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To: Governing Council Business Board Members

From: George Luste, President, University of Toronto Faculty Association (UTFA) and Professor, Physics Department, University of Toronto

Re: **Agenda item #7 - Pension Plans: Ensuring a Sustainable Pension Plan for the University of Toronto**[1]

The 5-minute time limit means I can only comment selectively on the 19-page report presented by the Administration to the Business Board.

Issue #1 – comparisons, economic downturns and investment returns

On page 3 the Administration states:

> "First, it should be understood that the University is not the only institution facing a pension problem. … the result of the economic downturns that have occurred …"

Response:

Many pension plans and investments have bounced back from the 2008 decline in equity markets[2]. UofT investments have not. For perspective, the following table compares the recent investment returns of the Healthcare of Ontario Pension Plan (HOOPP) to the UofT plan.

	2009	**2008**
HOOPP	+15.7%	-12.0%
UofT RPP	+5.4%	-29.5%
Difference	-9.8%	-17.5%

The UofT pension plan lost about $900 million in 2008. HOOPP recovered its 2008 losses in 2009 and by the end of 2009 was 102% funded. There has been no similar investment recovery in the UofT plan. Instead today we face a staggering solvency deficit problem of over $1 billion.

Until the UofT investment oversight problem is fixed it is difficult to have any confidence in the solvency payment plans and extrapolations presented in the Administration's report.

[1] The 19-page report Ensuring a Sustainable Pension Plan for the University of Toronto January 2011 is posted at http://www.governingcouncil.utoronto.ca/AssetFactory.aspx?did=7486

[2] While the Canadian equity index TSX lost -33.0% in 2008, it regained +35.1% in 2009 and another +17.6% in 2010.

Issue #2 – employee contribution increases are "key" to solvency relief

On page 3 the Administration states:

> "The Ontario Government has recently agreed that universities should be given flexibility regarding Solvency Deficits. Provided that the University meets certain metrics, key among which is a negotiated agreement from employees to increase their contributions …."

Response:

I don't believe this is accurate. In the meeting I attended with senior MTCU and Ministry of Finance officials (together with representatives from OCUFA and other unions) to discuss university pension issues, the metrics discussed were not ranked or weighted. There was no "key" metric. Besides, the increased contribution rate discussion is for future service costs only, for future sustainability; it is not intended to deal with the legacy deficit issue.

Issue #3 – current pension benefits warrant a higher contribution

On page 9 the Administration states:

> "… the current benefit levels require a higher level of contribution into the plan."

Response:

This is incorrect. Arbitrator Martin Teplitsky was asked to consider this issue in detail during the recent round of negotiations and found no substantial basis to the Administration's claim that "*the current benefit level requires a higher level of contribution into the plan*". UTFA presented data showing that the annual pension service cost ratio for employer to employee today was less than it was in the past. That is, today the employee is already paying a higher proportion of the total contribution into the plan than was the case in the past.

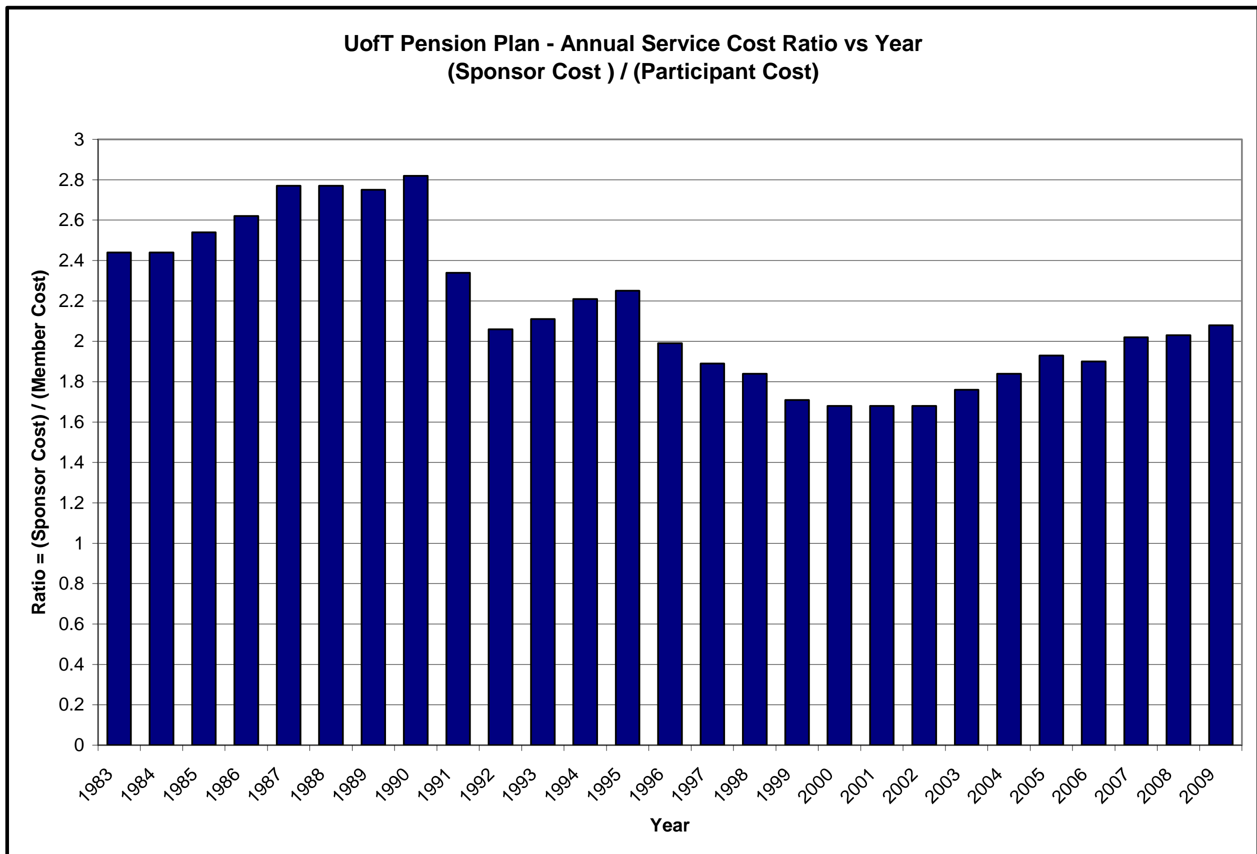
At the time of the 1987 pension agreement the service cost ratio was 2.77, that is, the Administration was supposed to contribute $2.77 to the plan for every $1.00 contributed by the member. At that higher ratio the Administration never claimed a higher contribution proportion was necessary by plan members. Why now?

At about the same time the Administration was taking numerous contribution holidays, neither putting their share of the service cost into the pension plan nor setting it aside in a reserve account. Yet, they also affirmed their responsibility for contributions in the following words:

> "Under the University of Toronto Pension Plan, the pension promise is funded by both the participants and the University. The participant contributions are determined by a specific formula. The balance of the cost of funding the pension promise is the sole responsibility of the University. In other words, the University bears the risk of fulfilling that pension promise and must manage that risk prudently. The pension promise has a very long time horizon. At various times over that time horizon, due to

economic and demographic circumstances, the university's funding to meet the pension promise may be quite high – as it was for the period prior to 1987 when the University contributions were 2 -2½ times participant contributions. At other times, the economic and demographic circumstances may result in lower contribution levels, as has been the case since 1987. The pendulum can easily swing either way…. Whatever the funding level, the pension promise does not change."

The following chart illustrates the ratio of the two service costs[3], from 1983 to 2009:



To repeat, the data clearly shows that today the Sponsor's share (i.e University's share) of the annual go-forward pension benefit cost is less than it was prior to 1995. There is no evidence in the report to substantiate the Administration's claim that the "current benefit levels require a higher level of contribution". Furthermore, the distribution of cost is a labour relations issue and not a pension financing issue[4].

[3] Please keep in mind that while this chart shows the ratio of the annual service costs, as determined by the plan actuary, what was actually contributed to the plan each year could be quite different given the many contribution holidays,.This chart shows the ratio of contributions that should have been made on a yearly basis.

[4] On this issue, late retirements, after age 65, will benefit the plan's finances as the eventual pension payments will be for fewer years (on average). That is, the faculty member's return on his/her lifetime cumulative pension contributions are reduced if he/she decides to retire after age 65.

Issue #4 – the 1:1 funding ratio vs the current 2:1 ratio

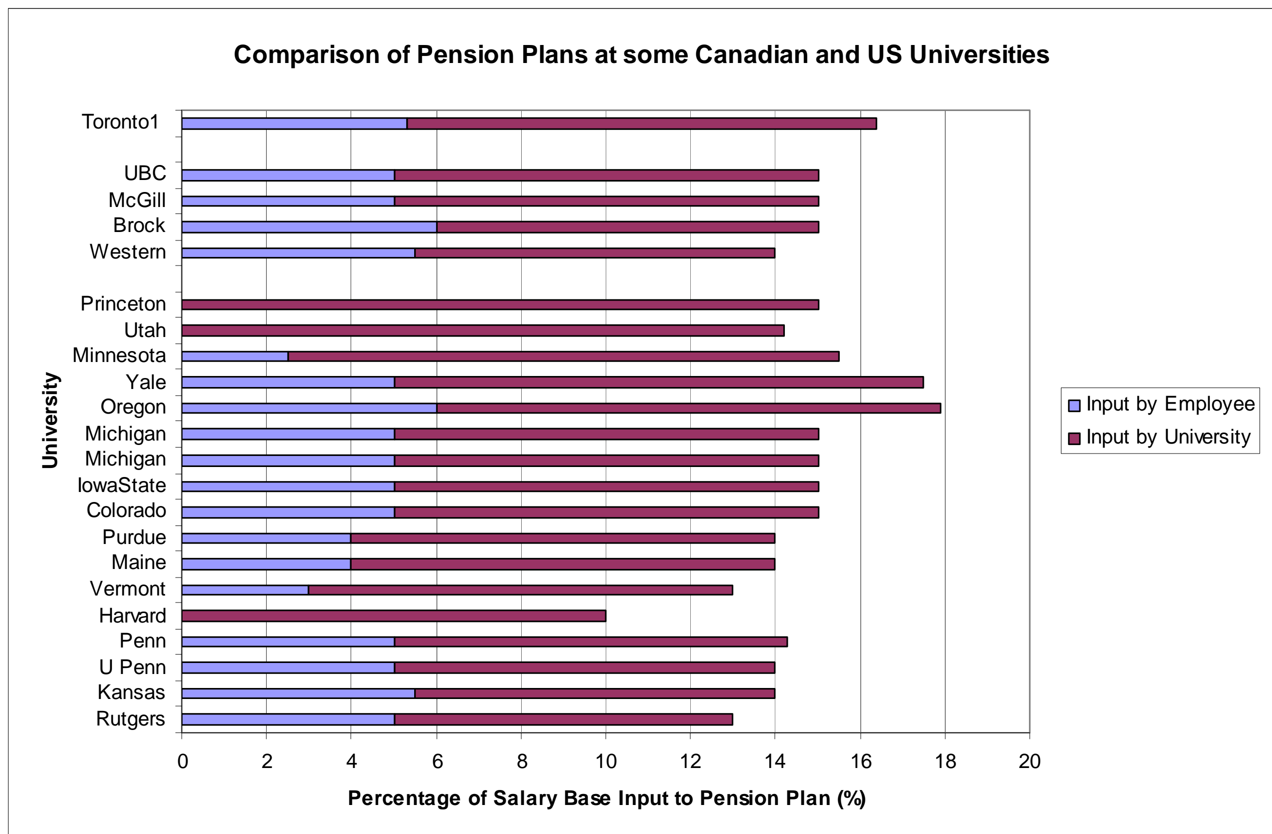
On page 17 the Administration states:

> "The Government believes that a more appropriate funding ratio going forward is a 1:1 current service contribution model with the employee and employer each supplying half of the required current service contribution."

Response:

UTFA and the Administration have a joint responsibility to point out to the Government that a 1:1 ratio is not a viable norm for faculty at an internationally competitive university. It would seriously handicap future recruiting efforts at UofT. Faculty need to invest many years in PhD and post-doctoral research before they start earning a modest salary. Many faculty start their tenure stream appointments as assistant professors in their 30's. This shortens the span of years in which funds can be set aside for retirement. In addition, the shortened span of yeas significantly reduces gains from the compounding benefit of returns on investments. Hence, the appropriateness of a 2:1 funding ratio for faculty.

The following chart illustrates the current funding ratio for some peer universities:



In summary, UTFA would endorse and support the Administration's desire to extend the solvency amortization period from five years to ten years, but <u>not</u> at the cost of a 1:1 service contribution ratio. The present 2:1 ratio is both justified and necessary for faculty. It is also in line with faculty pension benefits at competing peer universities.

In 2001, as a novice VP at UTFA I wrote my first UTFA Newsletter on pensions, *The UofT Pension Plan: Is it Competitive? Is it Equitable?,* which concluded that the University was not contributing its fair share to the pension cost. See attached Appendix A for a copy of this newsletter from almost ten years ago.

Issue #5 –longer term fundamental issues

Concluding Thoughts:

This memo comments on only some of the issues and statements in the Administration's report that should be challenged and questioned. Perhaps the forthcoming Pension Committee meetings will provide more time for debate and discussion.

The Administration's report understandably focuses on how to manage the anticipated funding of the solvency deficit as it comes due on July 1, 2011. At the same time there are additional longer term issues that need to be discussed and addressed. These issues concern pension governance, effective oversight of pension investments, improved plan administration and enhanced communication with plan members.

Appendix A

The UofT Pension Plan:

Is it competitive?   Is it equitable?

UTFA Information Report #2

October 12, 2001

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UTFA Information Report

University of Toronto Faculty Association October 12, 2001

Information Report #2

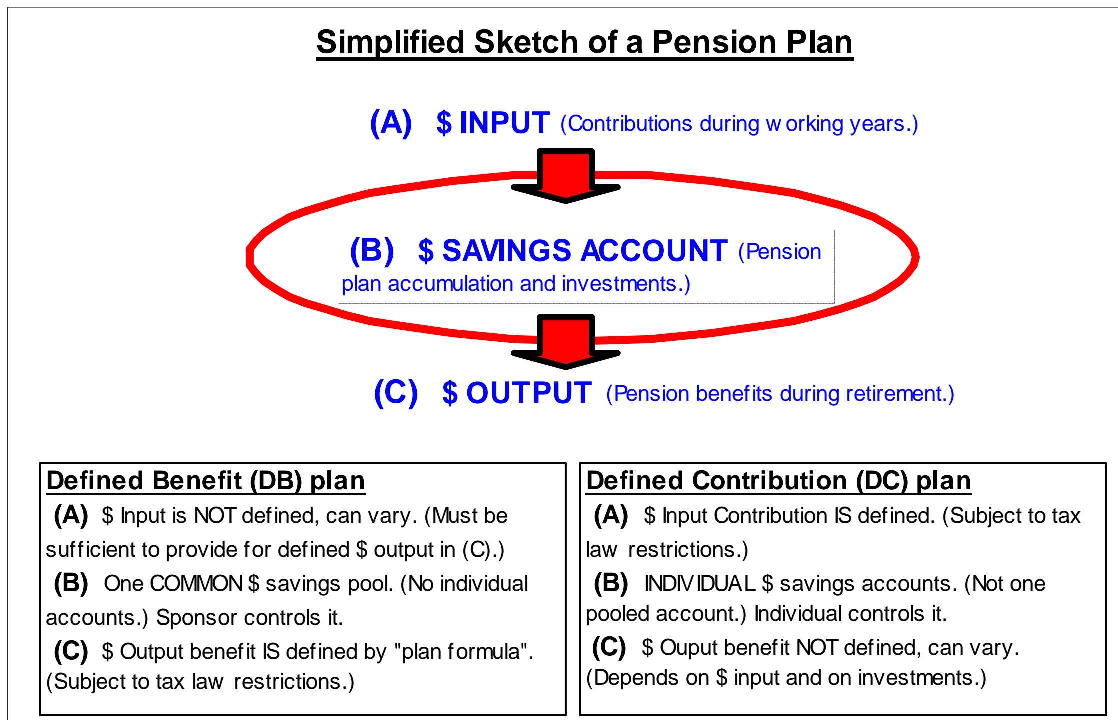
The UofT Pension Plan: Is it competitive? Is it equitable?

Most people, unfortunately, take little interest in their pension plan until they are about to retire. This is common but can be disastrous, as some of our retired colleagues have discovered. It is much too late to correct for past indifference when you retire. By then there is minimal leverage with the employer and by then financial investments no longer have the long time horizon necessary to compound assets.

The purpose of this report is to provide a brief perspective on the University of Toronto pension plan by means of two questions: Is the UofT pension plan competitive with peer academic institutions? Is the UofT pension plan equitable in its benefits to retired and to active faculty? The answer is, I believe, a clear "No" to both questions.

Successful recruitment by UofT of the best new faculty candidates requires that our pension plan be competitive. The following two pages illustrate how poorly our pension plan compares with pensions at US institutions. (Last year 45% of our new hires came from the US.)

But first a simplified sketch that may help in conceptualizing a pension plan and how defined benefit (DB) and defined contribution (DC) plans differ. The Appendix gives a more detailed explanation and provides examples.



Is the UofT pension plan peer-competitive?

Among major universities in North America, the University of Toronto is anomalous in that it has a DB pension plan without the option of a DC pension plan. Why?

Every university in the United States (that I have looked at), large or small, distinguished or less so, has a DC pension plan. Some offer both a DC and a DB plan and give the individual faculty member a one-time choice between the two plans.

Canada is different. It has universities with DC plans, universities with DB plans and universities with hybrid (HB) plans. To illustrate: In Canada HB plans exist at Brock, at York, at Queens and at McGill. DC plans exist at UBC, and at Western. DB plans exist at UofT, at McMaster, and at Trent.

How do we go about comparing different types of pension plans? We can compares a DC plan with other DC plans by comparing the "$ Input" numbers (which are defined in a DC plan and assuming the range of investment vehicles offered are the same) and we can compares a DB plan with other DB plans by comparing the "$ Output" numbers (which are defined in DB plans via the plan formula). But comparing a DC plan with a DB plan is fraught with difficulty, unless one has access to the annual actuarial reports of a DB plan and can tabulate the actual input dollars into the DB plan. I have done this for the UofT plan and that is why it is the only DB plan in the comparison that follows.

"Pension $ input is proportional to pension $ output", when seen over time. This notion is important in what follows and its logic applies to any financial savings plan, including a pension plan. Minimal contributions into a pension plan during one's working years must necessarily result in correspondingly minimal pension plan benefits as output upon retirement.

The chart on the next page shows "pension $ input" as a percentage of faculty salary[1] for five Canadian Universities and for nineteen US universities. The choice of universities was to some extent determined by the availability of the information on the web.

UofT is the only university of the 24 listed that has a DB plan and only a DB plan. The chart also shows how the total input contribution is shared between the member and the university. The amount of input varies, and so do the proportions that come from the employer and from the employee. The average total input contribution is about 15% of salary, - with 10% from the university and the remaining 5% from the faculty member. At some US universities (like Harvard, Princeton, Purdue, Utah), the DC pension plan is fully funded by the university.

The chart suggests that if UofT "normalized" its pension dollar input to that of peer institutions, pension benefits today could probably be twice what they are[2].

University of Toronto has the lowest standing. UofT's total pension input (averaged over the last 14 years) is about 6% of salary base[3], consisting of 3% from members, plus 1% from UofT into the regular pension plan and about 2% from UofT into the SRA[4] plan. The low input, of course, is due to the many contribution holidays.

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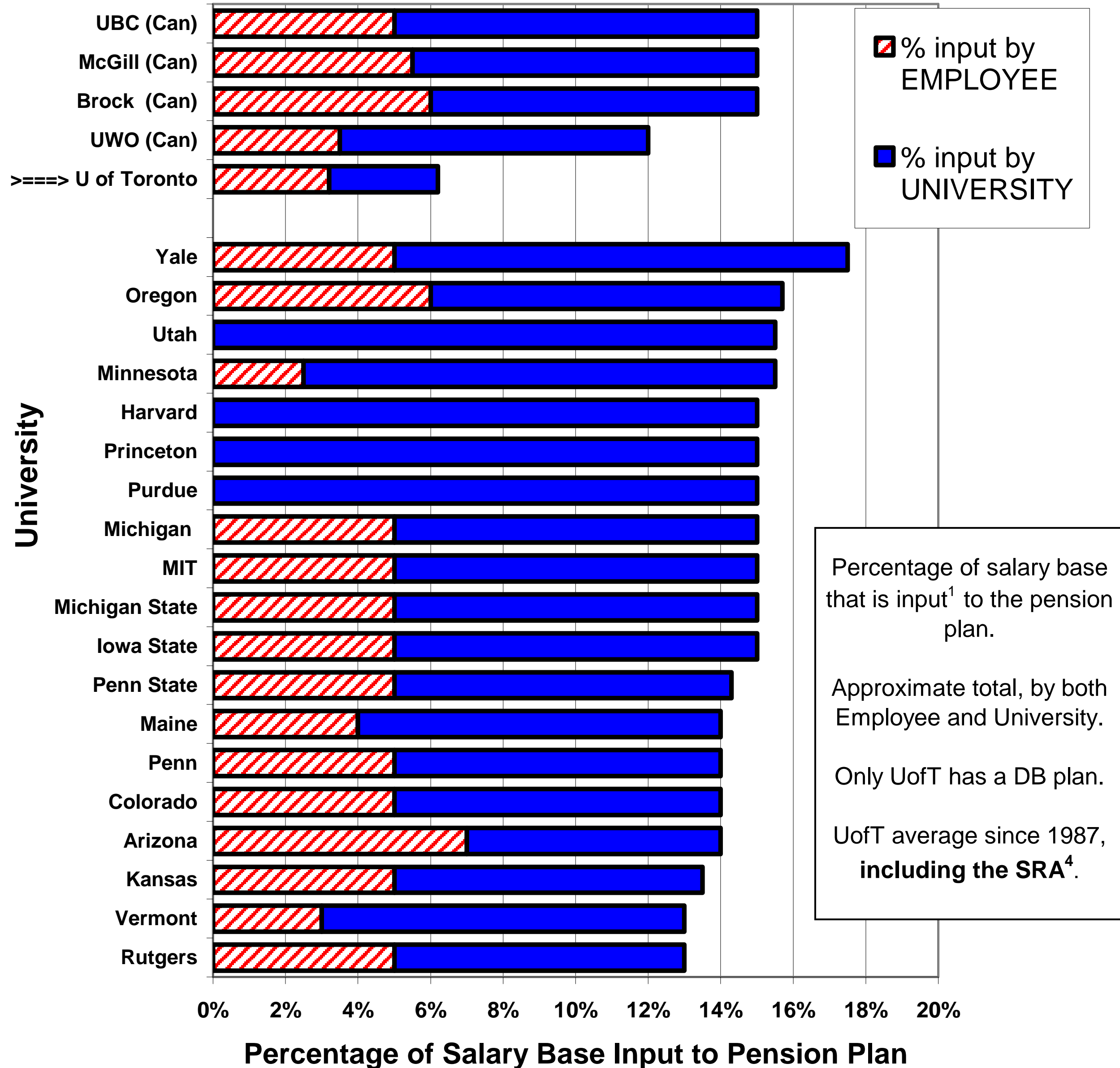
[1] The relative contribution numbers are approximate for some institutions since there may be multiple contribution steps in the pension input. In such cases the dominant input is shown.

[2] "Of Little Benefit", George Luste, UofT Bulletin, April 12, 1999, Forum article. The article arrives at a similar conclusion by means of a more detailed and quantitative approach.

[3] Data presented by G. Luste to Business Board of Governing Council on June 21, 2001.

[4] SRA is the "Supplamental Retirement Arrangement" introduced in 1996 to provide pension benefits for salaries in excess of the salary cap (about $98,500) set by the federal tax legislation in 1976. The SRA is not governed by the Ontario "Pension Benefits Act".



In fact the UofT standing is overstated and its real position is actually worse than shown. About 25% of UofT pension assets are in surplus (July 1, 2000 Hewitt report) and so at present do not translate into "pension $ output". (The "surplus" issue will be discussed in a future report.)

Is the UofT Pension Plan Equitable?

The UofT has a fiduciary responsibility for the welfare of the members in the pension plan. But a reduced pension benefit for the member means a reduced financial obligation, out of base budget, for the University. Thus the Administration has cause to minimize the pension payout benefits any way it can. The sketch on the first page illustrates that if less is paid out at retirement in a DB plan, then less is required as input by the university.

This may result in enrichment on the part of the pension plan sponsor. "Unjust enrichment" is the legal cause of a class action law suit recently initiated by four retired women faculty members (Ursula Franklin, Phyllis Grosskurth, Blanche Van Ginkel and Cicely Watson) against the UofT. Although this action bears on underpayment while they were employed, it also involves their diminished pensions. There are other retired faculty who have suggested similar possible legal action against the University as a result of "unfair" pension treatment.

Another factor that determines pension input (contributions by sponsor and or employee) are the actuarial assumptions. The University hires consultants who set the actuarial assumptions that determine the size of the pension "surplus" inside our DB plan. The existence of a surplus determines whether UofT can take a "contribution holiday". In the past 14 years the University of Toronto has taken a pension holiday every year save one and a half years (approximately). (To be fair, since 1996 they have set aside funds for the SRA.)

There are no corresponding conflict of interest issues in a DC pension plan. A DC pension plan is similar to an RRSP, as the account "belongs" to the plan member.

The following list is a sampling of some of the inequities of our DB pension plan. Space constraints do not allow for more than the briefest list and summary.

(1) **Broken-year-service**[5]. A break in continuity of service can have devastating consequences in our DB plan. UofT does not bridge non-consecutive years of employment service and unlike other DB plans, the UofT plan does not allow for purchase of missing years. This means that when you retire, you receive separate pension payments for each continuous segment of service. That is unfair.

To illustrate: former Dean of Dentistry, Gordon Nikiforuk, 78, was at Uof T initially for 14 years, until 1964, when he went on a temporary leave to UCLA. As planned, he returned to UofT in 1970 and retired in 1990. Today Professor Nikiforuk receives an annual pension of only $1,956 for his first 14 years of service at UofT.

(2) **Part-time-service**[5]. As in Professor Nikiforuk's case, part-time faculty who retired prior to July 1, 1996 receive an astonishingly small pension. They received no protection from inflation.

Professor Carol Brehaut, 69, who served UofT for 38 years, until 1994, today receives a total pension of about $22,000 from our DB plan. Professor Brehaut's part-time service pension benefit was not calculated by the same formula as was used for her full-time faculty colleagues.

(3) **New-spouse**[5]. If one marries or remarries after retiring, the new spouse has no survivor pension benefits at all in our DB plan should the plan member die first. In a DC plan, the new spouse is protected provided the member does not use his/her account to purchase an annuity prior to the remarriage. Among others, former Chief Librarian Bob Blackburn, 82, who retired in 1981, now lives with this anxiety.

(4) **Plan Changes**[5]. Past changes in the DB pension plan formula at UofT have disadvantaged various plan members. A case in point is the "Retiring Cohort of 1989", for whom Professor Frank Hooper has long sought a just resolution, but without success.

[5] Not applicable or not an equity issue in a DC pension plan.

(5) **Retroactive benefits**[5]. Pension plan improvements, pay equity adjustments, etc are usually made retroactive (out of the plan "surplus") for all service years for working people in the DB plan formula - but not for those already retired. Why should one group get retroactive benefits while others (the retirees) do not?

(6) **Exceptions** to (5) above. Not surprisingly, exceptions will be made if sufficient pressure is put on the University. In 1996, when the SRA was introduced, eleven senior professors who retired before July 1 (and were to be frozen out of this new benefit) threatened legal action. They were subsequently awarded the SRA benefit retroactively at a cost of $1.2 -million[6] to the University.

(7) **Exit-salary vagaries**[5]. Since our retirement pension is determined by the best three years of salary, everybody who retired in 1981 (like Bob Blackburn) received substantially less pension than everybody who retired in 1982, only one year later (after the 18% Burkett award). Similarly the 3-year-Social-Contract salary freeze reduced pensions - but did not affect those in DC plans as much. The pension surplus linkage to reduced across-the-board salary settlements (see UTFA Report #1, September 27, 2001) works greatly in favour of the University.

(8) **Cross-subsidization**[5]. Here is one example of many. Older retirees (like Blackburn and Nikiforuk) never had a "pension contribution holiday" during their many years of service. Yet the surplus, which their contributions helped create, is used to give "pension holidays" to current staff. Unfortunately, in a Defined Benefit plan there is no direct linkage between what a plan member contributes to the pension plan during a working career and what one receives in benefits upon retirement.

Defined Benefit versus Defined Contribution versus Hybrid

Which pension plan is best for you? That depends upon many factors. It depends upon your age, your career path, your retirement needs, your risk tolerance, your investment skills and probably a number of other factors. There is no one answer that applies universally to everybody.

In special cases, the answer is simpler. A young untenured or mobile faculty member should prefer a DC plan. But an older faculty member, within say 10 years of retirement, might prefer a DB plan.

In fact, one of the fundamental distinctions of a defined benefit plan is the way in which the contribution rate is determined on an average basis for the plan as a whole - regardless of how many years to retirement. Because each member is charged the average rate, when members are young they will be contributing more than the cost of their actual in-year service accrual. When members are older they will be contributing less than the cost of their in-year accrual. Throughout a continuous 35 year career with the same employer, the "overcontributions" and the "undercontributions" tend to balance out.

The Hybrid plan, as implemented by McGill and Brock and outlined in the appendix, warrants a close look. But one does not get "something for nothing". In a hybrid plan the DB component is usually a bit (10%?) less generous than in a pure DB plan. As well, the DC component may have more restrictions.

In his April 23, 2001 letter to the University community, former Vice-President Finlayson concluded his defense of the UofT defined benefit pension plan with these words:

> ***" … it is the University which bears all the risk. Whatever happens in the future, and it is not likely that the next ten years will replicate the last decade, the benefit defined for each of us by our Pension Plan is immutable. It is fully protected against market uncertainties and mostly protected against the ravages of inflation for your entire lifetime."***

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[6] Business Board minutes for April 21, 1998, page 9 (Report Number 92).

These are grand words but we should never accept this line of argument. In a non-profit public institution such as a university, who in fact is the real "risk bearer"? At Ford they can tap shareholder dividends. In the government they can "borrow" against the next generation (by "printing" more money). But at UofT they can only reach into our salary pockets. We bear the risk.

Professor Finlayson's earlier words (23 January, 1987 UTFA Newsletter, when he was President of UTFA) are much more persuasive:

> ***"Employers "contributions" to pension plans are not ex gratia payments. They are employees' deferred salary. For this University's administration to reduce payments into the Pension Plan is to reduce staff members' total compensation just as surely as it would be were the University to withhold money from our salaries."***

Conclusion

Let me assure the reader that no imminent change in our pension scheme is being proposed here. The aim of this report is to inform you and to begin debate on possible changes. And as additional assurance, if changes were eventually to be proposed, I believe there will need to be a "grandfather" clause that would allow current plan members to maintain the status quo if they so wished.

In the weeks ahead, prior to the formal negotiations in the new year, UTFA will be discussing pension matters with the Administration. Discussions are not the same as negotiations. Our aim will be to exchange views and to seek common ground.

But let me repeat from my last Report:

> "We believe profoundly that equitable and peer-competitive compensation is important for the well-being of our institution."

Please feel free to contact me if you have any questions or comments.

George Luste

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