTAM was currently a very different organization than it had been four years previously, with a more experienced staff and important strategic partnerships such as that with Morgan Creek, which worked with UTAM with respect to its private-market investments. UTAM's infrastructure had been developed, and the new governing structure, including the Investment Advisory Committee, had been very important. All of those factors had resulted in improved transparency and communication. Performance relative to the appropriate market benchmarks had improved for 2011, but the investment environment remained a challenging one. UTAM would in 2012 finish its restructuring and achieve a better balance between offence and defense.

Among the matters that arose in discussion were the following.

(a) Liquidity. A member observed that the investments in the alternative asset classes – hedge funds and private-market investments – were being included in the Reference Portfolio in the traditional asset classes along with public-market investments. They were, however, far less liquid. In the 2008 market crisis, there had been real problems in that it had not been possible to liquidate a portion of those investments in order to rebalance the portfolio and reduce the risk in it. Was the risk of illiquidity factored into the Reference Portfolio characterization of the alternative assets? Mr. Moriarty replied that the 2008 crisis had made it clear that hedge funds and private-market investments were not in fact separate asset classes; they suffered declines in value that were comparable to those of publicly traded securities. They simply had a different legal structure and a different set of strategies. UTAM had, therefore, analyzed the hedge-fund investments and the private-market investments and had placed them in an appropriate asset class, reflecting their risk characteristics. Those investments did, however, have a lower level of liquidity, making it essential that UTAM devise a separate framework to monitor liquidity closely. UTAM did monitor cash-flow needs and other potential liquidity needs on a regular basis (especially needs for re-balancing its portfolio in response to changes in the securities and

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011 (Cont'd)

foreign-exchange markets), and it did ensure that its portfolio would be able to meet those needs. The portfolio included investments in about sixty-five private-market limited partnerships. To enter such partnerships, UTAM had to agree to deliver money to those partnerships to fund their individual investments over an investment period, which usually lasted from four to five years. The funds would then begin to harvest the fruits of those investments and return capital to the partners. Beginning in 2011, UTAM had begun to receive back distributions that exceeded the amount of new capital calls. Nonetheless, Mr. Moriarty regarded the level of investments in private-market funds to be too large. Combining money invested with that committed, and after returns of capital, the private-market investments represented about 26% of the portfolio. Mr. Moriarty would prefer that the amount be closer to 15%. UTAM was not, therefore, making new private investments. It was working with the consultant, Morgan Creek, to understand the detail of the risk in those investments and to manage the assets in that category going forward.

(b) Similarity of pension plan and endowment fund portfolios. A member observed that, notwithstanding some expectation that the Reference Portfolios for the pension fund and the endowment fund would differ, they had remained the same. Mr. Moriarty and Ms Brown replied that the University, working with the actuaries, had completed modeling of the needs of the two funds and had agreed that the investment target for both funds should be a real (after inflation) return of 4%. Therefore, it made sense to have the same normal asset mix, i.e. the same Reference Portfolio, for both funds. While there were apparent differences between the two funds, both had very long-term time horizons but both also had need for a substantial cash flow to fund regular payouts each year, either: (i) payments to pensioners or (ii) endowment payouts to fund salary and benefit payments for holders of endowed chairs and payments to the recipients of endowed student awards.

(c) Constraints with respect to the investments of the Pension Fund and the Endowment fund. A member observed that the Investment Advisory Committee had recommended bands within which UTAM could vary its investments in each asset category from the asset mix established in the Reference Portfolio. Would those bands and other constraints apply equally to the pension fund and the endowment fund? Were there bands that would limit the proportion of active compared to passive investments?

Mr. Moriarty replied that the Reference Portfolio had been defined in the light of the historical risk for each asset category, and it was therefore important to ensure that the addition of active management around the Reference Portfolio did not add too much incremental risk. The total incremental risk that could be added to the actual portfolio for both the pension fund and the endowment fund was 75 basis points of standard deviation over and above that assumed for the Reference Portfolio. It was expected that the active management strategy that was made possible by this additional risk allowance would enable UTAM to achieve the long-term return needed for each fund. The limit was expressed in terms of a maximum amount of equity exposure, a minimum amount of investment in government bonds, and bands around the permissible

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011 (Cont'd)

allocation to each asset class as stated in the Reference Portfolio. The objective of the bands was to enable UTAM to add value above the return on the Reference Portfolio while avoiding an outcome that was significantly poorer than that of the Reference Portfolio.

(d) Foreign currency exposure. A member recalled that one factor in the underperformance of the University's portfolios in 2008 had been the policy of fully hedging foreign-currency exposure at a time when the Canadian dollar was very strong relative to foreign currencies. The member asked about the current policy for hedging foreign-currency investments. Mr. Moriarty replied that the foreign-currency exposure for the Reference Portfolio was 18.5%. Because of the cost of hedging the 10% exposure to emerging markets, those investments were left unhedged. Therefore only 8.5% of the remainder of the portfolio could be left unhedged, which amounted to about one quarter of the 34% invested in the U.S. and other developed-country markets.

(e) Matching of pension assets and liability. A member observed that the decline in interest rates had the effect of decreasing the rate that could be used to discount the liability of the pension plan, thereby increasing its unfunded liability. Because the actuarial calculation of that liability used averaging, the unfunded liability was likely to increase over the next two or three years, taking in to account the low level of recent interest rates. Was the liability of the plan offset in the portfolio of its assets? Mr. Moriarty replied that UTAM's mandate was defined only in terms of the assets of the funds. He went on to note that the duration of the liability of the pension plan was about fifteen years and that of the fixed-income portion of the asset portfolio was slightly less than eight years. UTAM took the view that the thirty-year bull market in bonds had likely reached its end. (It had been caused by the decline in interest rates and therefore the increase in value of existing bonds issued at higher rates.) Ten-year Government of Canada bonds currently provided a yield of only about 2.2% - which would probably represent a negative real (after inflation) rate of return. Barring a Japan-type deflationary period for the Canadian economy, which was unlikely, it appeared likely that interest rates would increase, reducing the value of the existing bond portfolio. To minimize that risk, UTAM was keeping the bond portfolio relatively small and at a relatively short duration of about eight years. (Existing shorter term bonds would suffer a lesser decline in value than longer term bonds in the event of an increase in interest rates.) Given the asymmetric risk/return relationship of a long-duration bond portfolio, UTAM deemed it reasonable to have the mismatch in the duration of the liability and the bond investments in the context of current market conditions.

(f) Risk measures. A member noted that Mr. Moriarty had acknowledged the insufficiency of reliance on standard deviation over ten years as the sole measure of risk in an investment portfolio. He asked whether other measures of risk would be forthcoming. Mr. Moriarty replied that UTAM had already developed a number of other risk measures, which would be rolled out shortly. It was in the final stage of putting a risk-management system in place, which would be forward-looking in its application. It would project the risk parameters of implementing various changes both to the Reference Portfolio and the actual investment portfolio. Finally, UTAM had also spent a considerable amount of time in testing out the outcome of various problematic

3. Investments: University of Toronto Asset Management Corporation (UTAM) - Annual Report, 2011 (Cont'd)

scenarios to examine the portfolio risk in such situations. UTAM would share the outcome of this work with the Board. The member commented that he was encouraged that UTAM was completing such extensive work on risk controls, and he urged that the controls arrived at be stated in University policy both for the pension fund and the endowment fund.

Ms Brown said that revisions to the Pension Fund Master Trust Statement of Investment Policy and Goals had been approved by the Pension Committee on March 28, 2012. That Policy had specified the objective of a real investment return of at least 4.0% over 10-year periods, while taking an appropriate amount of risk to achieve that target, but without accepting undue risk of loss. That provision replaced the risk limit stating a maximum volatility - a standard deviation of no more than 10% over ten years - which had been in the previous policy. The new policy also defined the asset mix of the Reference Portfolio, and it limited UTAM from assuming risk greater than "the risk determined for the Reference Portfolio plus 75 basis points (0.75%)." It also established minimum and maximum weights for each major asset class. The elimination of the standard deviation requirement opened the way for other options to control risk that could be added to the policy over time.

Ms Brown said that the administration would, likely early in the fall of 2012, propose approval of an amended Investment Policy for University Funds. That Policy would include the return target and risk tolerance for the endowment fund as well as a number of other elements. The amended Policy would also make provision for a small number of new investment funds that would be made available for new donations to the endowment. It would also include changes in the language of certain of its provisions to match that in the amended Pension Fund investment policy.

4. Service Ancillaries Operating Plans

The Chair said that responsibility for the operating plans for the service ancillary operations – the student residences, parking, food and beverage services, and Hart House – resided with the University Affairs Board. That Board had considered and approved the operating plans for 2012-13 at its meeting of March 13, 2012. The Business Board was responsible for the financial policies that set the ground rules for those operations, for example: the requirement that they break even, and that they set aside a reserve fund to deal with unforeseen contingencies. Their plans were before the Business Board at this meeting for information. They were sent to the Business Board to provide a complete overview of the University's financial picture. Ancillary operations formed a significant area of spending and an area of potential financial risk.

Ms Brown observed that collectively this group of operations was moving forward to recover from the high fixed costs associated with growth driven by the large increase in student enrolment and therefore in the population the operations served. The enrolment increase had required a major building program for such facilities as student residences and parking garages. The cost of additional facilities had been met by borrowing with the expectation that over time,

4. Service Ancillaries Operating Plans (Cont'd)

with inflation, the repayment of loans would come to represent a declining proportion of revenue. That had in fact taken place, and the operations were moving back to a break-even or in some cases a surplus situation. The results overall were encouraging.

5. Residential Housing – Operating Results for 2011-12 and Budget, 2012-13

On the recommendation of the Vice-President, University Operations,

YOUR BOARD APPROVED

The operating budget for the St. George Campus Residential Housing Ancillary for 2012-13, as contained in the "2012-13 Budget" column of Schedule 1 to the "Overview of Operations and Business Plan for 2012-2017."

6. Borrowing - Status Report to March 31, 2012

The Board received the status report on borrowing to March 31, 2012. Maximum borrowing capacity was $973.1-million. Borrowing allocated by the Business Board was $970-million (net of $83.3-million of repayments that could be re-allocated). In addition to the actual external borrowing of $724.1-million, internal borrowing outstanding was $168.7-million. Separate internal borrowing capacity had been approved for pension funding in the amount of $150-million, from which a loan in the amount of $112.6-million had been issued on June 1, 2011.

7. Borrowing Strategy: Annual Review

The Chair reminded members that the Board conducted an annual review of the University's borrowing strategy. In addition, it was anticipated that Ms Brown would bring forward a proposal later in the academic year, or in the fall, to revise the borrowing strategy, taking into account the new accounting rules, which would be discussed later in the meeting. The Chair said that he would propose a special committee of the Business Board to work with Ms Brown and her colleagues on this matter, and he would invite two or three members to serve.

Ms Brown said that the annual report was prepared on the same basis as previous years, with comparisons to benchmarks established by the Moody's Fiscal Year 2010 U.S. Public College and University Medians report, issued in July 2011. While the University of Toronto was not included in this U.S. study, it was useful to compare the University's borrowing to that of U.S. universities in similar rating categories. In that comparison, the University of Toronto had borrowed somewhat less than other universities in its category, and it had comparable resources, or slightly better resources, than peers in its category. Those comparisons made sense both to the University and to its credit-rating agencies. The conclusion was that the current amount of

7. Borrowing Strategy: Annual Review (Cont'd)

borrowing appeared to be reasonable. The annual report also dealt with the University's future borrowing capacity, using the current borrowing strategy and the current accounting rules. While undertaking a modest amount of further borrowing appeared to be a reasonable option on the basis of the peer comparisons in the report, the University was very near to the maximum of its permissible capacity according to its current borrowing strategy. That strategy defined maximum borrowing capacity as 40% of the amount of the University's net assets averaged over the past five years. The problem was that the University's net assets, as determined in accordance with current accounting rules, were declining owing to the growth of the unfunded liability for employee future benefits. At this time, however, there was a clear need for additional borrowing to augment donations being sought under the new "Boundless" capital campaign to build the facilities needed to continue the expansion of the University's enrolment and the improvement of the student experience. The new accounting rules, to come into effect for the 2013 financial statements, would lead to the inclusion in net assets of the current value of the University's land, which would in turn lead to a very large increase in borrowing capacity. That outcome might well, however, make it inappropriate to continue to use the current borrowing rule. The University was, therefore, reviewing the current borrowing strategy. Ms Brown and her colleagues had worked closely with the three debt-rating agencies over a long period and understood what kinds of ratios the rating agencies used when evaluating the university sector. The University might well turn to the income statement rather than the balance sheet for an appropriate new rule – perhaps one based on a debt-service ratio. Ms Brown looked forward to input from the members of the Board who would form the special committee to work with the administration in considering the matter. She anticipated that further work on the matter would commence in the fall.

Among the matters that arose in discussion were the following.

- **Interim funding for capital projects**. In response to questions, Professor Mabury said that governance consideration of new capital projects would have to be delayed until the fall, if possible after the approval of the revised Borrowing Strategy. In the interim, the Planning and Budget Office would complete additional analysis concerning the ability of academic divisions to handle debt service – principal repayments and interest on potential new borrowing – for those divisions planning new capital projects that would rely on some borrowing. In the interim, it would also be possible to sort out priorities for fundraising for capital projects and to obtain some better indication of the success of the initial stages of that fundraising. For particular capital projects, the administration did have the authority to approve up to $2-million of spending for purposes of planning and engaging architects and other consultants. By way of example, the Faculty of Law was proceeding with the planning of its capital project, using approval of spending under this authority.

- **Characteristics of the new strategy**. Ms Brown stressed the importance of taking the time to ensure that the proposal for a new Borrowing Strategy was a solid one. It was important that the new strategy avoid unpredictable changes in capacity such as the current change caused by

7. Borrowing Strategy: Annual Review (Cont'd)

the decline in the financial-statement value of net assets. It was also important that the new strategy be an enduring one. The credit rating agencies and the brokers appreciated the discipline imposed by a strategy that did not change frequently.

- **Implementation of the new strategy**. In response to a question, Ms Brown said that the proposed new strategy could become effective immediately upon its approval. It would not have to await the commencement of a new fiscal year.

- **Comparisons to other Canadian universities**. A member observed that the report now before the Board emphasized comparisons to public universities in the U.S. Would the planned new Borrowing Strategy and future reports include comparisons to other Canadian universities? Ms Brown replied that the University of Toronto had been the first to establish a borrowing program, and many other Canadian universities had followed its lead. As a result, Canadian programs were highly influenced by this University's programs. Therefore, a more appropriate comparison was provided by U.S. public universities, whose programs were not influenced by this University's model. Borrowing programs in the U.S. had, in addition, been in place for a much longer period of time. Nonetheless, the University had information on other universities in Ontario although not others nation-wide. In developing its new Strategy, this University would certainly look into metrics at other Ontario universities, and perhaps others in Canada.

- **The new annual report to the Business Board**. Ms Brown said that the new annual report to the Business Board, after the approval of a new strategy, would be amended to correspond with the terms and requirements of the new strategy.

8. Financial Statements: Impact of the New Accounting Rules

Ms Kennedy reported that the Audit Committee, at its meeting of March 21, 2012, had received a report from Mr. Piché on the impact of the new accounting rules, which would be applied beginning with the financial statements for the 2012-13 fiscal year. The Committee had found the paper on the subject and the presentation to be excellent ones. Ms Brown thanked Mr. Piché for his work on appropriate options for applying the new accounting rules. He had provided leadership not only within the University but also across the university sector in Ontario and nationally in an effort to gain as much consistency as possible among universities in their application of the new accounting policies.

Mr. Piché presented his paper on the impact of the new accounting rules on the University's financial statements, beginning with those for the year ending April 30, 2013. He recounted the history of discussions on the matter, which had begun in 2008. The University sector had decided not to adopt the new International Financial Reporting Standards, which did not provide a suitable framework for not-for-profit organizations. Rather, the University would adopt the rules in Part III of the Canadian Institute for Chartered Accountants Handbook, which

8. Financial Statements: Impact of the New Accounting Rules (Cont'd)

dealt specifically with accounting standards for not-for-profits. Where Part III did not provide guidance, the University would use Part II of the Handbook, which set out standards for private enterprises. Unfortunately, not all universities in Canada were able to adopt those standards. Where universities were controlled by their provincial governments, and where their financial results were incorporated into the Provinces' financial statements, the universities would have to adopt the rules in the Public Sector Accounting Handbook. As a result, there would no longer be comparability among all Canadian universities. They would, however, continue to produce other financial reports, which they would share with each other, using common accounting standards, enabling comparisons in at least some key areas. Among the highlights of Mr. Piché's presentation were the following points.

- **Employee future benefits**. The University currently accounted for the cost of providing future benefits to employees (pensions and other benefits) using a deferral and amortization approach. The cost of providing such benefits for active employees for their year's work was amortized and recognized on the statement of operations (income statement) over fourteen years – the average future service life of active employees. While that approach was familiar and enabled smoothing of gains or losses in the statement of operations, the University had decided against continuing to use that approach. Instead, it would exercise the option to start fresh, to write off the full cost of providing employee future benefits that had already been incurred, and - going forward - to recognize that cost fully in the financial statements each year. Using this immediate-recognition approach would have several benefits. The first was that the University would be permitted to use the same long-term interest rate assumption in valuing its liabilities for the University's financial statements as that used in determining its funding obligation for the pension-plan statements. With the deferral and amortization method, the University would be required to continue to use the current long-term corporate bond rate to value the liabilities. Second, using the same rate assumption for the financial statements as used for the calculation of required pension-plan funding would bring the University's financial statements and those of its pension plans into closer alignment. Third, it was very likely that the immediate recognition approach would in any event likely be required in 2015. That approach was included in a recent exposure draft of accounting rules from the Canadian Institute of Chartered Accountants and in a proposal concerning international standards. Fourth, the immediate-recognition approach would increase the transparency of the financial statements. The financial position of the University at any year-end would be clear to the reader without reference to the detail in the notes. Finally, it would be possible to write off the sudden increase in the cost of employee benefits in the financial statements against the increase in the value of the University's net assets, arising from the proposed inclusion of the current value of the University's lands in its balance sheet (see below). There would be one disadvantage to the approach: there would be the risk of significant fluctuation in the statement of operations arising from the immediate recognition of the cost of employee future benefits, calculated on the basis of changing long-term interest rates. Mr. Piché noted that four Ontario universities had already decided to move to the

8. Financial Statements: Impact of the New Accounting Rules (Cont'd)

immediate-recognition method. The remainder had not yet made their decision, pending discussions based on the University of Toronto paper, now before the Board. In response to a question, Ms Brown and Mr. Piché said that, with respect to the University's financial statements, the Government of Ontario did not require a consistent basis of accounting among the Ontario universities. The Government received another financial report from the Universities – the Council of Finance Officers Report - prepared on a cash basis, to meet Government reporting needs.

- **Valuation of capital assets**. The University would have, and intended to adopt, the option of valuing its land at its fair market value. After exercising that one-time-only option, the new valuation would remain on the University's books in perpetuity. The outcome would be a much better picture of the value of the University's assets. The land was currently carried on the University's books at its cost – an amount of $76-million. The impact of using the current valuation would be very substantial, increasing the valuation by $2.085-billion. The disadvantage of adopting the option was potential misunderstanding by some readers of the financial statements. The value did not represent cash that was available for spending. One outcome of valuing the land at its current fair value would be the need to re-examine the University's borrowing policy, which limited borrowing to 40% of net assets. Mr. Piché noted that a significant number of universities had stated their intention of adopting this option.

- **Impact of the changed accounting rules**. The increase in the liability for accrued employee future benefits would amount to $926.4-million. The increase in the valuation of capital assets would be $2.085-billion. The effect of a third change involving the valuation of financial assets would be an increase in the value of investments of $1.1-million. The total impact would be an increase in the value of net assets of $1.159-billion.

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

(a) Selection of options for the new accounting rules. A member asked if there had been any indication of "cherry picking" among the universities in the adoption of the new accounting rules, for example recognizing gains in the value of land assets while at the same time not recognizing increases in the liability for employee future benefits. Mr. Piché replied in the negative. Most universities, like the University of Toronto, sought simply to take advantage of the opportunity presented by the new rules to clean up their balance sheets without damage to their net assets, balancing the increase in the financial-statement liability, caused by the immediate recognition of the full cost of employee future benefits, with the increase in the financial-statement valuation of land assets.

(b) Governance approval. In response to a question, Ms Brown said that the current report was for information. The financial statements for 2013 and thereafter would be prepared in accordance with the new accounting rules and would be submitted to the endorsement of the

8. Financial Statements: Impact of the New Accounting Rules (Cont'd)

Audit Committee and the Business Board and the approval of the Governing Council. If any other matters arose until that time, the administration would report further to the Audit Committee and the Business Board.

Ms Brown concluded that the proposals represented a reasonable package. There were necessarily some trade-offs, but the outcome would be beneficial. The new rules presented the opportunity to present financial statements for the University and for its pension plans on the basis of the same accounting rules. While some differences would remain, they would arise largely as a result of the differing fiscal years: the University's fiscal year ending on April 30 and the pension-plan year on June 30. In addition all assets and liabilities would be reflected consistently on the balance sheet, reducing confusion.

9. Capital Projects Report as at March 31, 2012

The Board received for information the regular report on capital projects as at March 31, 2012. It reported on the progress of ten approved projects under construction for an estimated total construction cost of $288.31-million and a further seventeen projects that were occupied but not formally closed, costing a total of $210.25-million. Professor Mabury noted that construction of the Goldring Centre for High-Performance Sport and the renovation of the North Building at the University of Toronto Mississauga were about to begin. Construction of the new building for the Rotman School of Management had been completed and had just been occupied. The design of the building had proven to be very successful.

10. Date of Next Meeting

The Chair reminded members that the Board's next regular meeting was scheduled for Thursday, May 3, 2012 at 5:00 p.m. The main theme of the meeting would be the annual report of the Vice-President, Human Resources and Equity. It was also anticipated that a proposal for a revised funding strategy for the pension plan would be presented.

THE BOARD MOVED *IN CAMERA*

11. Human Resources: Confidentials and Professional/Managerial Staff at Levels 1 to 4 - Job Evaluation and Salary Range Market Adjustments

Professor Hildyard said that the proposal to adjust the salary ranges of members of the professional/managerial staff at levels 1 - 4 and of confidential staff arose as the result of the major job evaluation program that was on-going for other members of the administrative staff who were represented by the United Steelworkers union. As a consequence of adjustments to salary ranges for unionized staff, made in many cases to achieve pay equity, anomalies had developed with respect to the salary ranges of the lower levels of professional, managerial and confidential staff, some of whom performed identical or very similar functions but were not represented by the union. (They were not

11. Human Resources: Confidentials and Professional/Managerial Staff at Levels 1 to 4 - Job Evaluation and Salary Range Market Adjustments (Cont'd)

represented primarily because of the areas they worked in.) The University had engaged external consultants to assist in ensuring internal equity in such cases. While the total cost of increasing the mimima of the salary ranges was not great – about $44,000 per year – the benefit of so doing was very important in terms of fairness to the employees involved. Nothing in the Province's budget would preclude this adjustment for these levels of the professional / managerial and confidential staff.

On the recommendation of the Vice-President, Human Resources and Equity,

YOUR BOARD APPROVED

The job evaluation and salary-range market adjustments for Confidentials and Professional / Managerial Staff at levels 1 to 4, as proposed in Professor Hildyard's March 21, 2012 memorandum to the Business Board.

12. Canadian Union of Public Employees, Local 3902, Unit 1 (Teaching Assistants) - Collective Agreement, May 1, 2011 – April 30, 2014

Professor Hildyard reported on the settlement with local 3902 (Unit 1) of the Canadian Union of Public Employees, which represented the University's teaching assistants. She noted that while the cost of the salary increases was somewhat higher than for other groups, the outcome represented in substantial part an effort to increase financial support for the University's graduate students, which was a very important University objective.

13. Closed Session / In Camera Reports of the Administrative Assessors

Professor Hildyard reported on (a) the progress of negotiations with the Faculty Association, and (b) steps taken to improve occupational health and safety in one of the University's buildings.

THE BOARD RETURNED TO OPEN SESSION

The meeting adjourned at 7:00 p.m.

______________________ Secretary

______________________ Chair

April 26, 2012