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Date: December 15, 2008  
To: Governing Council Business Board Members  
From: George Luste, President, University of Toronto Faculty Association (UTFA)  
Re: **Agenda item #4. - Pension Plans: Annual Financial Report for the Year ended June 30, 2008<sup>1</sup>**

My 5-minute time limit requires I be selective and very brief in the few issues I can raise.

Background. UTFA members are the major stakeholder group in the UofT Registered and SRA pension plans. About 65%, or almost \$2 billion, of the liabilities and assets pertain to faculty and librarians.

**Issue #1. Our UofT Pension Plan is seriously underfunded. By how much?**

Pick your number. But you should understand what each number assumes and what it omits. Here are the numbers from the Report, as noted on page 2 in the report:

- (i) **\$165.4 million notional shortfall in a *going concern* valuation.** But this omits the additional \$xxx million liability due to optimistic assumptions (and in particular changes in the investment return assumption relative to the 1986 assumption)
- (ii) **\$217.2 million notional shortfall in a *solvency* valuation.** But this omits the additional \$yyy million liability due to our pension indexation. Pension indexation could have been included in the UofT solvency valuation – but is not.
- (iii) **\$1,139.0 million real shortfall in *wind-up* valuations.** This is how much our pension plan is short if it had been terminated on June 30, 2008 and had to pay all accrued obligations. In my view this number has more reality than the above two valuations. It has no loopholes.

The current financial market turmoil is NOT the main cause of this underfunding crisis, it does however help reveal the underlying problem. To quote Warren Buffett: **“You only find out who is swimming naked when the tide goes out.”<sup>2</sup>**

**Issue #2. What is the main cause of the underfunding? What is the ‘underlying problem’?**

To repeat: “In our view it is **not** the current market downturn.”

<sup>1</sup> See <http://www.governingcouncil.utoronto.ca/AssetFactory.aspx?did=5726>

<sup>2</sup> Warren Buffett, Berkshire 2001 report at <http://www.berkshirehathaway.com/2001ar/2001letter.html>

**Rather it is due to the many missing pension contributions.** For nearly two decades, from 1987 to 2004, the Administration of the University of Toronto made very few pension contributions towards the retirement benefits of faculty and staff. Please see the front page of the attached November 17, 2008 UTFA Information Report.

In particular the right hand column is telling. It reflects the power of compounding and gives meaning to “a dollar in time saves nine”.

**Taking into account the time-value-of-money, the total value of these missing pension contributions by the Administration is about \$1,393.3 million as of June 30, 2008.** (This is a slight decrease from the year earlier number in the UTFA Information Report due to the negative return for 2007-08.) This number is strikingly close the wind-up deficit of \$1,139.0 million.

For an overview and cumulative summary chart of actual pension contributions as well as the missing contributions, from 1987 to 2008, **please see the attached Chart A.**

**Issue #3. Annual expenses continue to increase. They now exceed \$27 million for 2007-08. Ten years ago they were closer to \$2 million.**

Please see page 34 in the Report and my **attached Chart-B and Chart-C.**

If annual costs had been maintained at the pre-UTAM level of 20 basis points per dollar of asset, the cost saving to the UofT base budget, since 2000, is on the order of \$90 million.

Another concern. On page 35 of the Report it notes:

“...the total amount of alternative investments rose from about \$600 million in June 2006 to over \$1.1 billion in June 2008.”

The risks and costs associated with pension plan investments in hedge funds and private equity must be challenged. Do we know our real losses in these opaque instruments? I'm doubtful.

**Issue #4. Business Board: Conflict of Interest and Fiduciary Duty.**

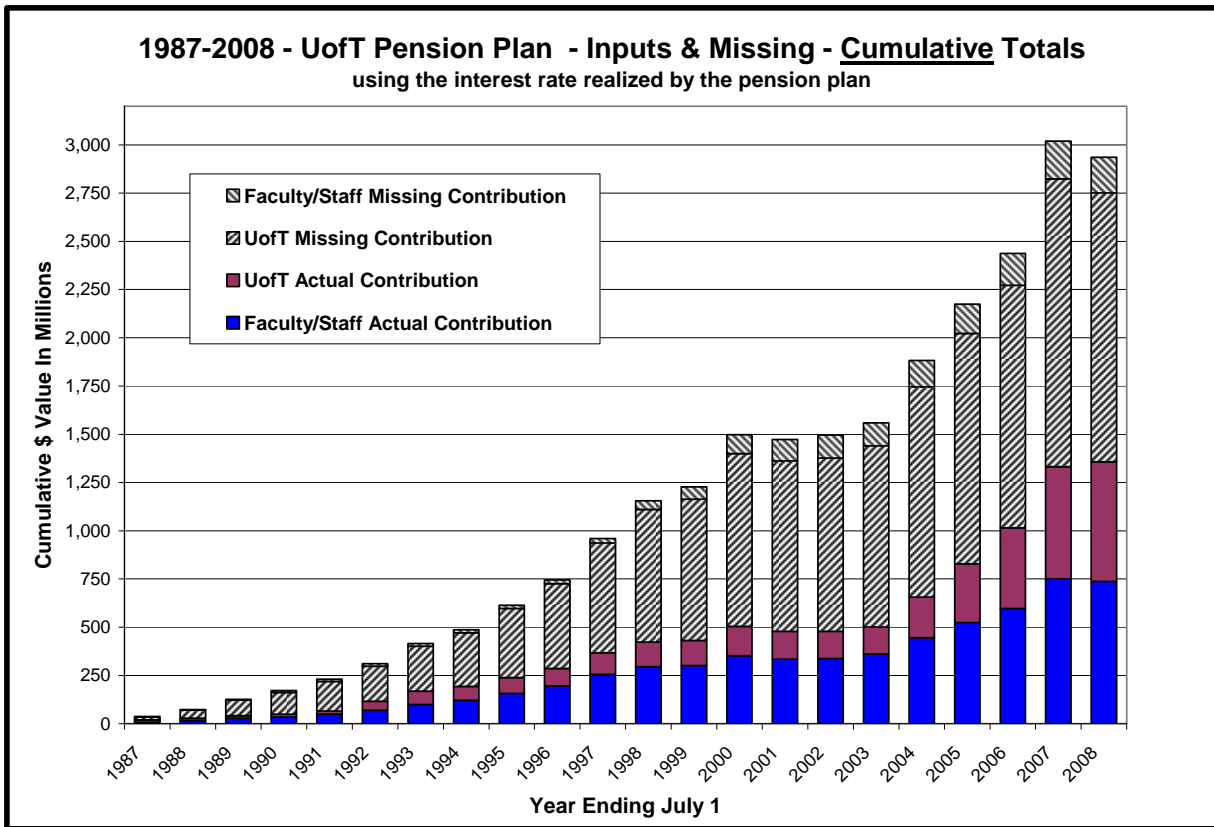
**Question. Does Business Board have an inherent conflict of interest in having oversight of both the universities finances as well as oversight of the pension plan and the interests of pension plan members?**

This seems to be the classic “two-hat” problem.

**Question. Given the volume and complexity of financial responsibilities that Business Board must consider, does Business Board really have the time and expertise to provide proper fiduciary oversight of the pension plan?**

UTFA believes that a change in pension plan governance is long overdue.

**I welcome questions.**



**Chart - A**

December 15, 2008

### U of T RPP - Service Costs - Contributions - Holidays - Time Value of \$ - Summary Data

All numbers are totals for both faculty and staff at U of T.  
All numbers are directly from or computed from Hewitt Annual Actuarial Reports.  
Columns [4], [6], [8], [10], [12], and [14] take onto account column [15], the pension plan time-value-of-money.

[1] Academic Year to July 1	[2] Total Salary Base \$ in Mil	Faculty & Staff - Pension Plan Members						Employer - U of T, Pension Plan Sponsor & Administrator						[15] Actual Market Return Rate
		[3] Pension Service Cost \$ in Mil	[4] Cumulative Service Cost \$ in Mil	[5] Actual Pension Input \$ in Mil	[6] Cumulative Pension Input \$ in Mil	[7] Yearly Pension Holiday \$ in Mil	[8] Cumulative Pension Holiday \$ in Mil	[9] Pension Service Cost \$ in Mil	[10] Cumulative Service Cost \$ in Mil	[11] Actual Pension Input \$ in Mil	[12] Cumulative Pension Input \$ in Mil	[13] Yearly Pension Holiday \$ in Mil	[14] Cumulative Pension Holiday \$ in Mil	
1987	251.9	8.9	10.1	6.9	7.8	2.0	2.3	24.8	28.1	11.1	12.6	13.7	15.5	13.2%
1988	270.3	9.6	19.7	8.5	16.4	0.0	2.3	26.6	54.8	0.0	12.6	26.6	42.2	0.3%
1989	290.1	10.4	34.0	8.8	28.4	1.6	4.4	28.5	94.0	0.0	14.2	28.5	79.8	12.8%
1990	314.8	11.2	46.0	5.2	34.2	6.0	10.6	31.4	127.8	0.0	14.5	31.4	113.3	1.9%
1991	339.3	12.2	63.0	12.2	50.2	0.0	11.4	28.6	169.2	0.0	15.7	28.6	153.5	8.2%
1992	360.4	13.1	84.7	13.1	70.4	0.0	12.7	35.7	227.9	25.6	45.9	10.1	182.0	11.2%
1993	358.6	17.2	116.1	17.6	100.3	0.0	14.5	36.4	301.3	14.7	69.1	21.7	232.2	14.0%
1994	353.4	16.8	137.6	17.1	121.5	0.0	15.0	37.0	350.1	0.0	71.5	37.0	278.6	3.5%
1995	345.7	16.0	175.1	16.4	157.3	0.0	17.1	35.8	439.9	0.0	81.5	35.8	358.4	14.0%
1996	335.0	15.5	214.6	16.4	195.5	0.0	19.2	30.8	530.0	0.0	91.8	30.8	438.3	12.6%
1997	339.7	16.1	279.8	15.7	256.2	0.0	23.3	30.6	680.0	0.0	111.3	30.6	568.7	21.3%
1998	353.5	16.9	340.0	1.8	295.7	15.1	44.1	31.1	815.0	0.0	127.6	31.1	687.4	14.6%
1999	362.2	18.0	365.2	0.0	301.6	18.0	63.3	30.9	862.8	0.0	130.1	30.9	732.7	2.0%
2000	385.0	19.8	450.0	0.0	352.6	19.8	97.1	33.3	1,047.5	0.0	152.1	33.3	895.4	16.9%
2001	403.2	20.7	446.7	0.0	334.6	20.7	111.8	34.7	1,027.0	0.0	144.4	34.7	882.7	-5.1%
2002	434.6	22.3	457.8	11.5	337.8	10.8	119.7	37.3	1,038.8	0.0	140.9	37.3	897.9	-2.4%
2003	462.5	24.4	480.7	24.4	361.1	0.0	119.3	42.9	1,078.5	0.0	140.5	42.9	938.0	-0.3%
2004	494.6	25.6	584.3	25.6	446.3	0.0	137.7	47.1	1,298.9	41.0	209.4	6.1	1,089.5	15.4%
2005	511.3	26.7	677.6	26.7	524.5	0.0	152.7	51.6	1,497.7	64.1	303.3	-12.4	1,194.5	10.9%
2006	563.4	29.5	762.3	29.5	597.3	0.0	164.6	56.0	1,674.9	83.9	417.4	-27.9	1,257.6	7.8%
2007	606.9	32.0	946.8	32.0	750.1	0.0	196.2	64.7	2,073.6	70.5	581.6	-5.8	1,492.1	19.2%
2008	640.8	33.9	921.8	33.9	736.9	0.0	184.5	69.0	2,014.0	78.8	620.8	-9.8	1,393.3	-6.0%
Sum	8,777.2	416.8	921.8	323.3	736.9	94.0	184.5	844.8	2,014.0	389.7	620.8	455.2	1,393.3	
Percentile-A		4.7%		3.7%		1.1%		9.6%		4.4%		5.2%		
Percentila-B				77.6%	79.9%	22.6%	20.0%			46.1%	30.8%	53.9%	69.2%	

**Table - 1 (basis for Chart-A)**

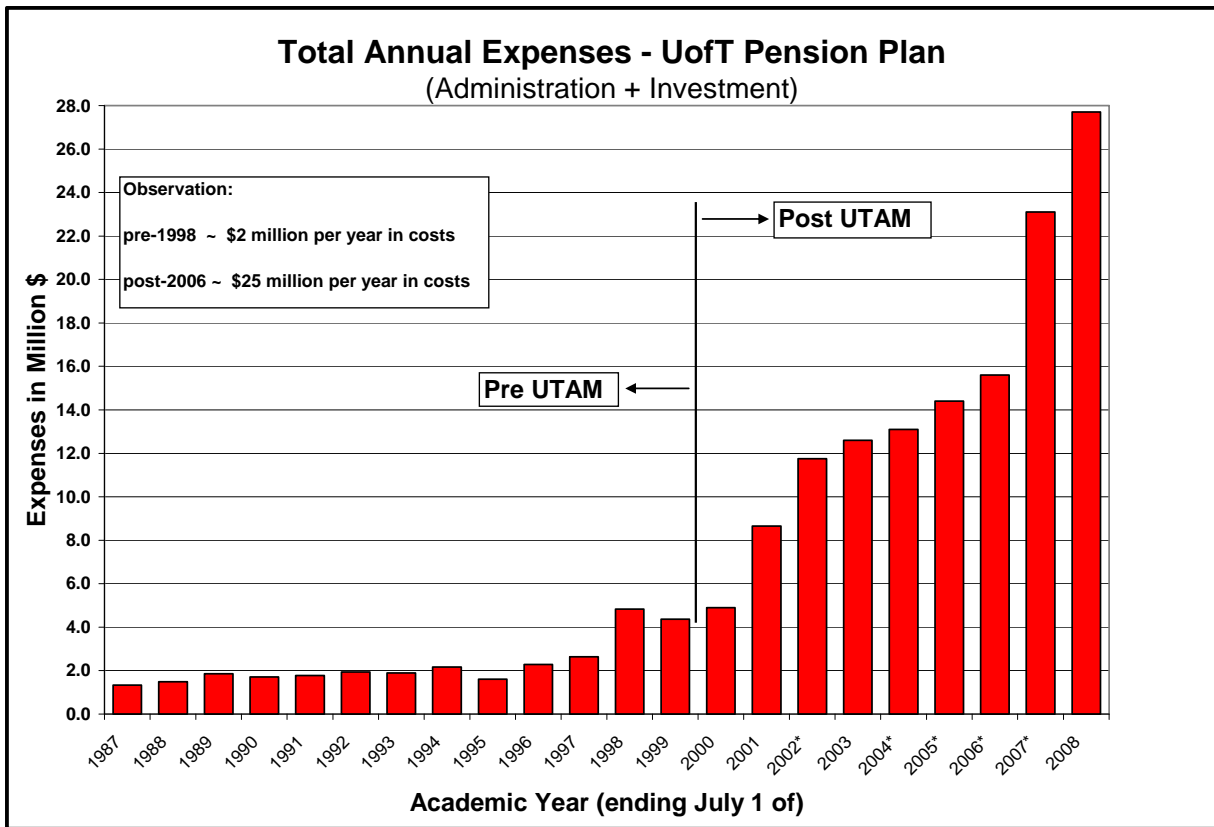


Chart - B

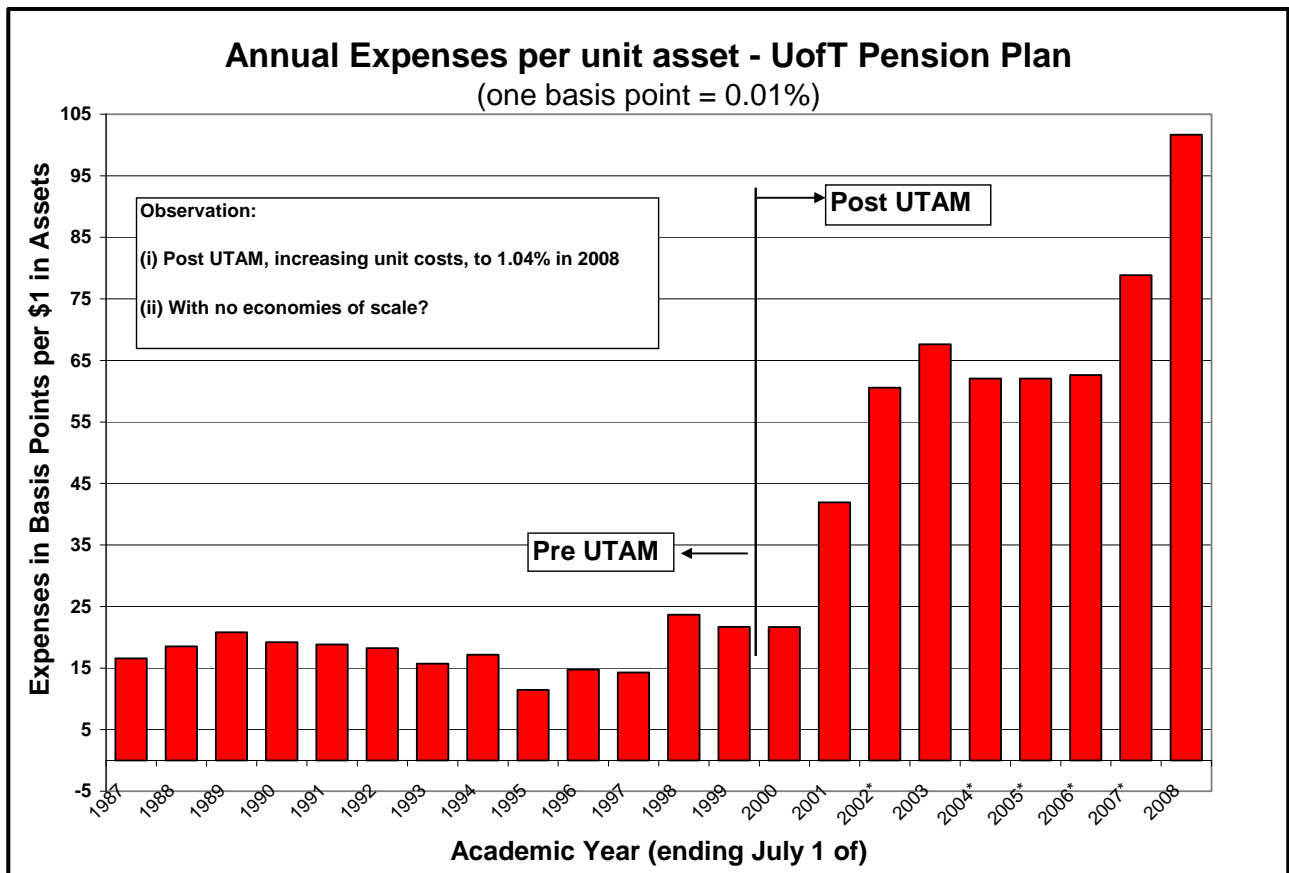


Chart - C