

# UTFA Newsletter

University of Toronto Faculty Association  
Tel:(416) 978-3351 Fax: (416) 978-7061

720 Spadina Avenue, Suite #419, Toronto, ON, M5S 2T9  
Email: [faculty@utfa.utoronto.ca](mailto:faculty@utfa.utoronto.ca)

No. 1 Sept 12, 2002  
website: [www.utfa.utoronto.ca](http://www.utfa.utoronto.ca)

---

## Salary, Benefits and Pensions Information Report #4

### The Anomalous UofT Pension Plan

#### Introduction

This report continues our discussions of the UofT pension plan. In a previous report<sup>1</sup> it was shown that the University of Toronto defined benefit (DB) pension plan is not peer competitive with pension plans at major academic institutions in North America. The UofT plan is in fact anomalous among peer institutions. The previous report also highlighted some of the inequities of the present UofT plan.

In this new report I want to focus on some other disquieting anomalies of the UofT plan.

The important topics of pension surplus and pension risk will be left to a future report.

#### Pension Costs or “Why has the employee share been increasing?”

Pension plans represent deferred compensation.

Both the employee and the employer may contribute to a pension plan during the working or active years. The ratio of the respective contributions varies from institution to institution and plan to plan. *At some universities (in the U.S.) only the employer contributes.* At others, the employee may bear a major share. For the past 15 years at UofT the employees have been bearing almost the *total* cost. During the same period the University has enjoyed a near continuous contribution holiday. While some of this holiday may be attributable to the unprecedented stock market run-up of the past decade, there are other significant reasons. To illustrate one such reason, the UofT pension plan has been gradually shifting more and more of the service cost onto the shoulders of the employees. This is a subtle anomaly. Pension issues are not always easy to communicate. Please bear with me.

When discussing pension “cost sharing”, we need to differentiate carefully between the *theoretical cost* of a year of pension benefits and the *actual cost*. In DB pension plan parlance, the annual theoretical cost is referred to as the “*service cost*”.

If the actuarial assumptions in a DB pension plan could be perfect<sup>2</sup>, the ongoing annual service cost calculation would be identical to the actual cost.

Every year the annual pension plan report<sup>3</sup> specifies the pension service cost for that year. It also breaks down the service cost into the employee share and the employer share.

---

<sup>1</sup> UTFA SB&P report #2, “The UofT Pension Plan: Is it competitive? Is it equitable?” Oct 12, 2001. Copies can be requested from UTFA. It is also on the web at [www.utfa.utoronto.ca/html/newsbul/html/oct1201.htm](http://www.utfa.utoronto.ca/html/newsbul/html/oct1201.htm)

<sup>2</sup> This of course is impossible in practice as it requires a perfectly accurate set of assumptions (predictions) about portfolio returns, salary increases and inflation changes for many years into the future.

<sup>3</sup> Prepared annually by Hewitt Associates for the academic year from June 30 to July 1 of the following year. This annual report usually becomes available sometime in November.

To illustrate, the annual pension report of July 1, 2001 specifies the following annual service cost figures for the UofT registered pension plan<sup>4</sup> (RPP). (The numbers will vary from year to year.)

\$55.4 million Total RPP Service Cost	=>	\$34.7M is employer share	- or 63%
	=>	\$20.7M is employee share	- or 37%

These numbers represent the *intended* (not actual) cost sharing split between the two, the employer and the employee<sup>5</sup>. The ratio of the split for 2001 is 1.7 (= 34.7 / 20.7) - let's call it the "R" ratio. The smaller the value of the R ratio, the less favourable the plan rules are to the employee.

The following two figures illustrate the historic evolution of R (in figure 1) at UofT from 1987 to 2001 and the actual contribution amounts (in figure 2). Figure 2 shows that in 2001 the *actual* contribution by employer and by employee was zero.

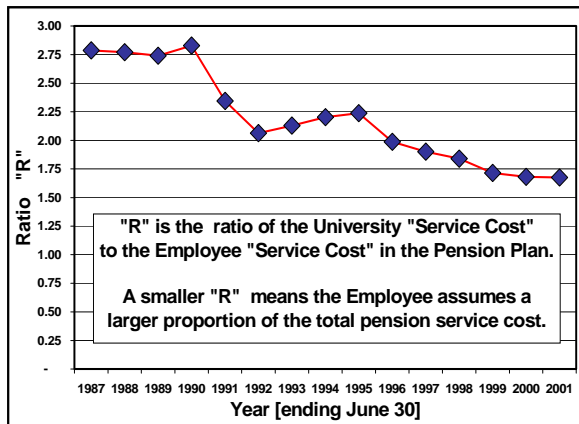


Figure 1

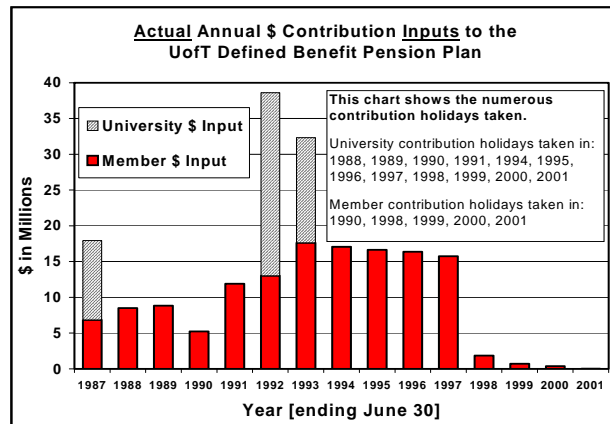


Figure 2

The 2001 R ratio of 1.7 *implies* that the University's obligation is to contribute \$1.70 for every \$1.00 contributed by the employee. In 1989 the service cost numbers were such that the University was responsible for about \$2.75 as a theoretical contribution for every \$1.00 by the employee. *This change from 2.75 to 1.70 represents a substantial shift.* The decreasing value of R<sup>6</sup> in Figure 1 reveals that since 1990 the employees of the University of Toronto have been shouldering an ever-increasing proportion of the total service cost of their pension plan. This gradual transfer of pension costs represents a real erosion of total compensation – in fact a subtle and hidden "take-back".

To add insult to injury, at the same time as this gradual cost-sharing transfer has been taking place, the University has in practice not had to contribute even its diminishing share of the service cost – as evidenced by its nearly continuous contribution holiday in figure 2 above.

*I am deeply troubled by what this data discloses.*

**My personal view is that if the wider academic community fully understood figures 1 and 2 and the implications for retirement pensions at UofT -- UofT would have serious difficulty recruiting and hiring the best young faculty. Unfortunately for them, most young faculty recruits pay little or no attention to the details of the pension plan when considering a job offer. To take advantage of this is not right and the underlying problem must be dealt with.**

<sup>4</sup> The discussion does not include the UofT Supplemental Retirement Arrangement (SRA) for salaries above \$95,000 (approximately). The service cost for the SRA in 2001 was \$3.1 million. The numbers given include all UofT employees; faculty, librarians, staff and administrators.

<sup>5</sup> In practice the employee share of the service cost in a DB plan is calculated first and the remaining balance of the total service cost is then the responsibility of the employer. This means that for the employee the "service cost" will exactly equal the "actual cost" – assuming no negotiated "contribution holiday". The employee's contribution rate at UofT is 4.5% of salary up to the YMPE limit and 6.0% of salary above the YMPE limit (up to the pension cap). The current YMPE limit is \$39,100. If the plan is in a "surplus" state, however, the employer gets an automatic contribution holiday – and then the actual cost for the employer is zero while the service cost is not zero.

<sup>6</sup> The precise reasons for the change in R are complicated - as a number of factors come into play, such as changes in pension plan assumption for investment returns, for inflation, for salary increases, for mortality tables, etc, changes in the employees' contribution rate (in 1986 they were 2.5% and 5.0%, today they are 4.5% and 6%), benefit changes, YMPE changes, RPP pension cap changes, etc.

## UofT Pension Plan Expenses or “Why have unit costs increased in the UofT plan?”

It costs money to run a pension plan and manage assets. That is not at issue. What is at issue is: “How much are the costs, are all the costs justified, and is the unit cost competitive?”

The July 1, 2001 plan report gives expenses for the year as \$8.648<sup>7</sup> million (see figure 3). This is an average of \$740 for each of the 11,691 plan members. Since assets of the plan were \$2,062M, the expenses for 2000-01 were about 0.42% of assets or in financialspeak, “42 basis points“ (as shown in figure 4).

Just five years ago, in 1996, the corresponding numbers were \$2.3M for expenses and \$1,549M for assets. Thus the expenses for 1996 were about 0.15 % of assets or 15 basis points. A substantial difference!

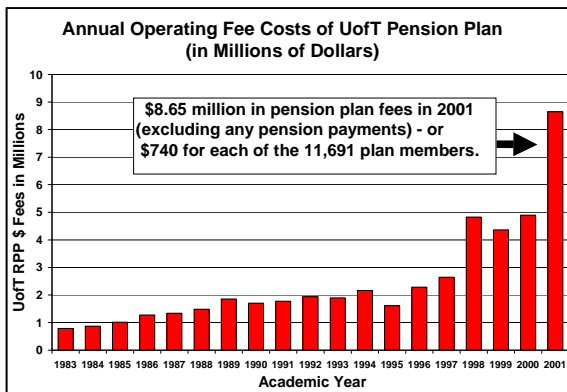


Figure 3

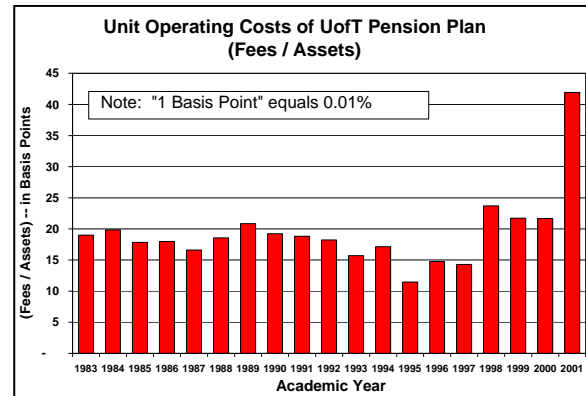


Figure 4

The reader may be wondering: “Why should we care? Our benefits are fixed.” The bottom line answer is that the more that is taken out of the pension fund for non-pension expenses, the less that remains for actual pension payments to retirees.

**Why have costs increased? Three reasons: UofT, UTAM<sup>8</sup> and Hewitt. They all take a generous bite.**

The last entry in figure 3, for 2001, is over \$8 million and stands out as anomalously high.

In 2001 the University charged the pension plan about \$1.3 million for administrative fees. (\$1.3 million represents considerable “administration” – and this must be questioned.) Before 1997 there was no such charge. In 2001 there was a charge of \$370,000 for administration of pension records. Before 1998 there was no such charge. In 2001 UTAM charged the fund about \$1.2 million. Before 2001 there was no UTAM. Since UTAM hires more external active managers, the external managers’ fees were \$4.5 million in 2001–about double what they used to be with less active management before 2001. In addition, there is \$598,000 for actuarial and consulting fees (to Hewitt) and another \$660,000 in trustee and custodial fees.

Is the current expense of 42 basis points reasonable? No, it is not reasonable, not in relation to the 15 basis points it cost in 1996. No, it is not reasonable, not in relation to the Canada-wide average of 27.7 basis points<sup>9</sup> for pension funds. And not in relation to my own experience. My wife and I have two self-directed RRSP accounts<sup>10</sup>. Our annual total expense is less than 30 basis points. This means our personal unit cost for pension plan expense is less than UofT’s unit cost – while our asset base is more than 2,000 times smaller than UofT’s. Talk about dis-economies of scale! This in part is the basis of my criticism of the current cost of expenses in the UofT pension plan.

What oversight was there? Have the fiduciary interests of the pension plan members (rather than those of the University) been represented and properly served?

**An energetic Pension Advisory Committee, representing all plan members and with considerable authority and influence, should have been in place years ago.**

<sup>7</sup> This includes fees for investment management, custodial fees, and administration fees – but no pension payments.

<sup>8</sup> UTAM is the University of Toronto Asset Management Corporation. It was established in May, 2000.

<sup>9</sup> Benefits Canada, April 2002, [The Top 100 Pension Funds](#).

<sup>10</sup> We use CIBC Investors Edge, low cost CIBC RSP index funds, have a well-diversified asset allocation, and foreign content that is in excess of 60%. It is simple, effective and requires no maintenance (except for infrequent rebalancing).

## A New Issue; Age Bias in a DB Plan or “How does a DB plan favour senior faculty?”

All defined benefit pension plans have a built-in age bias. The bias is that the younger plan member gets minimal benefit (a negative bias) while the older member gets maximal benefit just before retirement (a favourable bias). The difference between the two ages can be substantial. Figure 5<sup>11</sup> illustrates the age dependence of the service costs in the UofT DB pension plan. There is about a factor of 16 between the University service cost (the employer’s share of pension contributions) for a plan member at age 25-29 versus an older 60+ year plan member. Over a complete (and continuous) 35-year UofT academic career, this will average out to something like the 1.7 ratio (or more) discussed earlier. Note that the employee contribution is a flat line as a percent of salary. This represents a weighted average of the 4.5% and 6.0% rate referred to in footnote 5.

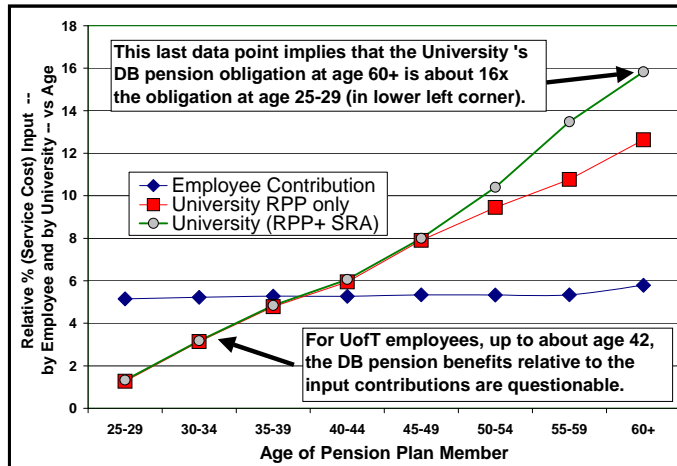


Figure 5

The practical implications of the above are that a young faculty member who plans to leave UofT will take a pension hit<sup>12</sup>, while the older member who takes a VEARP (Voluntary Early Academic Retirement Plan) is giving up the most lucrative DB pension plan years of his/her career. At age 55 and beyond the DB benefits are golden. To my knowledge this information is not mentioned in UofT brochures or presentations.

## Conclusions:

**Pension reform for faculty and librarians is overdue and badly needed at the University of Toronto.**

Pension reform now will have little, if any, impact on my pension or on that of other senior faculty. I'm 62 and the DB plan is quite generous at 62 – as is shown via Figure 5. But over my full 35-year career, and on average, I believe I've been badly treated by the University of Toronto pension plan. On balance the pension benefits at McGill, at UBC, at Wisconsin, at Michigan, etc, are superior to our own here at UofT.

The most important need for pension reform is to assist new incoming 30-year-old faculty members, to ensure that they are not victimized over their career at the University of Toronto.

In addition, there is immediate need for an effective voice on behalf of current pension members, both active and retired, via an effective Pension Advisory Committee (PAC). PAC needs to have a meaningful say in matters regarding pension plan costs, pension adjustments for disadvantaged retirees, the content of information brochures and related pension matters.

I welcome any comments or questions.

George Luste  
President, UTFA

luste@utfa.utoronto.ca                      416-978-4676

<sup>11</sup> The raw data comes courtesy of A. Shapira (Hewitt) at the UTFA/UofT Pension Forum. The interpretation is mine.

<sup>12</sup> The plan provisions provide a possible transfer of two times the participant's contributions with credited interest to another "locked-in" plan. This compensates in part, but only in part, for the age bias of figure 5.