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Date: April 26, 2010
To: Governing Council Business Board Members
From: George Luste, President, University of Toronto Faculty Association (UTFA)
and Professor, Physics Department, University of Toronto

Re: Agenda item #3. - Investments : UTAM – 2009 Annual Report

The suggested 5 minutes of time I have requires I be selective in what and how much detail I can present. I trust this memo may be helpful. The memo will also be posted on the UTFA pension webpage at http://utfa.org/index.php?option=com_content&task=view&id=108&Itemid=118

- I. Circumstances**
- II. Repeat Conclusion**
- III. 2008 and 2009 UTAM returns - and comeback percentiles**
- IV. Active (UTAM) vs Passive (indexes) – 2000 to 2009**
- V. Cost matters – a 700% increase with UTAM**
- VI. Pensions vs Management Fees**
- VII. Additional Issues & a Further Conclusion**
- VIII. Questions?**

I. Circumstances

All Board members and readers should know that last month (in March) George Luste was appointed to the transitional UTAM Board and to date has participated in one UTAM Board meeting. I was appointed on the understanding that I could and would continue to speak out about UTFA's concerns regarding the pension fund.

Any information I present here is already in the public domain and I will be respectful of UTAM Board confidentiality.

While UTAM manages both the Endowment funds and Pension funds, my focus will be mostly on the Pension funds.

II. Repeat Conclusion

A year ago, at the April 27, 2009 Business Board meeting, UTFA stated:

The evidence of the past nine years, not just the catastrophic losses in 2008, suggests 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.

This is consistent with the findings of the recent 'Report of the President's Committee on Investment Policies, Structures, Strategies and Execution' – Chaired by Henry N.R. Jackman with Larry Wasser as Vice Chair. This report is posted at the UTFA website on the pension page.

The Committee is therefore of the view that UTAM has not achieved its mission: "to deliver consistent superior investment returns."

III. 2008 and 2009 UTAM returns - and comeback percentiles

In 2008 the University of Toronto pension fund lost 29.5% of its \$3.0 billion value. It ended the year at \$2.1 billion. The table in Appendix A compares Canadian university pension fund returns in 2008. UofT is in last place.

A subsequent positive return of 41.8% is required - just to return the pension fund to its original \$3.0 billion value, without any net gain.

The 2009 UTAM return for the pension fund is 5.4%. This is a long way from 41.8% and a complete recovery of the 2008 losses - a fact that may be lost if one simply looks at average return numbers.

IV. Active (UTAM) vs Passive (indexes) – 2000 to 2009

Over the full ten years of UTAM's existence, its annual compounded rate of return has been 2.1% (for the pension plan funds). Inflation over the same time period has been the same, 2.1%.

The following table provides comparators for the public markets and indexes.

Nominal annual pretax returns in Canadian dollars - over the ten UTAM years													
Year	UTAM	Annual Canadian Inflation	3 month T-bills	Short Canadian Bonds	Long Canadian Bonds	All Canadian Bonds	Real Return Bonds	TSX Composite	S&P 500	Wilshire 5000	MSCI EAFE	MSCI Emerging Markets	Gold Bullion
2000	5.2%	3.2%	5.5%	8.2%	13.0%	10.2%	16.6%	7.4%	-5.6%	-7.4%	-10.6%	-27.9%	-1.8%
2001	-1.5%	0.7%	4.4%	9.4%	6.1%	8.1%	0.6%	-12.6%	-6.4%	-5.4%	-16.3%	3.7%	7.0%
2002	-7.0%	3.9%	2.5%	6.3%	11.1%	8.7%	15.3%	-12.4%	-22.8%	-21.6%	-16.5%	-6.9%	24.4%
2003	15.9%	2.0%	2.9%	5.1%	9.1%	6.7%	13.2%	26.7%	5.8%	8.2%	14.4%	28.4%	-1.5%
2004	11.4%	2.1%	2.3%	5.1%	10.3%	7.1%	17.5%	14.5%	2.8%	4.4%	11.9%	16.8%	-3.0%
2005	12.3%	2.2%	2.6%	2.4%	13.8%	6.5%	15.2%	24.1%	1.5%	2.9%	10.3%	30.2%	13.9%
2006	12.1%	1.6%	4.0%	4.0%	4.1%	4.1%	-2.9%	17.3%	16.0%	16.1%	27.1%	32.9%	23.5%
2007	6.0%	2.4%	4.3%	4.1%	3.4%	3.7%	1.6%	9.8%	-10.3%	-10.1%	-5.0%	18.9%	12.2%
2008	-29.5%	1.2%	2.8%	8.6%	2.7%	6.4%	0.4%	-33.0%	-22.6%	-23.0%	-30.0%	-42.5%	28.2%
2009	5.4%	1.3%	0.5%	4.5%	5.5%	5.4%	14.5%	35.1%	9.1%	11.7%	14.3%	54.5%	7.9%
Geo Mean	2.1%	2.1%	3.2%	5.7%	7.8%	6.7%	8.9%	5.6%	-4.0%	-3.3%	-1.6%	6.7%	10.5%
Std Dev	13.3%	1.0%	1.4%	2.3%	4.1%	2.0%	8.1%	21.1%	12.8%	13.4%	18.2%	29.6%	11.5%
Average	3.0%	2.1%	3.2%	5.8%	7.9%	6.7%	9.2%	7.7%	-3.2%	-2.4%	0.0%	10.8%	11.1%
Min	-29.5%	0.7%	0.5%	2.4%	2.7%	3.7%	-2.9%	-33.0%	-22.8%	-23.0%	-30.0%	-42.5%	-3.0%
Max	15.9%	3.9%	5.5%	9.4%	13.8%	10.2%	17.5%	35.1%	16.0%	16.1%	27.1%	54.5%	28.2%

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Question:

How do passive investment returns compare to UTAM's active management returns for the UofT pension plan?

Assume the passive is a 50:50 mix of the All-Canadian-Bond index and the TSX equity index. (This is the same passive mix as was used in past presentations by UTFA to Business Board.)

Answer:

The passive return beat the UTAM return in seven of the ten UTAM years, from 2000 to 2009 inclusive, with a lower volatility. The compounded annual return is 6.7% for passive vs 2.1% for UTAM. This translates to about a \$956 million total difference in favour of passive over UTAM over the ten years.

(Less about 10-15 basis points on assets, or \$20-\$30 million total, for passive management costs.)

The following table provides year by year details. The annual returns are for the calendar year. The pension plan asset value is taken as that in mid-year, on June 30th.

Year	Assets	Passive		Active-UTAM		Difference
	Pension Assets on Jun 30 \$ in Billions	Passive Mix 50% All-Can Bonds and 50% TSX	Passive Pension Gain or Loss in \$ Mil	Active UTAM returns	UTAM Pension Gain or Loss in \$ Mil	Passive \$ less UTAM \$ in Millions
2000	2.26	8.8%	199	5.2%	117	82
2001	2.06	-2.3%	-46	-1.5%	-30	-16
2002	1.94	-1.9%	-36	-7.0%	-135	99
2003	1.86	16.7%	311	15.9%	296	15
2004	2.11	10.8%	228	11.4%	241	-13
2005	2.32	15.3%	355	12.3%	285	70
2006	2.49	10.7%	266	12.1%	301	-35
2007	2.93	6.8%	198	6.0%	175	23
2008	2.72	-13.3%	-362	-29.5%	-802	441
2009	1.95	20.3%	396	5.4%	105	291
Compounded % St Dev		6.7% 10.3%		2.1% 13.3%		
Average %		7.0%		3.0%		
Sum			\$1,508		\$553	\$956

V. Cost matters – a 700% increase with UTAM

Prior to UTAM, the annual fees and expenses for the pension plan were less than \$5 million annually and in the range of 20 basis points.

In 2009 the total cost for fees and expenses to the pension plan was \$28 million. This corresponds to a rate of about 150 basis points of assets - representing a 700% increase relative to the pre UTAM days.

Given that the pension plan total return in 2009 was only 5.4%, the 1.5% frictional loss reflects a substantial portion of the pre-cost returns. Considered next to the 2.1% ten year compounded return rate, the current 2009 frictional loss of 1.5% is even more outrageous.

Appendix B charts the fees and expenses for the pension plan from 2000 to 2009. This page was shown to Business Board at the December meeting by the Ms. S Brown.[Report Number 178 of the Business Board.] It illustrates the growth in both dollar cost and as a percentage of assets – for the academic year (not the calendar year).

From 2000 to 2009, the additional and cumulative cost is about \$110 million above an annual baseline of \$5 million. This accounts for a portion of the \$985 million advantage for passive investing. These numbers refer only to the pension plan. The corresponding costs for the Endowment fund are extra.

Why is there no discussion about costs in the UTAM annual report?

VI. Pensions vs Management Fees

In 2008-09 the 4,569 retired members (both faculty and staff) of the registered pension plan received a total of \$127.6 million in pensions, or on average pension of about a \$30,000 per retiree. The Pension plan fees (investment management, custodial and administration) totaled \$28.1 million. This cost is 22% of the \$128 million total paid out in pensions. Surprising large.

Appendix C is from the Hewitt annual pension report and substantiates these numbers.

VII. Additional Issues & a Further Conclusion

There are many other significant issues that could be raised regarding UTAM's operation and the annual report before you today. I will list a few, in no particular order.

- (i) **Complexity.** Asset Allocation too complicated. Alternative assets excessive.
- (ii) **Risk.** Misconceptions and generalities.
- (iii) **Liquidity.** Why a problem? Pension and Endowment cash flows predictable.
- (iv) **Valuation** of illiquid assets. How reliable? FAS 157 type accounting?
- (v) **Passive Investing.** Need for meaningful debate.
- (vi) **Endowment vs Pension returns differ.** Why? Same Asset Allocation.
- (vii) **UTAM oversight.** Lacking.
- (viii) **Annual Report.** Heavy on PR and minimal on basic issues. Cost discussion?

In a second conclusion, my personal view is that our pension plan would be better served in the long run if we returned to the lower-cost and simpler pre UTAM days as quickly as possible and used only public market investments – for 95% or more of our assets.

VIII. Questions?

Appendix –A

For April 26, 2010 UTFA Memo to Business Board

2008 Returns

Canadian University Pension Plans

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			Market Value
		1 Year	4 Years	10 Years	(\$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

Appendix –B

For April 26, 2010 UTFA Memo to Business Board

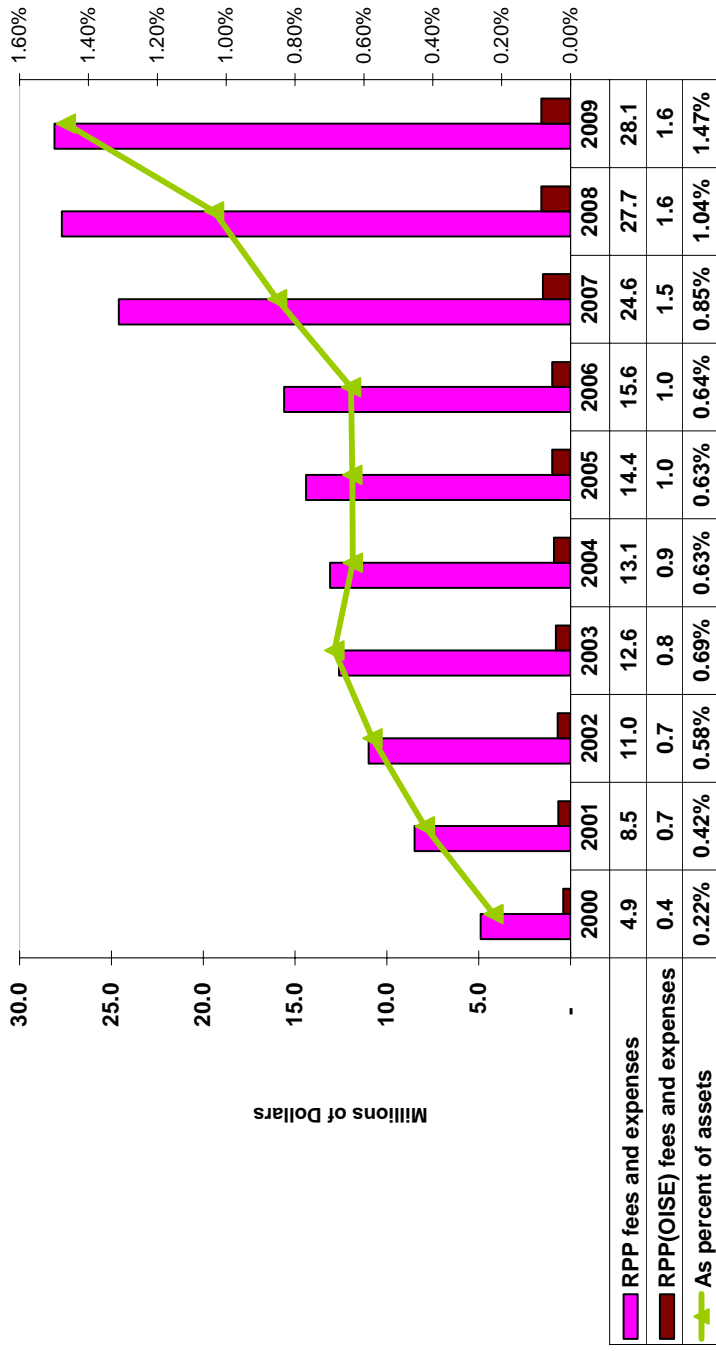
2008-09

UofT Pension Plan Costs

From report by Ms S Brown, Chief Financial Officer,
at December 14, 2009 Business Board meeting

Fees and Expenses

University of Toronto Registered Pension Plans
 Fees and Expenses as a Percent of Assets
 (excluding SRA)
 for the Year Ended June 30



Appendix –C

For April 26, 2010 UTFA Memo to Business Board

2008-09

Hewitt Actuarial Report

RPP Revenue Account Summary Page

Assets and Liabilities (continued)

Revenue Account (Thousands of Dollars)

Market Value of Assets, July 1, 2008	\$ 2,724,186
Plus: University Contributions	87,054
Participant Contributions	34,606
Incoming Transfers	2,237
Net Investment Gain (Loss) from Master Trust	(721,431)
Less: Pensions Paid	(127,568)
Lump-Sum Payments and Transfers	(16,115)
Fees (Investment Management, Custodial, and Administration)	<u>(28,121)</u>
Market Value of Assets, June 30, 2009	\$ 1,954,848