UTfA
UNIVERSITY OF TORONTO
*faculty* ASSOCIATION

# Pensions

*Backgrounder #1 for UTFA Members*

This backgrounder introduces some of the key issues driving current discussions about the U of T pension plan and why a jointly sponsored pension plan (JSPP) option is being explored. You will receive additional backgrounders in the coming weeks and months. For an overview of the U of T plan, please see *U of T Pension Plan at a Glance.*

## Current status of U of T pension plan

The U of T pension plan is a defined benefit plan. Under this type of plan, the amount of pension you receive at retirement is defined by a formula based on earnings and service. Pensions are paid from the pension fund, which is made up of employer and employee contributions, and investment earnings on these contributions. Employee contributions are based on an earnings-related formula set out in the plan. On the other hand, the employer is required to contribute whatever is required to meet Ontario's funding rules.

Managing the U of T Administration's contributions to the pension plan has become increasingly challenging in recent years. Like most defined benefit pension plans in the Ontario university sector, the U of T plan has a significant funding shortfall due largely to the adverse impact of the 2008 financial crisis on the plan's finances.

To pay down the shortfall, in addition to its regular pension contributions, the university is currently making annual special payments of $78.7 million from its operating budget. However, in the absence of major changes to the plan or current provincial funding rules (see page 2), or both, the university will be faced with hundreds of millions of dollars in additional pension payments. These payments could have serious repercussions for U of T's programming, and may create pressure for additional employee contribution increases.

**TWO SIDES OF PENSION PLAN**

| Assets in pension fund | Liabilities |
| --- | --- |
| Contributions and investment earnings | Cost of pension owed to active, inactive and retired members |

**Estimated cost of $50,000 annual pension paid for life with a 10-year guarantee, starting at age 65**

10 years ago: **$740,000**

VS

Today: **$960,000**

## How we got here

Three factors contributing to the plan's current funding challenges are:

1. volatile investment markets, which are making it more difficult to achieve reasonable and predictable investment returns;
2. improvements in life expectancy, which translate into longer pension payouts (and costlier pensions); and
3. low and unpredictable long-term interest rates.

These challenges are compounded by current provincial funding requirements, which determine how the financial health of the plan is measured and what additional contributions must be made in the event of a shortfall.

## Provincial funding requirements

The plan is required to file a formal valuation with the Ontario pension regulator at least once every three years. This valuation tests the plan's health based on two scenarios:

1. **going concern**, which assumes the plan will continue to operate as expected for many years to come; and
2. **solvency**, which assumes the plan ends on the date of the valuation, and is designed to protect plan members in the case of employer bankruptcy.

Any going-concern or solvency shortfall reported in the valuation must be paid off within a specified period.

The plan's most recent valuation showed that, as of July 1, 2016, the plan had both going-concern and solvency shortfalls—and that these shortfalls were bigger than they were in 2015. In particular, the plan experienced a significant deterioration in its solvency position. This is largely because the solvency valuation is required to use point-in-time interest rates to determine how much money is needed to provide pensions owed to members. When interest rates drop, more money is required to provide these pensions—and vice versa. Even minor changes in interest rates can have a dramatic impact on solvency funding results.

A drop of

**1%**

in interest rates, increases U of T's solvency funding obligation by about 17% or

**$973 million**

based on 2016 valuation

In recognition of the negative impact current low interest rates have had on Ontario university plans' solvency results, the province has granted temporary solvency relief that eliminates, or substantially reduces, any payments to address their solvency shortfall. Based on the 2016 valuation results, the going concern shortfall was $573 million and the solvency deficit was $1.7 billion. If solvency funding applied, this solvency deficit (after accounting for the going concern shortfall) would have to be funded. Of course, the plan's solvency funding status could look very different if interest rates change.

## Provincial funding review

Given the extreme unlikelihood of the U of T suddenly shutting its doors, many experts agree that the solvency test is not an appropriate measure of our plan's financial health. In fact, most provinces in Canada don't require universities to fund for solvency, and Ontario universities have been lobbying for the removal of the solvency funding requirements for many years.

In 2016, the Ontario government launched a review of its current solvency funding regime led by David Marshall, former president and CEO of the Workplace Safety and Insurance Board. Marshall's report is expected to be released in spring/ summer 2017. It would then be up to the provincial government to determine which, if any, of Marshall's recommendations will be implemented.

We know that managing the cost of funding and maintaining defined benefit pension plans in the university sector has been on the provincial government's agenda since its 2012 release of the Drummond report on the reform of Ontario's public services and subsequent budget. The province wants equal sharing of pension costs between employers and employees—which naturally leads to equal participation in plan governance. It also supports the consolidation of plans to achieve efficiencies of scale.

## Jointly sponsored pension plan option

JSPPs aren't new. Ontario's JSPPs currently include six of the largest pension plans in the province, such as the Ontario Teachers' Pension Plan (OTPP), the Ontario Municipal Employees Retirement System (OMERS) and the Healthcare of Ontario Pension Plan (HOOPP). These plans have a long history, and are internationally respected for their ability to provide secure, high-quality pensions. They are also exempt from solvency funding, with employers and employees sharing in both costs and governance.

The most recent comprehensive review of pension regulations in Ontario, conducted by Professor Harry Arthurs in 2010, highlighted the potential role for new JSPPs in Ontario. The provincial government responded by issuing draft regulations governing the conversion of existing defined benefit pension plans to JSPPs.

Like the current U of T plan, JSPPs provide defined benefit pensions. This means that pension amounts are pre-defined based on a formula that uses earnings and service. However, whereas the university is responsible for governing the U of T plan and ensuring it meets provincial funding requirements, employers and employees in a JSPP are jointly responsible for plan governance and plan costs.

*Three important drivers of UTFA's interest in the tri-university JSPP option:*

1. *Protect defined benefit pensions, which provide a secure and predictable income at retirement;*
2. *Establish a prudent and stable funding regime; and*
3. *Give employees an equal voice in the management of the plan.*

### Why now?

In other jurisdictions in Canada, the U.S. and U.K., defined benefit pension plans are under attack, including in the university sector. Here in Ontario, continued political support for defined benefit plans (like the U of T plan) for public sector workers is far from certain.

The JSPP option presents an opportunity to move university sector pension plans to a framework that includes world-renowned plans generally considered to be untouchable—thereby taking both solvency risk and political risk off the table.

*The goal is to model the pension provided by the new plan as closely as possible on the current U of T plan.*

### Tri-university option

Ministry of Finance officials have consistently advised that the government will consider granting solvency exemptions only to JSPPs that include more than one employer (although this could change depending on the recommendations contained in the Marshall report and the government's response to those recommendations). To achieve exemption from solvency funding and the administrative economies of scale desired by the province, the U of T has partnered with Queen's University and the University of Guelph to explore a tri-university JSPP option. The goal is to model the pension provided by the new plan as closely as possible on the current U of T plan.

### How transition to the new plan could work

We are at the very early stages of investigating the feasibility of participating in a tri-university JSPP, and we still have more questions than answers. However, we are reviewing approaches that are fair and equitable to pension stakeholders at all three institutions.

To that end, one of the underlying principles is that each university would be responsible for funding its current deficit at the time of conversion to the new plan. With these deficit payments, the JSPP would be fully funded on a going-concern basis at inception. Future gains and losses would be managed jointly by a sponsor board, with equal representation by employers and employees—and future contributions and benefits would be calculated on the same terms across all three universities.

All pensions already earned would be fully transferred to the new plan with no change and would be guaranteed. Retirees would continue to receive their pensions as usual, but payments would be made by the new JSPP administrator.

The decision to convert to the new plan will require a formal consent process and ratification by active, inactive, and retired members and beneficiaries.

*The decision to convert to the new plan will require a formal consent process and ratification by active, inactive, and retired members and beneficiaries.*

## The process for moving forward

Over the coming weeks, UTFA's Ad Hoc Pensions Discussion Committee will make recommendations to our Executive and Council. With Council's approval, UTFA would start formal discussions with the representatives of other faculty associations and unions, as well as the administrations of the three universities. The goal would be to reach consensus on a potential JSPP design. That design would be carefully considered by Council, with a formal decision deferred until there is some clarity about the potential impact of the Marshall recommendations. Should Council endorse moving forward, a broader education and consultation process would begin. This would be followed by the necessary U of T internal approval processes, union processes and member ratification processes.

### WHAT YOU CAN DO

Our task is to learn as much as we can about the additional implications of converting to a JSPP to support an informed judgement about the future of U of T's pension plan.

We encourage you to follow and become active in the discussions. Here's how you can do that:

- **Understand the issues**: In the weeks ahead, there will be several presentations, question and answer documents, and a website set up as a focal point for all supporting materials.
- **Lend your voice**: Your feedback on the issues will play an important part in how the JSPP option unfolds.
- **Stay up to date**: We'll keep you informed along the way, and send notifications when new information becomes available.

This document describes highlights of the University of Toronto Pension Plan in simple terms. If there are any errors or differences between the information given here and the legal plan documents, the legal documents will apply.