UTFA Information Report

University of Toronto Faculty Association February 24, 2010

Information Report #12

SRA Pension Inequity

Summary

UTFA Information Report #12 examines the current Supplemental Retirement Arrangement (SRA) at the University of Toronto. We conclude that: the SRA was poorly conceived and implemented; it was not and is not sustainable; it rewarded a select number of high-salaried plan members very well and pointedly disadvantaged other plan members. It was both expensive and selective.

In 1997 while the University was faced with the massive funding cuts of the Harris years the SRA approval enriched the top 10% highest paid faculty and staff at UofT with a $76-million pension bonus.

The current SRA salary cap of $150,000 will soon be eclipsed by the regular Registered Pension Plan (RPP) salary limit, with the result that in a few years the current SRA at UofT will provide no pension benefit to future retirees.

Our SRA contrasts dramatically with that at the University of British Columbia (UBC). The UBC SRA has no salary cap, is sustainable over time and is more equitable. It is probably less expensive to the university. It is unfortunate that in 1997 UofT did not consider adopting the UBC model for our pension supplement arrangement.

Background

Registered pension plans in Canada have limits on how much money they can shelter from taxes for retirement purposes[1] whether they are Defined Benefit (DB), like our RPP, or Defined Contribution (DC) or individual RRSPs. In a DB pension plan the Income Tax Act limits the maximum pension payable per year of pensionable service. In any specific DB pension plan this will translate to a salary cap for that plan, above which one does not earn any additional pension entitlement. When the SRA was first introduced at UofT in 1996 via the 1997 agreement, the RPP salary limit at UofT was approximately $98,500. It has since increased, to about $138,500 in 2010.

The SRA proposal was introduced by the Administration in the 1996/97 round of negotiations. The purpose of the SRA is to provide a supplemental pension benefit for higher paid members of the university, in addition to their pension from the RPP. The SRA itself is not a registered plan, and its

[1] An excellent reference on Canadian pensions is *The Pension Puzzle* by Bruce Cohen and Brian Fitzgerald, 3rd ed., John Wiley, 2007. For example, on page 48 it discusses the so called “Factor of 9” – which explains how pension legislation attempted to equate RRSP benefits to the benefits in a DB pension plan.

funds cannot be irrevocably earmarked for pension purposes. That is, SRA funds are not protected to the same extent as RPP funds.

Our SRA came into being as a result of the three-year (1996-1999) mediated agreement, signed on June 16, 1997, between the Administration and UTFA. A copy of this agreement is posted on the UTFA website[2]. The SRA was implemented starting July 1, 1996.

SRA Highlights

In most aspects, the SRA is an extension of our current defined benefit registered pension plan. Two features of our SRA plan, however, warrant special attention.

First, in the terms and conditions of the SRA, the 1996-99 agreement states that, retroactively:

> *(i) The SRA will apply to the pension benefit for **all years** of pensionable service, for active members in the University Pension Plan on July 1, 1996.*

The two words "***all years***" is what provided the special $76 million SRA pension bonus on July 1, 1996 to the 600 faculty and staff with the highest salaries. This contrasts sharply with an earlier 1991-1993 agreement which clearly stipulated that its pension improvement was only for "pensionable service on or after July 1, 1992" [3] - in other words, without retroactivity. It is the combination of highest salary selectivity and the retroactivity in the SRA benefit that is so disconcerting.

Second, the highest average salary in the new SRA pension calculation started at $135,000 as of July 1, 1996 and increased by $3,000 each year, up to a $150,000 maximum in 2001. The SRA cap remains at $150,000 to this day. Meanwhile the Revenue Canada RPP salary limit has also been increasing and will shortly overtake the SRA salary cap.

The following discussion will reference Table A-1 in Appendix A, which provides a chronological summary of the various parameters and caps in the RPP and SRA from 1996 to 2013.

Inequitable Aspects of the SRA:

One might assume that faculty serving the university for the same number of years, with similar salary profiles, similar input contributions to the pension plan and similar exit salaries should receive approximately similar pensions. This is not the case with the SRA at the University of Toronto.

[2] The 1996-1999 Agreement at http://utfa.org/images/file/Memorandum%20of%20Settlement%201996-1999.pdf

[3] That improvements - in the lower deck benefit from 1.0% to 1.3% - was not a "freebie" - as the members' contribution rate was increased by more than 50%, from 2.5% to 3.9% of salary. That specific pension benefit improvement was on a go-forward basis, not retroactive and provided a universal benefit to **all** pension plan members, not just the highest salaried members. The 1996-1999 agreement did extend the 1.3% benefit to "all years" of service – but again universally to all active members, not selectively to a privileged few.

To illustrate the inequities of the SRA, let's examine three different professors (or senior administrators) who fit the above criteria but retire at different times with an exit salary in excess of the SRA cap.

Professor X, after 35 years at UofT, retired on June 30, 1996, the day before the SRA was introduced. Professor Y, after 35 years at UofT, retired on June 30, 1997, one year after Professor X. Professor Z, after 35 years at UofT, retires on June 30, 2013, three years from now, when the RPP salary cap eclipses the SRA salary cap.

The SRA pension benefits for the above three professors differ dramatically.

Professor X did not contribute to the SRA and did not receive any benefit from the SRA.

Professor Y contributed, at most $2,190[4], to the SRA over one year (from July 1, 1996 to June 30, 1997) but received a much larger pension via the SRA for the rest of his/her life (and a surviving spouse's as well). Table A-1 suggests that Y's overall pension income could be 30% to 40% larger than X's, yet their respective total lifetime dollar inputs to the pension plan would have been almost the same. This is a consequence of the SRA condition that "*The SRA will apply to the pension benefit for* ***all years*** *of pensionable service, …*"

Professor Z contributed to the SRA because his salary exceeded the RPP salary cap, perhaps in all 16 years prior to 2013, but will see no benefit from the SRA fund because by 2013 the SRA benefit will be eclipsed by the RPP benefit. In fact he/she is penalized by the contributions to the SRA. Peofessor Z would have been better off financially if the SRA had never been introduced.

This illustrates why the SRA plan was not and is not equitable.

Why isn't the SRA sustainable?

Why couldn't the SRA salary cap be increased annually so that it always tops up the RPP salary limit by $35,000 to $50,000? Or why not remove the SRA salary cap altogether? The short answer is that it would be exceedingly costly. DB pension plans in Canada are generally funded in a way that causes them to be back-end loaded and the UofT Pension Plan is no exception. This means that as you age in a DB plan it costs the employer an increasingly larger contribution to fund the pension promise. To illustrate this point, the employer contributes approximately 50 cents for every dollar contributed by a plan member aged 30 under the UofT plan but $2.50 for every dollar contributed by a plan member aged 60. This is five times more per salary dollar for the older member which is then compounded further by the higher salary of the older member. Most of the higher salaries at UofT - those that exceed today's RPP cap of $138,480 – are paid to older faculty and administrators. Thus the employer incurs a much larger cost to fund older faculty and staff in a defined benefit SRA.

In 1996-97, when the SRA was introduced, the <u>notional surplus</u> in our RPP was thought to be in excess of $200 million, premised on optimistic assumptions about future investment returns. Unfortunately a notional surplus is not the same as a real surplus. The Administration of the day equated the two and the result is today's massive under-funding of our RPP. Hewitt, the plan actuary, states that our RPP

[4] $2,190 derives from 6% times the maximum SRA salary benefit of $36,499 in 1996, as shown in Table A-1.

now has a notional deficit of $638 million (July 1, 2009, annual report). We have repeatedly argued that even this is too optimistic and that the real RPP deficit will prove to be substantially larger. In my most recent presentation to Business Board[5], on December 14, 2009, I thought it appropriate to liken our registered pension plan to a legal Ponzi scheme.

How costly was the SRA?

It is difficult to determine the real and total cost of the SRA. Unfortunately there is no actuarial report for the SRA prior to July 1, 2000[6]. The following information provides some guidance:

(i) **$78 million** was the start-up figure cited by R.G. White, Chief Financial Officer, for the "*initiation of the new supplementary retirement arrangement*" according to the October 27, 1997 minutes of Business Board (BB).[7] This statement suggests that this is the estimated cost of the retroactive benefit for "*all years of pensionable service*". The BB meeting report goes on to say: "*The supplemental retirement arrangement would benefit about 600 of those pension plan members.*" Thus the average pension benefit gift is about $130,000 for each of the 600 members who were earning in excess of $98,500. At that time there were 6,000 active members of the RPP and about 3,000 retired participants. Granting such a generous bonus to the top 10% salaries is quite astounding, given the existing "*conditions of financial stringency*" at the time[8]

(ii) **$107.9 million** was the accrued liability of the SRA as of July 1, 2000, four years after the SRA was initiated. This is the first year for which we have a formal actuarial report for the SRA from the plan actuary. Without additional information, one cannot determine how much of this total was contributed by members. By July 1, 2000 the SRA salary cap would have risen to $147,000. The annual SRA service cost is given as $3.4 million as of July 1, 2000. Of the $107.9-million total liability, $18.5 million was attributed to those already retired. This seems very substantial given that as of July 1, 2000 the SRA was only four years old and only 189 retirees were eligible for it.

(iii) **$136.1 million** is the accrued 'going-concern' SRA liability as of July 1, 2009 with about $117 million of this total accrued for already retired participants. At this point the 893 eligible retirees are receiving an average annual SRA pension of about $10,678. The value of the SRA to active members has clearly diminished, as Table A-1 column H shows.

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[5] Posted on the UTFA website at http://utfa.org/images/file/UofT%20Bus-Board%20-%20%20Dec-2009-final-26p.pdf

[6] There appears to be no SRA actuarial report for July 1, 1998 and or July 1, 1999. We do not know why.

[7] Report number 88 of the Business Board, October 27, 1997, page 2. The stated $76 million could be an underestimated total if the implicit and assumed interest rate is overestimated. The interest rate assumption used to determine the $76 million total is not specified.

[8] A reminder of the dire fiscal situation at the time is provided in the recent "Long Term Budget Guidelines". On page 2 at http://www.planningandbudget.utoronto.ca/__shared/assets/budget2007-082490.pdf one reads that: "*In 1995 the new government fulfilled its election promise to further reduce operating grants to universities by $280 million – a loss of $53.9 million to the University of Toronto. … The University's operating grant revenue reached a peak of approximately $400 million in 1992-93 and fell to $339 million in 1997-98.*"

The University of British Columbia (UBC) model for a supplemental pension

The UBC Faculty Pension Plan, which became effective July 1, 1967, is a defined contribution pension plan[9]. Members contribute 5% of basic salary above the lower deck and the University matches this with an additional 10% of basic salary. There is a different and higher matching ratio for the lower deck.

The UBC Supplemental Arrangement (Non-Registered Plan)[10] is an extension to the UBC Faculty Pension Plan, and has been in effect since December 1992. This plan is equitable to all participants and is sustainable over time. It has no salary caps. In 2009 total contributions to the UBC Supplement plan were about 6.7% of the total contributions to the UBC registered pension plan.

On a related issue of pension investment returns, the UBC pension site shows the relative performance of 23 university pension plans in Canada, those with over $500 million in assets, as of December 31, 2008. This table is attached as Appendix B. Toronto is in last place for investment returns in 2008, in last place for the prior 4 years and in last place for the prior 10 years. (The web link in footnote 5 discusses the UTAM investment issues.)

Concluding Comments

Sadly, the inequities and problems of the SRA are not a one-off phenomenon. As UTFA's earlier Information Reports have demonstrated in detail, it seems that every chapter of the UofT pension plan story is similar[11]. If it's not the SRA, it's the catastrophic and cumulative effect of the numerous contribution holidays taken by the Administration: or the self-serving changes in actuarial assumptions: or the inability to acknowledge the intrinsic conflict of interest in simultaneous oversight of the operating budget and the pension plan: or the poor oversight of the investment process: or the enrichment of the money managers at the expense of pension plan assets: or the reluctance to give plan members a meaningful role in pension governance.

The pension plan wind-up deficit now stands at $1.8 billion. Both our pension plan and its governance are in crisis. It's time the Administration recognized this.

As always, any and all comments are welcome.

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[9] *2010 Plan Guide of the University of British Columbia Faculty Pension Plan* at http://www.pensions.ubc.ca/faculty/publications/brochures/overview.pdf Support staff at UBC have a separate Defined Benefit pension plan.

[10] See http://www.pensions.ubc.ca/faculty/supfac.html

[11] See UTFA's web page on pensions, http://utfa.org//index.php?option=com_content&task=view&id=108&Itemid=118

Appendix A

UofT Pension Plan, RPP and SRA, parameters and Caps								
Year (July 1) (A)	UofT RPP Accrual ≤ YMPE (B)	UofT RPP Accrual >YMPE (C)	YMPE Cap (D)	Rev Can Cap on Annual DB Benefit (E)	RPP Salary Cap (F)	SRA Salary Cap (G)	SRA Cap less RPP Cap (H = G-F)	Max Years Contributing to SRA (I)
2013	1.5%[1]	2.0%[1]	$ 53,130[2]	$ 2,805.05[2]	$ 153,535	$ 150,000	$ -	
2012	1.5%[1]	2.0%[1]	$ 51,334[2]	$ 2,710.19[2]	$ 148,343	$ 150,000	$ 1,657	17
2011	1.5%[1]	2.0%[1]	$ 49,598[2]	$ 2,618.55[2]	$ 143,327	$ 150,000	$ 6,673	16
2010	1.5%[1]	2.0%[1]	$ 47,921[2]	$ 2,530.00[2]	$ 138,480	$ 150,000	$ 11,520	15
2009	1.5%	2.0%	$ 46,300	$ 2,444.44	$ 133,797	$ 150,000	$ 16,203	14
2008	1.5%	2.0%	$ 44,900	$ 2,333.33	$ 127,892	$ 150,000	$ 22,108	13
2007	1.5%	2.0%	$ 43,700	$ 2,222.22	$ 122,036	$ 150,000	$ 27,964	12
2006	1.5%	2.0%	$ 42,100	$ 2,111.11	$ 116,081	$ 150,000	$ 33,919	11
2005	1.5%	2.0%	$ 41,100	$ 2,000.00	$ 110,275	$ 150,000	$ 39,725	10
2004	1.5%	2.0%	$ 40,500	$ 1,833.33	$ 101,792	$ 150,000	$ 48,208	9
2003	1.5%	2.0%	$ 39,900	$ 1,722.22	$ 96,086	$ 150,000	$ 53,914	8
2002	1.5%	2.0%	$ 39,100	$ 1,722.22	$ 95,886	$ 150,000	$ 54,114	7
2001	1.5%	2.0%	$ 38,300	$ 1,722.22	$ 95,686	$ 150,000	$ 54,314	6
2000	1.5%	2.0%	$ 37,600	$ 1,722.22	$ 95,511	$ 147,000	$ 51,489	5
1999	1.5%	2.0%	$ 37,400	$ 1,722.22	$ 95,461	$ 144,000	$ 48,539	4
1998	1.3%	2.0%	$ 36,900	$ 1,722.22	$ 99,026	$ 141,000	$ 41,974	3
1997	1.3%	2.0%	$ 35,800	$ 1,722.22	$ 98,641	$ 138,000	$ 39,359	2
1996	1.3%	2.0%	$ 35,400	$ 1,722.22	$ 98,501	$ 135,000	$ 36,499	1

[1]Assumes same accrual rate as 2009.
[2]Assumes 3.5% increase per year.

Table A-1

Column (B) - shows the UofT pension plan benefit parameter in the pension formula for the portion of the salary below the CPP earnings ceiling, also called the YMPE for Year's Maximum Pensionable Earnings.

Column (C) - shows the UofT pension plan benefit parameter in the pension plan for the portion of the salary above the YMPE limit.

Column (D) - lists the YMPE value for that year. This is set by the government and represents the salary number you may see in your annual income tax forms for CPP contributions.

Column (E) - lists the maximum pension payable per year of pensionable service if you retire in the year in column (A). The Income Tax Act determines this number. It is currently increasing by 3.5% per annum.

Column (F) - shows the corresponding maximum UofT salary above which the registered pension plan does not offer any benefit. This dollar number is determined by the respective numbers in Columns B, C, D, and E. One observes that in 1999, when the column B number was raised to 1.5% (from the prior year 1.3%), as expected, the RPP cap in column F was reduced.

Column (G) - shows the salary cap in our SRA.

Column (H) - shows the maximum salary value added by the SRA relative to the RPP cap should you retire in the year indicated in column (A). If you retire in 2013 or later the SRA will not provide any pension benefit, even though you may have been a contributor to the SRA for a number of years.

Column (I) - indicates the maximum number of years one may have been contributing to the SRA fund, since its inception in mid 1996.

Appendix B

A University Pension Plan Performance Indicator Table

University Plans over $500 million as at December 31, 2008

Source: *Canadian Association of University Business Officers (CAUBO) Investment Survey*

Rank*	Plan	Rate of Return 1 Year	Rate of Return 4 Years	Rate of Return 10 Years	Market Value ($000s)
1	Saskatchewan	-11.1	2.3		668,900
2	UBC - Faculty	-13.0	3.5	4.9	1,097,096
3	Montreal	-13.5	3.0	5.5	2,140,173
4	Memorial	-13.7	2.6	5.1	630,243
5	Guelph	-14.2	3.7	6.2	755,162
6	Laval	-14.6	1.9	4.2	1,799,834
7	McGill - Accumulation	-14.9	2.9	5.1	868,568
8	Victoria - Comb. & Money	-15.0	2.8	5.8	554,628
9	Ryerson	-15.3	5.6	7.7	646,232
10	Manitoba	-15.5	2.0	5.1	832,401
11	Dalhousie	-16.2	1.7	5.3	598,565
12	Ottawa	-16.4	2.1	4.6	1,033,355
13	Waterloo	-16.8			773,310
14	McMaster	-17.1	1.4	4.0	855,384
15	Quebec	-18.0	2.4	7.1	1,839,343
16	UBC - Staff	-18.1	1.6	5.8	666,606
17	York	-18.8	0.9	4.5	1,062,291
18	Carleton	-18.8	1.5	6.4	617,450
19	Concordia	-19.3	1.0		505,019
20	Western Ontario	-20.2	0.5	4.4	913,300
21	UAPP (Alberta)	-20.4	1.6	4.1	1,974,659
22	Queen's	-21.2	1.6	5.1	1,110,481
23	Toronto	-29.1	-1.0	3.1	2,071,885

**Rank based on 1 Year Rate of Return*