UNIVERSITY OF TORONTO

THE GOVERNING COUNCIL

REPORT NUMBER 7 OF

THE PENSION COMMITTEE

Wednesday, March 28, 2012

To the Governing Council,
University of Toronto.

Your Committee reports that it held a meeting on Wednesday, March 28, 2012 at 5:00 p.m. in the Council Chamber, Simcoe Hall, with the following members present:

Mr. W. John Switzer, In the Chair
Professor George Luste, Vice-Chair
Professor C. David Naylor, President of the University
Mr. Donald Andrew
Professor Laurence Booth
Professor Ettore Vincenzo Damiano
Ms Nancy Edwards
Mr. Thomas Finlay
Ms Shirley Hoy
Mr. Alex McKinnon
Mr. Gary Mooney
Mr. Philip Murton
Ms Jane Pepino
Ms Helen Rosenthal
Mr. Keith Thomas
Mr. W. David Wilson

Non-Voting Assessors:

Ms Sheila Brown, Chief Financial Officer
Professor Angela Hildyard, Vice-President, Human Resources and Equity
Professor Scott Mabury, Vice-President, University Operations

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

Secretariat:

Ms Cristina Oke, Acting Secretary

Regrets:

Mr. Steve (Suresh) K. Gupta
Ms Melinda Rogers
Mr. Howard Shearer
Ms Rita Tsang
Mr. Andrew Ward

In Attendance:

Mr. Michel Malo, Managing Director, Asset Allocation & Portfolio Strategy, University of Toronto Asset Management Corporation (UTAM)
Mr. Geoff Matus, Chair, President's Investment Advisory Committee
Mr. William W. Moriarty, President and Chief Executive Officer, UTAM
Mr. Alan Shapira, Plan Actuary, AON Hewitt

Chair's Remarks

The Chair welcomed Professor Mabury to his first meeting as a non-voting assessor, replacing Ms Cathy Riggall, Vice-President, Business Affairs. He also welcomed Mr. Matus to the meeting.

The Chair thanked the members who were able to attend the Information Sessions held on March 13 and 15, 2012.

The Chair congratulated Professor Luste on his election as Chair of the Committee, effective July 1, 2012. Professor Luste thanked members for their support and said he welcomed input and advice from Committee members. It was noted that the Chair had been acclaimed as Vice-Chair, effective July 1, 2012.

1. Public Sector Pensions

At the invitation of the Chair, Mr. Shapira summarized the Ontario government's plans to ensure the sustainability and affordability of public sector pensions that had been included in the provincial budget released on March 27, 2012. [1]

- ***Jointly Sponsored Pension Plans***
  - the government would consult with its partners to develop a legislative framework involving the following parameters:
    - In case of a deficit, plans would be required to reduce future benefits or ancillary benefits before further increasing employer contributions.
    - In exceptional circumstances, a limit would be set on the amount or value of benefit reductions before additional contribution increases could be considered.
    - Any benefit reductions would involve future benefits only, not those that had already been accrued. Current retirees would not be affected.
    - Where employee contributions were currently less than employer contributions, increased employee contributions would also be available as a tool to reduce pension deficits.
    - Where plan sponsors could not agree on benefit reductions through negotiation, a new third-party dispute resolution process would be invoked.
    - The framework would be reviewed after the budget was balanced.

- ***Single-Employer Public Sector Pension Plans***
  - The government expected that single-employer public sector pension plans would move to a 50–50 cost sharing formula for ongoing contributions within five years.
  - Building on the temporary solvency relief measures already in place, the government would create additional incentives for plans to move to equal contribution-sharing.
  - Employers would continue to be responsible for plan deficits.

- ***More Efficient, Effective Pension Asset Management:***
  - The government intended to introduce framework legislation in the fall of 2012 that would pool investment management functions of smaller public sector pension plans in Ontario.
    - Under this framework, management of assets could be transferred to a new entity or to an existing large public sector fund.

[1] http://www.fin.gov.on.ca/en/budget/ontariobudgets/2012/bk2.html

2. Report of the Previous Meeting

Report Number 6 (December 14, 2011) of the Pension Committee was approved.

3. Business Arising from the Report of the Previous Meeting

a) Pension Solvency Relief

Ms Brown informed the Committee that the University's application for Stage 1 Temporary Solvency Funding Relief had been approved. This provided budget stability for the current year and the next three years, absent any plan changes that would trigger an actuarial valuation of the Pension Plans before the next required valuation at July 1, 2014.

b) Follow-up to December 14, 2011 Motion passed by Pension Committee [2]

The Chair reminded members that the report requested in the motion of December 14, 2011 had been presented at the information session held on March 15, 2012. A brief presentation would also be presented as part of agenda item 5.

4. Actuarial Reports

The Chair explained that the Committee was responsible for approving the actuarial valuation of the pension plans. The deadline for filing these reports with the Financial Services Commission of Ontario (FSCO) was March 31st.

Ms Brown reminded members that the figures in the reports had been approved by the Committee at its meeting of December 14, 2011. Mr. Shapira added that the figures in these reports were presented in the format required by FSCO, and had been reconciled with the figures of the July 1, 2008 actuarial valuation of the pension plans, which had been the last valuation filed with the regulator.

A member asked whether the figures in the History of Accrued Liability and Surplus/(Deficit) represented the solvency or going concern value of the pension plans. Mr. Shapira replied that the figures reflected the going concern value of the pension plans.

The member asked about the revised practice-specific standards referred to on page 10 of the Actuarial Report (*Report*). Mr. Shapira replied that the Canadian Institute of Actuaries (CIA) had introduced new standards effective December 31, 2010. Included in the revised standards was the requirement that the valuation report disclose the impact on the Accrued Liability and the Total Current Service Cost of using a discount rate 1.00% lower than that used for the Going Concern Valuation.

The member noted that footnote 5 on page 16 of the *Report* referred to a change in the smoothing method, and suggested a description of the change would have been informative.

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[2] It Was Resolved
THAT, in preparation for an information session to be held prior to the next meeting of the Pension Committee with the Pension Committee, the President's Investment Advisory Committee, and any experts that the University of Toronto Faculty Association (UTFA) or other committee members wish to invite, the University of Toronto Asset Management Corporation (UTAM) be asked to prepare an information report for a range of scenarios regarding:
i) the expected return and cost advantages and or disadvantages of moving to a much simpler, less costly investment portfolio with varying degrees of reliance on passive management rather than active management; and
ii) the potential transition costs and realistic timetables that would be involved in moving to such portfolios.

4. Actuarial Reports (cont'd)

The member asked about the Experience of the Pension Plans from July 1, 2008 to July 1, 2011. Mr. Shapira explained that the Experience section of the *Report* reconciled the Going Concern Surplus/(Deficit) over the three years and provided explanations for various assumptions.

A member asked what effect a 2 year wage freeze would have on the valuation of the pension. Mr. Shapira replied that if actual salary increases were less than the increases that had been assumed, there would be an actuarial gain in the valuation.

On motion duly made, seconded and carried

It was Resolved

a) THAT the actuarial report for the University of Toronto pension plan as at July 1, 2011, attached as Appendix A to the memorandum from the Chief Financial Officer dated March 9, 2012, be approved;

b) THAT the actuarial report for the University of Toronto (OISE) pension plan as at July 1, 2011, attached as Appendix B to the memorandum from the Chief Financial Officer dated March 9, 2012, be approved; and

c) THAT the actuarial report for the Supplemental Retirement Arrangement as at July 1, 2011, attached as Appendix C to the memorandum from the Chief Financial Officer dated March 9, 2012 be approved.

5. University of Toronto Pension Fund Master Trust Statement of Investment Policies and Goals

Chair's Remarks

The Chair reminded members that the Committee was responsible for approving at least annually the Statement of Investment Policies and Goals (SIP&G) for the Pension Fund Master Trust (PMT). The Statement had to include return objectives, normal risk tolerance, asset allocation and benchmarks for the evaluation of performance.

The Chair explained that the information sessions held on March 13 and 15 had been intended to provide members with context and background information in preparation for consideration of this item. Once the Committee had approved this Statement of Investment Policy and Goals, the University of Toronto Asset Management Corporation (UTAM) could proceed with implementing the proposed asset allocation.

Introduction

Ms Brown informed members that the content of the SIP&G was determined in large part by regulation. The proposed policy consolidated two previous policies. [3] The Pension Committee had approved the return and risk objectives at its meeting of October 18, 2011. The asset allocation to meet the return and risk objectives had been included in the SIP&G.

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[3] The *University of Toronto Pension Fund Master Trust Investment Policy* (December 14, 2009) and the *University of Toronto Asset Management Corporation Pension Fund Master Trust Investment Policy* (March 23, 2011)

5. University of Toronto Pension Fund Master Trust Statement of Investment Policies and Goals (cont'd)

Presentation

At the invitation of the Chair, Mr. Malo and Mr. Moriarty made a brief presentation summarizing the key points of the proposed asset allocation model. Highlights of the presentation included the following:

Investment Policy Decision

- It had long been established that 'asset allocation policy' was the principal determinant of a fund's long-term investment performance, explaining about 90% of return variability.
- The major decision underlying the choice of an 'asset allocation policy' for a pension fund was the 'policy' exposure to major asset classes under the two broad headings of equity and debt. Most other so-called asset classes could be viewed as mainly different forms of debt and/or equity exposure.

Reference Portfolio

- The 'Reference Portfolio' (sometimes called a Policy Portfolio) was intended to embody the fund owner's long-term investment objectives and risk tolerances.
- Objectives (giving due consideration to the fund's liability structure and funded status) should be specified in terms of expected return and risk.
- Given specific objectives, various Reference Portfolio asset mixes could be developed, tested and discussed.
- The asset classes used and ultimate asset mix chosen should be easily implementable using a low cost passive investment program.
- Performance of this portfolio over any shorter-term period (1-year, 4-years,etc) would normally deviate somewhat from the long-term objectives (for both return and risk), but would generally reflect Capital Markets return then available. Over the long-term, however, this portfolio could reasonably be expected to meet the fund owners' objectives with respect to return and risk.
- Defined in this manner, the Reference Portfolio provided an objective measure of return and risk against which alternative portfolios and an 'active' management approach could be evaluated on a regular basis.

Recommended Reference Portfolio

Asset Class	Allocation	Minimum Weight	Maximum Weight	Benchmark	Current Portfolio
Equity					
Canadian	16.0 %	11.0%	21.0%	S&P TSX Composite Total Return Index	17.6%
				S&P 500 Total Return Index	
US	18.0%	13.0%	23.0%	MSCI EAFE Total Return Index (Net)	24.2%
EAFE	16.0%	11.0%	21.0%	MSCI Emerging Markets Total Return	21.0%
Emerging Markets	10.0%	5.0%	15.0%	Index (Net)	2.2%
TOTAL EQUITY	**60%**	**50%**	**70%**		**65.0%**
TOTAL CREDIT	**20%**	**10%**	**25%**	DEX Investment Grade Bond Index	**18.3%**
RATES	**20%**	**10%**	**30%**	DEX Government Bond Index	**6.7%**
OTHER	**0%**	**0%**	**15%**		**10.0%**
GRAND TOTAL	**100%**				**100%**
CURRENCY	**18.5%**	**5.0%**	**25.0%**		

5. University of Toronto Pension Fund Master Trust Statement of Investment Policies and Goals (cont'd)

President's Investment Advisory Committee
At the invitation of the Chair, Mr. Matus described the work of the President's Investment Advisory Committee (PIAC). He informed members that the Committee had spent a lot of time with management of UTAM to develop a reference portfolio. The final decision had been unanimous. Mr. Matus emphasized the amount of time and effort that members of PIAC had committed to the University.

Passive Management with Active Management Overlay
- The President's Investment Advisory Committee (PIAC) and the Administration had concurred with UTAM and had recommended the adoption of a limited 'active' management approach for the Portfolio.
- In recommending this approach a key consideration was to ensure that UTAM had sufficient flexibility to achieve the value-added objective but that changes made to the portfolio did not result in the assumption of a level of risk that would put the Fund's assets at undue risk of loss relative to the Reference Portfolio.
- The most important constraint on active management decisions was establishing the level of 'active' risk allowed and thus the total risk limit for the portfolio.
- PIAC and the Administration believed that a Fund-level risk limit equal to that of the recommended Reference Portfolio plus 75 basis points (i.e., 12.5% based on current assumptions) represented a prudent constraint.

Discussion
A member asked if the Committee would approve the SIP&G every year. Ms Brown replied that the Committee was responsible for reviewing the policy each year. Changes would be made if necessary and appropriate.

A member requested that the annual report from UTAM include a clear report of whether the benchmarks in the Reference Portfolio had been met. Mr. Moriarty commented that the Committee needed to agree on a framework for reporting so that UTAM could develop an appropriate report. The Chair proposed that the core item on the agenda at the June 6, 2012 meeting be governance. A member cautioned the Committee to be aware of their role, which was to govern, not to manage.

A member asked how the decision was made for a 60:40 ratio of equity to debt, rather than a 70:30 ratio. Mr. Moriarty replied that various asset mixes had been examined with a focus on the risk of downside. The member asked what guidance the University had provided during the consideration of asset mixes. Ms Brown reminded members of the work that had been done to decide upon a 4% target return. A lower target return would have resulted in the need for increased pension contributions. Mr. Shapira commented that while assets could be smoothed over a shorter term on a going-concern basis of pension valuation, in the longer term, poor investment returns would require higher levels of contributions.

A member stated that members had a fiduciary responsibility to plan members. The President agreed that the obligation was to plan members. The return and risk targets had been arrived at through careful analysis, and were prudent.

Professor Luste Presentation

Professor Luste distributed a set of slides entitled *UTAM Pension Investments and Related Issues* to members. He suggested that the following issues should concern members of the Pension Committee:
i) Transparency of investments and assets. Do we know where pension funds are invested?
ii) Complexity of investments. Do we really understand how assets are invested?
iii) Validity of valuations for illiquid assets.
iv) Investment cost issues. Why are UTAM unit costs so high? Costs raise the bar on required returns.
v) Investment management people issue.

5. University of Toronto Pension Fund Master Trust Statement of Investment Policies and Goals (cont'd)

Professor Luste Presentation (cont'd)

Professor Luste recommended that approval of the SIP&G be deferred to the June 6, 2012 meeting of the Pension Committee.

He expressed his view that emerging markets were incredibly volatile and voiced his concern at their inclusion in the Reference Portfolio asset classes. Mr. Moriarty noted that the proposed allocation to equity in emerging markets had the lowest weighting of the asset classes because of their volatility. However, the realistic rate of growth in developed markets was 2-3%, while emerging markets could grow at 5-6%.

Professor Luste remarked that, in his view, the Pension Committee was expected to take direction from PIAC, but members had not been involved in the selection of members of PIAC. The President noted that three members of PIAC had attended the information session on March 15, 2012, and that Mr. Matus had been present at this meeting of the Pension Committee.

The Chair noted that PIAC members provided advice to the President, and had no governance role. The role of the Pension Committee was to consider recommendations brought forward by the administration, assess the work that had been done in developing the recommendations, and accept, reject or refer back those recommendations.

A member commented that he appreciated the different views expressed by other members. In his view, the recommendations included in the SIP&G were appropriate. In June, the Committee could discuss the reports that it would like to receive to monitor investment performance.

A member stated that the Pension Committee was a governance body. After attending both information sessions, the member believed that the documentation provided to the Committee had been appropriate. She encouraged the Chair to incorporate material from the information sessions and from the first orientation for members of the Committee into the discussion of governance at the June meeting.

Professor Luste explained that the intention of his presentation and comments was to raise questions to increase his understanding of pension and investment issues. Members acknowledged the sincerity of his efforts.

On motion duly made, seconded and carried

It was Resolved

THAT the Pension Fund Master Trust Statement of Investment Policies and Goals, attached as Appendix A to the memorandum from the Chief Financial Officer dated March 13, 2012, be approved, replacing the Pension Fund Master Trust Investment Policy dated December 14, 2009.

6. Annual Financial Report for the University of Toronto Pension Plans for the Year Ended June 30, 2011

The Chair reminded members that the Committee was responsible for approving an annual financial report on the pension plans.

6. Annual Financial Report for the University of Toronto Pension Plans for the Year Ended June 30, 2011 (cont'd)

Ms Brown explained that the financial report for the pension plans consolidated, and placed in historical perspective, information on the funded status of the pension plans, the plan liabilities (including participants, benefit provisions and assumptions) and plan assets (including contributions, investment earnings, fees and expenses and payments to pensioners). Included in the report were extended graphs displaying information year by year from 1983 to 2011.

On motion duly made, seconded and carried

It was Resolved

THAT the Pension Committee approve the Pension Annual Financial Report for the Year Ended June 30, 2011, attached as Appendix A to the memorandum from the Chief Financial Officer dated March 16, 2012.

7. Assessors' Reports

Professor Hildyard reported that a survey on communication issues had been proposed.

8. Date of the Next Meeting

Members were reminded that the next regular meeting of the Pension Committee was scheduled for Wednesday, June 6, 2012 at 5:00 p.m. The Chair advised members that there was a convocation ceremony starting at 2:30 pm that afternoon so parking would be limited.

9. Other Business

There was no other business.

The meeting adjourned at 7:05 p.m.

Acting Secretary Chair

May 23, 2012