UTFA Information Report

University of Toronto Faculty Association July 14, 2011

Information Report #18

The UTAM[1] Pension Investment Disaster

Serious shortfalls in the University of Toronto registered defined benefit pension plan will be a continuing burden on the operating budget for years to come. Today's problem has two major sources. This report focuses on the plan's investment *loss* of one billion dollars and only briefly comments on the missing contributions.

UTAM has managed the investments of the University of Toronto pension plan assets for the last eleven years. Prior to 2000 the pension assets were managed by an in-house UofT investment committee. The following table shows a summary of the annualized investment returns in the 15 years prior to the UTAM time period as well as in the subsequent 11 UTAM years. (All returns presented in this report are 'nominal', not 'real' returns above inflation.) To provide a comparative reference we also show the returns for two comparators[2].

The following table encapsulates the two major financial calamities in our pension plan during the last 26 years.

Annualized Investments Returns from 1985 to 2010 for the UofT Pension Plan and Two Comparators		
1985-1999 15 years pre-UTAM	2000-2010 11 years for UTAM	
11.7%	2.7%	UofT Pension Plan annualized returns
		Comparators
11.8%	5.6%	Median Return, DEXIA all pension universe
11.5%	7.2%	50% TSX Index + 50% All Can Bond Index
2.9%	2.1%	annualized CPI in Canada during same time

Table A

Disaster #1: the missing pension contributions. In the 15 pre-UTAM years, from 1985 to 1999 the annualized return of the pension plan investments was a remarkable 11.7%. This was a once in a lifetime bull market, but unfortunately the University took one pension contribution holiday after another, year after year, during this period. This failure to put money into the plan means that our pension plan's assets did not realize the gains they should have. The cumulative pension plan *loss*, due to the missing contributions, is about one billion dollars today. This has been discussed in detail in prior Information Reports[3] and we will not do so again here.

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[1] The University of Toronto Asset Management Corporation (UTAM) was established by the University of Toronto in May 2000. UTAM is a Not-For-Profit Corporation that is a wholly owned subsidiary of the University of Toronto that manages the University's pension funds, its endowment and other short and long-term investments.

[2] The Appendix provides the year by year annualized return tables for each of the eight summary numbers in Table A.

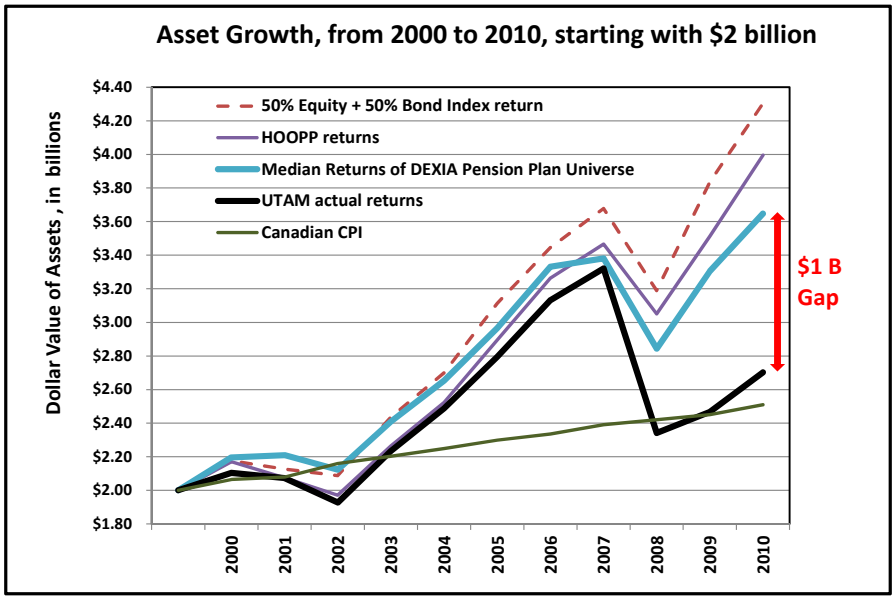
[3] For a detailed discussion of disaster #1 please see Inconvenient Truths about the UofT Pension Plan: the missing contributions - at http://www.utfa.org/sites/default/files/webfiles/pdf_files/Inf%20Rep-9-II-%20final-c(1).pdf

Disaster #2: due to UTAM investments. In the subsequent 11 years, from 2000 to 2010, the markets have been less generous. But what is truly ruinous for the UofT is how much UTAM underperformed the markets and how badly we fared relative to our comparators during this period. The annualized return for the UofT plan over the 11 years was only 2.7%. This compares to a 5.6% annualized return for the median return of the DEXIA pension plan universe[4] and a 2.1% increase in inflation over the same time period. If UTAM had just been able to realize the median returns of other pension plans during the last 11 years, there would be an additional one billion dollars in the UofT pension plan today. Keep in mind that this more recent UTAM $1 billion loss is in addition to the $1 billion *loss* due to the missing pension contributions noted above.

Without these two failures, the UofT pension plan today would have about $4 billion in assets instead of its actual $2 billion. There would be a surplus instead of a serious shortfall – and the current solvency crisis.

When and how did the one billion dollar UTAM loss take place?

UTAM was created at the start of 2000 (with an aim *to realize improved returns*) when the pension plan had about $2 billion in assets. The following chart illustrates the growth of a $2 billion asset[5] over the subsequent eleven years, given the UTAM annual investment returns, together with the annual returns of three comparators and CPI for an inflation reference. The UTAM underperformance is striking.



Graph #1

The heavy black line represents the growth of the initial $2 billion in our pension plan from 2000 to 2010. The heavy blue line shows the corresponding growth for the median return of the RBC DEXIA pension plan universe. By the end of 2010 our pension plan would have had approximately $1 billion ($946 million to be more exact) dollars more if it had simply been in the middle of the pack and realized the median investment return of all defined benefit pension plans in Canada. Had that been the case, there would no 'UofT pension solvency[6] crisis' today.

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[4] The Canadian Institute of Actuaries Annual Report publishes the RBC Dexia median pension returns used in this report. From a private correspondence with RBC Dexia I am told that: RBC Dexia use 145 pension plans in their "All Plans Universe". (They start with 300 pension plan candidates with about $340 billion in assets.). The Canadian DB Plans are a subset of the All Plans and is tested to make sure it also tracks the overall plan universe.

[5] For simplicity we exclude any inflows and outflows, such as pension payments, contributions, transfers, commuted take aways, etc.

[6] The 'solvency' word here can be misleading. It refers to the provincial 'pension reporting solvency' requirement and not to the larger 'wind-up solvency' deficit.

Our DEXIA comparator is not exceptional – as it represents the median. The HOOPP[7] pension plan did better than the median of the DEXIA pension plans, as did the OTPP (not shown) and many other pension plans. From 1985 to 1999, prior to UTAM, our pension returns did approximate the median return.

The two most telling observations from graph #1 are that the UTAM losses in 2008 exceeded those of other pension plans by a wide margin and, secondly, UTAM did not recover from the losses in the following two years, in 2009 and 2010, as did most other pension plans and the stock markets. It follows that UTAM experienced a permanent loss of a significant amount of capital during this period[8]. Why? We hear that currency bets were made and lost, margin calls in the hundreds of millions of dollars resulted, but pension assets were tied up in illiquid alternative placements and hedge funds, and so only the better assets (like the real return bonds) could be sold to meet the margin calls. Pension plan members should be asking: "Where was the oversight by the UTAM Board, by the Business Board and by the UofT Administration?" - oversight that could have avoided this investment disaster.

Over the eleven years, from 2000 to 2010 a simple passive asset allocation of 50% 'All Canadian Bond Index' plus 50% 'TSX Composite Equity Index' would have outperformed even OTPP and HOOPP. (Studies show that passive index investing, without expensive money managers, usually outperforms active investing.) If the UofT pension plan had achieved the above 50-50 index returns, from 2000 to today, our pension plan would have about $1.6 billion dollars more in assets today. Understandably passive investing is not promoted by active money managers or the investment industry. Their handsome compensation profits would evaporate if passive investing became the norm. See Warren Buffett's engaging article[9] on this issue.

Even more astounding is that during the eleven years that this catastrophe unfolded, senior UTAM officers received performance bonuses - which are not publicly reported. However the total salaries are presented in the provincial government annual sunshine salary list. The total 2010 salary of the UTAM CEO was $698,720. And the CEO salaries have been in excess of $550,000 every year since 2004.

Conclusion:

We repeat our past conclusion, made at Business Board of Governing Council and at the Jackman-Wasser review committee of UTAM:

> **"The evidence of the past [eleven] years, not just the catastrophic losses in 2008, suggest that it is time to admit, for the good of the pension plan and our institution, that the UTAM experiment has been an expensive mistake."**

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[7] HOOPP is the Healthcare of Ontario Pension Plan. See http://www.hoopp.com/

[8] This suggests that UTAM management and its overseers (the UTAM Board and Senior UofT administrators) were unaware of the imbedded risks in the pension portfolio they were managing. This in turn suggests that any outperformance prior to 2008, like the modest 4.5% outperformance in 2007, was also probably achieved with more risk exposure than the pension plan sponsor-administrator should have taken. While this gamble provided a slight reward in 2007, it has resulted in disastrous losses in 2008 and 2009. Warren Buffett aptly equates investment risk with 'not knowing what you are doing'.

[9] See the link to Warren Buffett's 2005 article: "How to Minimize Investment Returns" at the bottom of the UTFA webpage at http://www.utfa.org/content/pension-issues

Appendix

for Information Report #18

Showing the year by year annualized returns for

(i) 1985 to 1999, the pre-UTAM years, table A1 to table A4

and

(ii) 2000 to 2010, the UTAM-years table B1 to table B4

Uof T Pension Plan Returns, 1985 to 1999

Annualized UofT Pension Plan Investment Performance in the pre-UTAM Years															
Year Ending Jun 31	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years	Twelve Years	Thirteen Years	Fourteen Years	Fifteen Years
1999	2.0%	8.1%	12.3%	12.4%	12.7%	11.1%	11.5%	11.5%	11.1%	10.2%	10.4%	9.5%	9.8%	10.7%	**11.7%**
1998	14.6%	17.9%	16.1%	15.6%	13.1%	13.2%	12.9%	12.3%	11.1%	11.3%	10.2%	10.5%	11.4%	**12.4%**	
1997	21.3%	16.9%	15.9%	12.7%	12.9%	12.6%	12.0%	10.7%	10.9%	9.8%	10.1%	11.1%	**12.2%**		
1996	12.6%	13.3%	9.9%	10.9%	11.0%	10.5%	9.2%	9.7%	8.6%	9.0%	10.2%	**11.5%**			
1995	14.0%	8.6%	10.4%	10.6%	10.1%	8.7%	9.3%	8.1%	8.7%	10.0%	**11.4%**				
1994	3.5%	8.6%	9.5%	9.2%	7.7%	8.5%	7.3%	8.0%	9.5%	**11.2%**					
1993	14.0%	12.6%	11.1%	8.7%	9.5%	7.9%	8.7%	10.3%	**12.1%**						
1992	11.2%	9.7%	7.0%	8.4%	6.8%	7.8%	9.8%	**11.8%**							
1991	8.2%	5.0%	7.5%	5.7%	7.1%	9.6%	**11.9%**								
1990	1.9%	7.2%	4.9%	6.9%	9.9%	**12.5%**									
1989	12.8%	6.4%	8.6%	11.9%	**14.8%**										
1988	0.3%	6.6%	11.7%	**15.3%**											
1987	13.2%	17.8%	**20.8%**												
1986	22.6%	**24.8%**													
1985	**27.0%**														

Table A1

[Note: This is the only table in which returns are shown for the academic year, not the calendar year. For comparisons over longer time periods this should not be an issue.]

Median RBC DEXIA Pension Universe Returns, 1985 to 1999

Annualized Median Investment Performance from 1985 to 1999 for the DEXIA All Pension Universe (pre-UTAM Years)															
Year Ending Dec 31	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years	Twelve Years	Thirteen Years	Fourteen Years	Fifteen Years
1999	11.4%	9.7%	11.4%	13.2%	14.0%	11.4%	12.8%	11.9%	12.5%	11.1%	11.5%	11.4%	10.8%	11.0%	**11.8%**
1998	8.0%	11.4%	13.8%	14.7%	11.4%	13.0%	12.0%	12.7%	11.1%	11.5%	11.5%	10.8%	11.0%	**11.8%**	
1997	14.9%	16.8%	17.0%	12.3%	14.1%	12.7%	13.3%	11.5%	11.9%	11.8%	11.0%	11.2%	**12.1%**		
1996	18.8%	18.1%	11.5%	13.9%	12.2%	13.1%	11.0%	11.6%	11.5%	10.7%	10.9%	**11.9%**			
1995	17.4%	8.0%	12.3%	10.6%	12.0%	9.7%	10.6%	10.6%	9.8%	10.2%	**11.3%**				
1994	-0.7%	9.8%	8.5%	10.6%	8.3%	9.5%	9.6%	8.9%	9.4%	**10.7%**					
1993	21.4%	13.4%	14.7%	10.6%	11.7%	11.5%	10.3%	10.7%	**12.1%**						
1992	5.9%	11.5%	7.2%	9.3%	9.6%	8.6%	9.3%	**11.0%**							
1991	17.4%	7.9%	10.5%	10.5%	9.1%	9.8%	**11.7%**								
1990	-0.8%	7.2%	8.3%	7.2%	8.4%	**10.8%**									
1989	15.9%	13.2%	10.0%	10.8%	**13.3%**										
1988	10.5%	7.1%	9.2%	**12.6%**											
1987	3.8%	8.5%	**13.3%**												
1986	13.4%	**18.4%**													
1985	**23.6%**														

Table A2

[The RBC DEXIA pension universe is referenced in footnote #4.]

50% Bond + 50% Stock, Index Returns, 1985 to 1999

Annualized Returns for a 50% Bond + 50% Equity Index Benchmark from 1985 to 1999																	
Year Ending Dec 31	TSX	All Bond	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years	Twelve Years	Thirteen Years	Fourteen Years	Fifteen Years
1999	31.7%	-1.1%	15.3%	9.4%	10.4%	12.8%	13.7%	10.9%	12.8%	11.7%	12.3%	10.6%	11.2%	11.1%	10.6%	10.7%	**11.5%**
1998	-1.6%	9.2%	3.8%	8.0%	11.9%	13.3%	10.0%	12.4%	11.2%	11.9%	10.1%	10.8%	10.7%	10.2%	10.4%	**11.2%**	
1997	15.0%	9.6%	12.3%	16.2%	16.7%	11.6%	14.2%	12.5%	13.1%	10.9%	11.6%	11.5%	10.8%	10.9%	**11.8%**		
1996	28.3%	12.3%	20.3%	18.9%	11.4%	14.7%	12.5%	13.3%	10.7%	11.5%	11.4%	10.7%	10.8%	**11.8%**			
1995	14.5%	20.7%	17.6%	7.2%	12.9%	10.7%	11.9%	9.2%	10.3%	10.3%	9.7%	9.9%	**11.0%**				
1994	-0.2%	-4.3%	-2.3%	10.7%	8.5%	10.6%	7.6%	9.1%	9.3%	8.7%	9.1%	**10.4%**					
1993	32.5%	18.1%	25.3%	14.3%	15.2%	10.2%	11.5%	11.3%	10.4%	10.6%	**11.9%**						
1992	-1.4%	9.8%	4.2%	10.4%	5.5%	8.3%	8.7%	8.1%	8.6%	**10.3%**							
1991	12.0%	22.1%	17.1%	6.2%	9.7%	9.9%	8.9%	9.4%	**11.2%**								
1990	-14.8%	7.5%	-3.7%	6.2%	7.6%	6.9%	7.9%	**10.3%**									
1989	21.4%	12.8%	17.1%	13.7%	10.7%	11.0%	**13.3%**										
1988	11.1%	9.8%	10.5%	7.7%	9.0%	**12.4%**											
1987	5.9%	4.0%	5.0%	8.3%	**13.1%**												
1986	9.0%	14.7%	11.9%	**17.4%**													
1985	25.1%	21.2%	**23.2%**														

Table A3

[Note: this is a passive investment comparator, excluding any investment costs.]

For reference, inflation CPI numbers, 1985 to 1999

Annualized Changes in Canadian CPI from 1985 to 1999															
Year Ending Dec 31	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years	Twelve Years	Thirteen Years	Fourteen Years	Fifteen Years
1999	2.6%	1.8%	1.4%	1.6%	1.7%	1.4%	1.5%	1.5%	1.8%	2.1%	2.4%	2.5%	2.6%	2.8%	**2.9%**
1998	1.0%	0.8%	1.3%	1.4%	1.2%	1.3%	1.4%	1.7%	2.0%	2.4%	2.5%	2.6%	2.8%	**2.9%**	
1997	0.7%	1.4%	1.6%	1.2%	1.3%	1.4%	1.8%	2.2%	2.5%	2.7%	2.8%	2.9%	**3.0%**		
1996	2.2%	2.0%	1.4%	1.5%	1.6%	2.0%	2.4%	2.7%	2.9%	3.0%	3.1%	**3.2%**			
1995	1.8%	1.0%	1.2%	1.4%	1.9%	2.4%	2.8%	3.0%	3.1%	3.2%	**3.3%**				
1994	0.2%	0.9%	1.3%	1.9%	2.5%	3.0%	3.1%	3.3%	3.4%	**3.5%**					
1993	1.7%	1.9%	2.5%	3.1%	3.5%	3.6%	3.7%	3.8%	**3.8%**						
1992	2.1%	2.9%	3.6%	4.0%	4.0%	4.0%	4.1%	**4.1%**							
1991	3.8%	4.4%	4.7%	4.5%	4.4%	4.4%	**4.4%**								
1990	5.0%	5.1%	4.7%	4.6%	4.5%	**4.5%**									
1989	5.2%	4.6%	4.5%	4.4%	**4.4%**										
1988	4.0%	4.1%	4.1%	**4.2%**											
1987	4.2%	4.2%	**4.3%**												
1986	4.2%	**4.3%**													
1985	**4.4%**														

Table A4

Uof T Pension Plan Returns, 2000 to 2010, via UTAM

UTAM Annualized UofT Pension Plan Investment Performance during the UTAM Years											
Year Ending Dec 31	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years
2010	9.5%	7.4%	-6.7%	-3.7%	-0.7%	1.4%	2.8%	4.2%	2.9%	2.5%	**2.7%**
2009	5.3%	-13.8%	-7.7%	-3.1%	-0.2%	1.7%	3.5%	2.1%	1.7%	**2.1%**	
2008	**-29.5%**	-13.6%	-5.7%	-1.5%	1.0%	3.2%	1.7%	1.3%	**1.7%**		
2007	6.0%	9.0%	10.1%	10.4%	11.4%	8.1%	6.7%	**6.5%**			
2006	12.1%	12.2%	12.0%	12.8%	8.5%	6.8%	**6.5%**				
2005	12.3%	11.9%	13.0%	7.6%	5.7%	**5.6%**					
2004	11.5%	13.3%	6.1%	4.2%	**4.4%**						
2003	15.2%	3.5%	1.8%	**2.6%**							
2002	-7.0%	-4.3%	**-1.2%**								
2001	-1.5%	**1.8%**									
2000	**5.2%**										

Table B1

[Note the extraordinary loss in 2008 and the failure to recover in 2009 and 2010.]

Median of RBC DEXIA Pension Universe, 2000 to 2010

Annualized Median Investment Performance from 2000 to 2010 for the DEXIA Pension universe (data from Canadian Institute of Actuaries Report, March 2010)											
Year Ending Dec 31	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years
2010	10.4%	13.3%	2.6%	2.3%	4.2%	5.4%	6.1%	7.0%	5.7%	5.2%	**5.6%**
2009	16.2%	-1.1%	-0.3%	2.7%	4.5%	5.4%	6.5%	5.2%	4.6%	**5.1%**	
2008	**-15.9%**	-7.6%	-1.4%	1.7%	3.4%	5.0%	3.7%	3.3%	**4.0%**		
2007	1.5%	6.8%	8.4%	8.8%	9.8%	7.3%	6.4%	**6.8%**			
2006	12.3%	12.0%	11.4%	11.9%	8.6%	7.2%	**7.6%**				
2005	11.8%	10.9%	11.8%	7.6%	6.2%	**6.8%**					
2004	10.1%	11.8%	6.3%	4.8%	**5.8%**						
2003	13.5%	4.4%	3.1%	**4.8%**							
2002	-3.9%	-1.7%	**2.0%**								
2001	0.6%	**5.1%**									
2000	**9.8%**										

Table B2

[Note the relative loss in 2008 and the full recovery in 2009 and 2010.
The RBC DEXIA pension universe is referenced in footnote #4.]

50% Bond + 50% Stock Index Comparator, 2000 to 2010

Annualized Returns for a 50% Bond + 50% Equity Index Benchmark from 2000 to 2010													
Year Ending Dec 31	TSX	All Bond	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years
2010	17.6%	6.7%	12.2%	16.1%	5.4%	5.7%	6.7%	8.1%	8.5%	9.5%	8.1%	7.1%	7.2%
2009	35.1%	5.4%	20.3%	2.1%	3.6%	5.4%	7.3%	7.9%	9.1%	7.6%	6.5%	6.7%	
2008	-33.0%	6.4%	-13.3%	-3.8%	0.8%	4.3%	5.5%	7.3%	6.0%	4.9%	5.3%		
2007	9.8%	3.7%	6.7%	8.7%	10.9%	10.8%	12.0%	9.6%	7.8%	7.9%			
2006	17.3%	4.1%	10.7%	13.0%	12.2%	13.3%	10.1%	8.0%	8.1%				
2005	24.1%	6.5%	15.3%	13.0%	14.2%	10.0%	7.4%	7.6%					
2004	14.5%	7.1%	10.8%	13.7%	8.3%	5.5%	6.2%						
2003	26.7%	6.7%	16.7%	7.0%	3.8%	5.1%							
2002	-12.4%	8.7%	-1.9%	-2.1%	1.4%								
2001	-12.6%	8.1%	-2.3%	3.1%									
2000	7.4%	10.2%	8.8%										

Table B3

[Note: this is a passive investment comparator, excluding any investment costs.]

For reference, inflation CPI numbers, 2000 to 2010

Annualized Changes in Canadian CPI from 2000 to 2010											
Year Ending Dec 31	One Year	Two Years	Three Years	Four Years	Five Years	Six Years	Seven Years	Eight Years	Nine Years	Ten Years	Eleven Years
2010	2.4%	1.8%	1.6%	1.8%	1.8%	1.8%	1.9%	1.9%	2.1%	2.0%	2.1%
2009	1.3%	1.2%	1.6%	1.6%	1.7%	1.8%	1.8%	2.1%	1.9%	2.1%	
2008	1.2%	1.8%	1.7%	1.8%	1.9%	1.9%	2.2%	2.0%	2.1%		
2007	2.4%	2.0%	2.1%	2.1%	2.1%	2.4%	2.1%	2.3%			
2006	1.6%	1.9%	2.0%	2.0%	2.4%	2.1%	2.2%				
2005	2.2%	2.1%	2.1%	2.5%	2.2%	2.3%					
2004	2.1%	2.0%	2.7%	2.2%	2.4%						
2003	2.0%	2.9%	2.2%	2.4%							
2002	3.9%	2.3%	2.6%								
2001	0.7%	1.9%									
2000	3.2%										

Table B4