UTFA Information Report

University of Toronto Faculty Association September 15, 2010

Information Report #15

UofT's Pension Abyss and the Way Forward: ?

The University of Toronto leads all other Ontario universities in the size of the deficit in its pension plan – both in absolute dollars and as a percentage of its assets . This is well documented[1]. In fact, it is likely UofT probably has the highest pension deficit of all Canadian universities.

Just how big is the problem? As of July 1, 2008, the UofT pension wind-up deficit stood at $1.1 billion. The corresponding wind-up deficit for all 22 defined benefit university pension plans in Ontario, including UofT's $1.1 billion, totaled $1.9 billion – meaning that our provincial pension deficit share is more than 50% of the provincial total yet our share of total pension assets was only 22%. Moreover, given UofT's record investment losses in late 2008[2], today's wind-up deficit is now probably closer to $2 billion.

Why? How did UofT find its way into this pension abyss? It's a long and sorry story well-documented elsewhere, so there is no need to repeat it here[3]. Rather, the main purpose of this report is to examine the issues and corrective choices that should be addressed as we move forward.

For the last four years UTFA has attempted to engage the UofT Administration in meaningful discussions on pension governance. To date there is very little to show for it. The negotiating efforts did result in an arbitration award on pension governance from Martin Teplitsky in August, 2009[4]. As a result of this award we are now in the final stages of defining the terms of reference for a new 20-member Pension Committee (PC) that will replace the current pension responsibilities of the Business Board. Please be assured that UTFA will do its utmost to be a constructive member of this new body. But the governance structure and mandate of the PC do not address the root causes of our descent into the pension abyss. At best this new Pension Committee can only serve as an interim step. We need to do much better.

Are there any other university pension plans in Canada we should look at for guidance? Plans that are solvent and have better governance? Yes there are. For example, the two pension plans at the University of British Columbia have much to teach UofT. UBC is a natural comparator for the University of Toronto, as its size and organizational complexity mirrors our own. To date, its pension plans and pension governance have done a better job of ensuring that the needs of faculty are met within a sustainable structure.

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[1] *COU report of the Working Group on University Pension Plans*, February, 2010, page 11. Most of the data in this report is from 2007 and 2008 and so predates the financial meltdown of late 2008 and early 2009.

[2] -29.5% investment return for the UofT pension plan in 2008. The corresponding 2008 loss at UBC for the faculty pensions was -13.0%

[3] For a background read on the deficit please go to: *Inconvenient Truths - Part II - Missing Pension Contributions* November 17, 2008 at http://utfa.org/images/file/Inf%20Rep-9-II-%20final-c(1).pdf

[4] Pension Governance – Arbitration Award by Martin Teplitsky, August 17, 2009 at http://utfa.org/images/file/Award%20-%20Teplitsky-%202009-Aug%2017.pdf

The following explores the important issues UofT needs to address, and indicates some corrective changes suggested by the UBC example.

Issue #1 – Existing Conflict of Interest

The new 20-member Pension Committee at UofT will have 11 members appointed from Governing Council. Herein lies an imbedded conflict of interest. How can the eleven governors serve two fiduciary masters at the same time? On Governing Council they must serve the interests of the University by setting priorities, making decisions, and determining financial allocations in the operating budget. Annual pension plan allocations are budget items – and decisions need to be made on pension plan matters every year. For example, should pension contribution rates in the operating budget be increased? Or, what is the right contribution rate? On the Pension Committee, these same governors must serve the best interests of the pension plan members, not the University, through its decisions regarding investment risks and pension benefits. For example, should the pension plan invest in risky assets in the hopes that this will increase returns and so minimize demands on the university budget – but at some risk to pension plan members? What if a decision made with an eye to the University's bottom line drives the plan deeper into the financial abyss? In pension matters, what is best for the university is not always best for pension plan members. The proposed governance structure will make it difficult for the PC to always act in the interest of UofT's employees, which is exactly the problem we need to correct.

Pensions represent deferred compensation and as such employers should not control and manage pension plan assets. The UofT Administration fails to see this conflict and has rejected UTFA's position that the pension plan should be at arm's length from Governing Council and the operating budget. In fact, this conflict of interest is responsible for the years of missing pension contributions at UofT. Since 1987, the administration has implemented numerous contribution holidays in response to short-term financial circumstances. The long-term effect of these budget-minded decisions is our current pension deficit.

UBC's governance of the defined benefit pension plan for staff has no such conflict of interest. [5] Not surprisingly, the UBC defined benefit pension plan has never taken a contribution holiday. It funds its pension plan consistently and so, unlike UofT, the plan does not have a solvency deficit today. The UBC staff pension plan Board has eight members, half of whom are elected by plan holders. The UBC faculty pension plan is a defined contribution plan[6], currently seven of the eight Board members are faculty and there is no governance conflict of interest.

In some European countries it is against the law for the employer to be both the sponsor and the administrator of pension plans. The two must be independent. Not so in Canada – with tragic consequences for pensioners at companies such as Nortel and Stelco.

Perhaps, to serve the greater public good, UTFA should consider a legal challenge on this issue of pension governance and conflict-of-interest. (There is some precedent for this type of litigation—many years ago, UTFA participated in the early legal challenge of mandatory retirement, finally losing at the Supreme Court.)

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[5] UBC SPP at a Glance at http://www.pensions.ubc.ca/staff/glance.html

[6] UBC FPP at a glance at http://www.pensions.ubc.ca/faculty/glance.html

Issue #2 – One pension size does not fit all

Should faculty and staff be in the same pension plan? At most major universities, UBC included, there are two distinct plans, one for faculty and one for staff. Again, not so at UofT. All employees at UofT –staff and all faculty alike— are in the same defined benefit pension plan. But not everybody in the UofT plan has exactly the same contribution rate or the same pension formula. The salary scales for staff and faculty are quite different, as are average starting ages. Faculty lose years of income while in graduate school and pursuing postdoctoral research. Average earned pension benefits will also be very different for faculty and staff. In our plan there are approximately twice as many staff members as faculty members yet the total accrued liability in dollars for staff is much less, only a bit more than half that for faculty. There are more staff but they represent far fewer pension dollars. This disparity is an impediment to effective governance. How will differences be resolved in a fair and efficient manner?

The new 20-member Pension Committee will have 5 faculty representatives and 4 staff representatives. The 19 unions representing staff in the UofT plan have already threatened legal action because they are not happy with their minority representation on the PC. It will also be very difficult to accommodate and resolve all of the differing union perspectives and interests in one pension committee.

The major US universities, from state universities to the Ivy league schools, have different pension plans for the faculty and staff. UTFA believes it is in the best interests of all concerned to have two plans at UofT, one for faculty and one for staff, with respective governing bodies for each. However, the UofT Administration insists on the status quo of one plan for everyone.

In the years ahead I anticipate that potential new faculty hires, and younger faculty in particular, could view our pension plan as a serious drawback when considering employment at UofT. In my view the UBC faculty pension plan is far superior to UofT's for younger faculty[7].

Issue #3 – Joint pension governance

UTFA proposed a 50:50 joint pension governance structure on a go-forward basis. By 'go-forward' we mean taking joint responsibility for future pension accruals without assuming responsibility for past accruals or deficits for past years of service. The Administration rejected this proposal. The Administration also insisted on a voting majority on the Pension Committee – which they have, 11 to 9.

UBC has an excellent joint governance structure for both the staff and faculty pension plans. The UBC plans have a total of 16 board members for their two plans, with eight members per board and with equal or majority representation for plan members.

Issue #4 – Sustainability

There is no evidence that the current contribution rate in the UofT pension plan is insufficient for sustainability on a go-forward basis. The member contribution rate is not the cause of the abyss we are in. The real problem is the legacy deficit due to the missing contributions, the time value of those missing contributions, the investment losses by UTAM and the Administration's failure to properly manage the plan.

[7] There are many reasons for making this claim and perhaps a separate newsletter on this issue is warranted.

The Administration is anxious to increase the contribution rates for all members in the pension plan – without improving the pension benefits. In our current round of bargaining the Administration proposed that faculty increase their contribution rate by an additional 2.7% of salary[8]. This proposal represents an increase of about 50% from the current average contribution rate of 5.43%, which is approximately in line with that for faculty at UBC, to an overall future average rate of 8.14%. In effect they want the members to replace the dollars lost due to the Administration's past contribution holidays. UTFA opposes this categorically.

It is worth noting that prior to 1987 there was an agreement between faculty and the Administration for sharing the risk and ensuring the sustainability of our plan. Prior to 1987 the ratio of dollar input by faculty to the input by the University was fixed at approximately 2.5, in both good times and bad times. That is, the consequences of investment upturns and downturns alike were shared in a well defined manner. This was changed in the 1987 agreement – when the faculty's contribution rate became a fixed percentage of salary and the University assumed responsibility for the rest of the pension promise[9]. As noted in footnote nine, the Administration was quite clear and insistent about this arrangement and its pension responsibility – during the years in which it took contribution holidays.

Conclusion

My sense is that the Administration's public position on the pension issues raised here is mainly one of denial. But denial is not a solution.

I welcome any and all comments.

Sincerely

George

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For readers interested in further background on pensions at UofT, please visit:
http://utfa.org//index.php?option=com_content&task=view&id=108&Itemid=118

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[8] UTFA Arbitration Brief, April 19, 2010 page 99 at http://utfa.org/images/file/2009-10%20UTFA%20Arbitration%20Brief-xtra.pdf

[9] See pages 100-102 at http://utfa.org/images/file/2009-10%20UTFA%20Arbitration%20Brief-xtra.pdf In years past, when the Administration believed there was a pension surplus, it stated the following : *"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."*