



UTFA Information Report

University of Toronto Faculty Association October 24, 2008

Information Report #9¹ – part I – the introduction

Inconvenient Truths

about the

U of T Pension Plan

The University of Toronto Pension Plan (RPP) has a wind-up² actuarial deficit of \$513 million.

University of Toronto Pension Plans, Annual Financial Report³

“Public pension promises are huge and, in many cases, funding is woefully inadequate.”

Warren Buffett, February, 2008⁴

“America is sitting on a retirement time bomb. Financial debacles are as old as the sun. Virtually all involve some form of borrowing, and borrowing is essentially an arrangement between the present and the future. This is why pensions are so vulnerable. Retirement schemes necessarily involve a treaty between today and tomorrow, and on a mass scale. It is no surprise that so many have run aground, or that when they do, financial upheaval is the result.”

Roger Lowenstein, 2008⁵

¹ This Information Report will be posted at the new UTFA website at <http://www.utfa.org>. The main emphasis in prior Information Reports was on presenting data on various topics. We will be reposting these prior reports on the new website shortly.

² The *wind-up* concept is an important pension term and the reader needs to understand how it differs from *going-concern*. The difference is discussed on the next page and in more detail on pages 9-11 of the #3 footnote reference, or <http://www.finance.utoronto.ca/Assets/reports/pension/2007.pdf>

³ Page 2 of University of Toronto Pension Plans, Annual Financial Report, for the year ended June 30, 2007, on the web at <http://www.finance.utoronto.ca/Assets/reports/pension/2007.pdf>. This wind-up sum of \$513 million considers the obligation to all members of the pension plan, not just faculty. Given the significant investment downturn since July 1, 2007, the wind-up deficit in October 2008 is going to be greater. The same page shows the going-concern pension plan as having a \$184 million surplus. Why the difference? The going-concern liability can change dramatically with changes in the actuarial assumptions. This difference is noted in our discussion and will be discussed in more detail in future reports.

⁴ Berkshire's Annual Report for 2007, at <http://www.berkshirehathaway.com/letters/2007ltr.pdf>

⁵ “While America Aged: How Pension Debts Ruined General Motors, Stopped the NYC Subways, Bankrupted San Diego, and Loom as the Next Financial Crisis”, by Roger Lowenstein, Penguin Press, 2008, pages 221 and 231.

[Has the UofT defined benefit pension plan already run aground?](#)

In these unsettling economic times, faculty and staff at the U of T deserve answers to some key questions about our pension plan: Is it fully funded? Can it meet all of its existing pension promises? Or are we already borrowing from the future?

There are two sets of answers, based on two very different time perspectives.

Time perspective #1 (i.e. the *wind-up* perspective) is based on paying today⁶, in full, all accrued pension obligations. If our pension plan were terminated today, it could **not** meet its obligations to honour existing pension accruals to all faculty and staff, retired and active, using today's interest rates (as required by law). As of July 1, 2007 the "wind-up actuarial valuation" has a deficit of \$513 million⁷.

Time perspective #2 (i.e. the *going-concern* perspective) considers the long term or going-concern obligations and assumes pension obligations are paid out as they come due (rather than immediately and all at once). This involves making assumptions about the future. In this case the proper answer is: nobody knows for certain if today the plan is adequately funded to do this. The claimed surplus or deficit in a going-concern estimate is strictly a *notional* number. Nobody knows how the future will unfold. Therefore, to estimate the going-concern liability the actuaries⁸ must make assumptions about future investment returns, future inflation numbers, future salary increases, future mortality rates, and so on. Defined benefit pension plans are all about assumptions and trust. As the UofT Annual Financial Report attests, if one adjusts the actuarial assumptions regarding the future, then today's wind-up deficit can be recast as a going-concern surplus.

But, as the quote from Lowenstein reminds us, the question is: Is the UofT pension plan in fact borrowing from the future, from the next generation of faculty and staff? We think so and future reports will show that the borrowing started some twenty years ago. The unfortunate truth about defined benefit pension plans is that it is very easy to effect inter-generational transfers of liabilities (or assets).

In summary, from time perspective #1, the pension plan has a very serious deficit with a shortfall of about half a billion dollars. This is real and factual. And my own view is that the UofT pension plan is also in serious deficit from time perspective #2.

In the reports that follow⁹ I shall discuss how the deficit came to be. It was not always so. But very briefly, the genesis of today's deficit is the pension agreement of 1987. Abetted by unduly optimistic actuarial assumption changes since 1987, that agreement allowed the Administration to take numerous

⁶ By 'today' we mean July 1, 2007 as this is the date of the latest official actuarial data available to UTFA.

⁷ The source for the \$513 million is already noted in footnote 3.

⁸ On this point, Warren Buffett has written, in the December 10, 2001 issue of Fortune (vol 144, issue 12): "*The actuaries who have roles in this game know nothing special about future investment returns. What they do know, however, is that their clients desire rates that are high. And a happy client is a continuing client.*"

⁹ In the forthcoming continuation of this information report I shall be discussing other pension topics. Over the last several years I, as UTFA President, have made numerous presentations to Business Board of Governing Council expressing these concerns, but with little effect. The interested reader can access the memos summarizing these presentations on the UTFA website at http://utfa.org/index.php?option=com_content&task=view&id=76&Itemid=101

unilateral pension contribution holidays. Today we would have a wind-up pension surplus and not a \$513 million deficit if these pension holidays had not occurred.

What does the Administration say?

The Administration has recently made the following public statements:

“You don’t have to worry 20 years down the road,” ... “We’ve made a legal promise to pay pensions. It’s the University’s responsibility to ensure that the funds are there to do so.”

and

“... the University of Toronto's pension plans are fully funded.”¹⁰

These unqualified statements are not supported by the half billion dollar wind-up deficit as of July 1, 2007. And one must ask: Who bears the final responsibility or risk when the shortfall must be made good? Where does the money come from, at a non-profit public institution like a university? We cannot borrow as easily as governments can – or tax the public directly. We cannot raise the price on our product since the Province regulates tuition. Will we have to sell UofT land and buildings? Will we continue to increase workloads with yet higher student-faculty ratios, and with the corresponding erosion of quality? Or might the Province come to our rescue? No one knows how this can or will be resolved.

Every faculty member and librarian has a monetary stake in the pension plan

Pensions are deferred compensation; your pay stubs show the significant contributions you make every month. The legal pension plan contract guarantees that the University will contribute its share as well. The individual pension stakes are high. To illustrate, a senior faculty member with 30 to 35 years of service will at age 65, have an accrued commuted pension asset on the order of a million dollars. This translates into an annuity that provides a guaranteed income as long as they and their partner live. For most members and spouses the pension will be the principal source of income when they retire.

The overall and average numbers for faculty and librarians are shown in the following table. The ratio of active faculty to retired faculty is about 7:5, indicating that it is now a fairly mature pension plan. At present only the liabilities owing to the faculty are known, not the corresponding actual assets. The assets are *owned* in total by everyone in the plan, not just faculty. In addition to the 4,702 faculty, there are at present about 7,600 administrative and unionized staff who also belong to the same pension plan.

¹⁰ UofT website (January 14, 2008) at <http://www.news.utoronto.ca/bin6/080114-3577.asp> and UofT Bulletin, January 15, 2008, page 3 at http://www.news.utoronto.ca/bulletin/PDF_issues/01-15-08.pdf The stated going-concern actuarial valuation shows an \$183.9 million surplus (see page 2 of the University of Toronto Pension Plans, Annual Financial Report, for the year ended June 30, 2007, at <http://www.finance.utoronto.ca/Assets/reports/pension/2007.pdf>) This, presumably, is the reason for claiming that the RPP is “fully funded”. But the going-concern numbers are not market based. The wind-up deficit numbers are market based.

UofT Pension Plan - Summary for Faculty and Librarians			
	Contributing Members ('active')	Pension recipients ('retired')	Total
Member count	2,736	1,966	4,702
Percentage of total	58%	42%	100%
Total accrued going concern liability	\$ 752,271,000	\$ 946,378,000	\$ 1,698,649,000
Percentage of total	44%	56%	100%
Total accrued wind-up liability	\$ 942,896,000	\$ 1,186,190,000	\$ 2,129,086,000
Average going concern liability per member	\$ 274,953	\$ 481,372	\$ 361,261
Average wind-up liability per member	\$ 344,626	\$ 603,352	\$ 452,804

Note: The going concern data is as of June 30, 2007 and comes from Hewitt's actuarial summary as prepared for an UTFA Information Request. The wind-up liability numbers are 25% higher and are estimated by the author, GL, based on the numbers in the footnote 2 reference. The faculty members classified as 'terminated vested' and 'suspended, exempt, or pending' do not represent a significant total liability and so are not included in this table.

Conclusions

I take no pleasure relaying inconvenient truths about our pension plan. These are uncertain and unsettling times. Every few days we read or hear about another major financial blowout or threat of one. Trust in our institutions is being seriously undermined. Why is this happening? I think that major contributing factors are: lack of transparency, unnecessary complexity, conflicting agent-principal issues, and shortcomings such as erroneous risk assessments by the agents and complacency and blind trust by the principals.

As a public institution of higher learning, inconvenient truth and reality must trump any concern over public relations.

In the information reports that follow I will discuss the following pension topics:

- actuarial assumptions and contribution holidays,
- investment issues and oversight, and
- pension governance.

I welcome any and all comments.

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