UTfA
UNIVERSITY OF TORONTO *faculty* ASSOCIATION

Pensions

Supporting Documents for UTFA Members

Answers to member questions

The University Pension Plan (UPP)

Q. What is the University Pensions Plan (UPP)?

A. The **University Pension Plan (UPP)** – the proposed **jointly sponsored pension plan** (JSPP) for the Ontario university sector – has been developed with extensive participation and direction by elected leaders of:

- University of Toronto Faculty Association (UTFA);
- Queen's University Faculty Association (QUFA);
- University of Guelph Faculty Association (UGFA);
- United Steelworkers Local 1998 (U of T);
- USW Local 2010 (Queen's); and
- USW Local 4120 (U of Guelph).

These leaders have been meeting regularly with representatives of the administrations at the three universities, determining the UPP's details and transitional arrangements.

The creation of the UPP represents a once-in-a-generation opportunity to sustain the defined benefit (DB) pension system with the Ontario University sector. The move to the UPP would enable us to maintain a ZDB pension plan while addressing the significant financial challenges that exist under the current plan.

Q. If the UPP includes shared governance and shared costs, what does this mean practically?

A. Sharing costs starts with setting employee and employer contribution rates, which will be negotiated by the sponsor board based on the UPP's funding needs and with the goal of keeping contribution rates steady over the long term. Employees and employers will also share any future surpluses or deficits that might arise related to the pensions earned within the UPP.

In the event of a funding deficit, both employees and employers share responsibility for bringing the plan back to full funding. The responses to covering a shortfall arising in the UPP could include:

1. Raising contribution rates (these are paid by both employers and employees);
2. Reducing future pension benefits for those paying in now (for the portion of pension earned after the start of the UPP); and/or
3. Reducing or suspending cost of living increases for pensions in pay earned after the start of the UPP.

In the event of a funding surplus, the employee group and employer group would each determine the use of their portion of the surplus based on the terms of the funding policy (to be developed as part of the UPP). Employees could potentially use their surplus to hold in reserve as a financial cushion—or to lower contribution rates, increase future pensions, and/or raise cost of living increases for pensions in pay.

Converting to the UPP

Q. Why does the UTFA support converting the U of T pension plan to the UPP?

A. The creation of the UPP represents a unique, once-in-a-generation opportunity to improve and sustain the retirement income system in the Ontario university sector. While there are several reasons to support this transition, they can be distilled to these two most significant:

1) Moving to a JSPP model means securing our defined benefit pension plan. Our current circumstances carry too much risk for employers – and, therefore, for plan members. The UPP addresses some of the financial challenges faced by our current 'single-employer' university pension plans, providing a solution that supports plan sustainability and alleviates employment risk, which includes the risk to other benefit programs.

2) Moving to a JSPP provides **joint governance** – employees, unions and faculty associations representing plan members will finally have an equal say with the university administration in the design, funding, investment and administration of our pensions.

Q. What would happen to pension benefits already earned under the current plan, including the benefits of retired members, if the U of T plan were converted to the UPP?

A. All pensions earned under the U of T plan would be fully transferred to the UPP with no change. The UPP cannot reduce pensions while the plan is ongoing, and the U of T must make up any shortfall related to pensions earned in the U of T plan in the unlikely event that the UPP ends.

Anyone who retired under the U of T plan before conversion to the UPP would continue to be paid the same amount of pension after conversion. These retirees would not be affected by any contribution increases and would receive the same cost-of-living increases after conversion that they would under the current U of T plan. In the unlikely event the UPP was wound up, the U of T would be required to pay into the UPP any additional amount required to ensure that retirees and their beneficiaries receive full payment of the pension earned under the U of T plan.

Starting the first day of the UPP, all future benefits would be earned within the UPP.

Q. Will conversion to the UPP create cross-subsidies among participating universities or members?

A. Cross-subsidies (also known as risk pooling) are inherent in the design of all pension plans, including the current U of T plan, and distinguish a pension plan from a savings plan. For example, the lifetime pensions paid to members who live longer than average are subsidized by those whose lifespan is shorter. The fact that women tend to live longer than men results in a cross-subsidy between men and women. By pooling investment risk, benefits earned during periods of low investment returns are subsidized from excess returns generated in other periods.

Other examples of cross-subsidies are tied to specific plan design features. For example, in a final average earnings-related plan like U of T's, members whose salaries grow more quickly towards the end of their careers are subsidized by members whose salaries grow more slowly or whose salaries hit the pension maximum earlier in their careers.

In the multi-employer UPP, there may be cross-subsidies between universities as well as among groups within a given university, although the extent of these cross-subsidies is likely to be relatively small.

Q. My main concern is that a pension based on the highest 36 months of earnings means that people who contribute different amounts can be paid the same amount of pension if they end their careers with the same earnings. This already occurs in the U of T pension plan but when combined with other universities this will amount to large subsidies by the U of T and U of T staff and faculty for the pensions of those at the other universities. These transfers will (likely) occur because the U of T has (1) higher average salaries, meaning we spend more time "capped out," (2) younger average faculty, and (3) we work longer, which mean fewer years of payouts.

If the system were to change to one where it was based on contributions more directly, rather than just the highest 36 months of earning, could we avoid these problems?

A. The points you make with respect to cross-subsidies are correct in part, but do not present the complete picture. Your point about salaries is correct. In the case of two faculty members starting on the same day, one of whom reaches the CRA maximum before the other, the one who reaches the CRA maximum first will have contributed more to the plan than the other. And to the extent that U of T faculty tend to reach the maximum earlier than those at other institutions, there will be a cross-subsidy between institutions. However, that is not the only circumstance under which differences in the relationship between contributions and benefits can arise. Career earnings increase more rapidly for faculty than administrative and other support staff. That means that those staff effectively subsidize faculty.

There are also differences between universities that will produce other effects. Your premise that faculty members at the University of Toronto are younger is not correct. U of T faculty tend to be older when they are hired than faculty at other universities. As a result, the plan cost of providing benefits to U of T faculty will be higher than the plan cost of providing benefits to faculty at universities that tend towards hiring at a more junior level. There are other differences in the relationship between contributions and benefits that arise from differences in cost-relevant demographic and economic factors.

All of these effects, combined, are reflected in current service costs. So, if it were true that U of T is subsidizing others, we would see it in differences in current service costs among universities. Based on the work that has been done to date, there aren't substantial differences.

Indexation

Q. Under the current U of T plan, retirees are guaranteed an annual increase in their pension based on increases in the Consumer Price Index. What happens to cost of living adjustments for retirees under the UPP?

A. Current retirees would see **no change** in the indexation rules that apply to their pension benefits if our plan converted to the UPP. All pension benefits earned by active employees under the current plan design up to the conversion date, including indexation provisions, would also be maintained.

For benefits earned after conversion to the UPP, indexation provisions are being negotiated as part of the plan design.

Pension plan funding

Q. Is U of T's pension shortfall increasing?

A. The most recent valuation of the U of T pension plan is as of July 1, 2017.

It shows a going concern shortfall of about $360 million and a solvency shortfall of about $1.2 billion (or $900 million after reflecting scheduled special payments to be made).

Both of these shortfalls are smaller than estimated at July 2016, due mostly to investment returns and additional contributions to eliminate the shortfalls.

Q. If the U of T plan were to be converted to the UPP, who would be responsible for any remaining shortfall?

A. It is expected that the UPP will be exempted from solvency funding requirements, so the need to fund the solvency deficit would disappear on conversion. The university would remain responsible for any going-concern deficit associated with pre-conversion pensions and would have to pay it down within a specified period (such as 15 years). *Refer to UTFA Pension Newsletters #2 and #3 for details on this topic.*

Before converting to the UPP, all parties must agree on the period within which the going-concern deficit associated with pre-conversion pensions would have to be paid down and the length of time during which any new gains or losses related to pre-conversion pensions would belong to the university.

Q. What caused the current deficits in the U of T Plan?

A. There are several reasons why the plan's going-concern and solvency deficits have grown:

- Increased longevity (people living longer than the plan design originally anticipated);
- Historically low interest rates (this translates into higher levels of assets needed to pay the pensions owed to members);
- Weak investment returns from 2001 to 2008, the investment market crash of 2008, generally poorer investment returns since then, and an expectation that returns will be lower in the future.

Plan comparison

Q. Would the benefits in the UPP be considered more or less valuable than the benefits under the existing U of T plan?

A. It depends. As a whole, the cost of the benefits provided by the current U of T plan is about 21% of pay. For the UPP as a whole, the cost of the benefits will be 20.25% of pay until 2025. After January 1, 2025, when the plan is changed to integrate with enhancements to the Canada Pension Plan, the overall cost of the UPP will amount to 20% of pay.

For plan members, the relative value of the two plans will vary slightly, depending on their individual circumstances. That is because some of the differences will serve to increase benefits (for example, the increase in the benefit rate from 1.5% of pay to 1.6% of pay up to the new Canada Pension Plan maximum earnings) while others will serve to reduce benefits (the change in the earnings averaging period from best 36 months to best 48 months, for example)

Whether the difference favours the current U of T plan or the UPP depends on individual circumstances. But in any case, the differences, positive or negative, are very small.

Q. I understand that plan member contributions to the proposed plan are somewhat higher than contributions to the current plan. Is this correct?

A. Correct. UTFA members are currently contributing 7.15% on earnings up to the YMPE (the YMPE is the "Year's Maximum Pensionable Earnings" – the earnings cap set annually for purposes of CPP contributions and benefits) and 9.5% on earnings above the YMPE. This will be increased to 9.2%/11.5% above and below the YMPE respectively under the UPP. In 2025, that break point will change from the YMPE to the YAMPE ("Year's Additional Maximum Pensionable Earnings") – a second earnings threshold for CPP purposes which will be 114% of the YMPE). The effect of this change will be to reduce contributions on the range of earnings between the YMPE and the YAMPE from 11.5% to 9.2%.

The University's contributions to the current Plan are 12.9% of earnings. UTFA is conscious of the very real government pressure on public and broader public sector pension plans in Ontario to move to equal cost sharing between employers and employees. UTFA expects the university sector to be impacted by this one way or another. Without the UPP, U of T employees could expect their contributions to increase by about 2.5% to be equal to those of the University, whereas the UPP will require a 2% increase in employee contributions.

UTFA will be negotiating dollar for dollar increase to pay to offset the pension contribution increase. It was always UTFA's objective to ensure no reduction in the University's overall compensation costs through the move to the UPP.

Q. UTFA is currently exploring adding a supplemental plan and means of redressing any increase in aggregate contributions. Is this correct.

A. It has been a condition of UTFA throughout the UPP negotiations that a companion, supplemental retirement benefit arrangement be established at the same time. UTFA is in the process of negotiation terms of a supplementary plan to benefit members with earnings in excess of the maximum permitted under the UPP.

As noted above, UTFA is also seeking dollar for dollar salary offsets to the pension contribution increase.

More complicated questions

The current U of T plan has a going concern shortfall of about $360 million and a solvency shortfall of about $900 million. I understand this to mean that there are insufficient assets in the plan to cover the pension promises.

When we all sign off on the terms and conditions of the JSPP, U of T and the other universities will presumably transfer assets into the JSPP.

Q. How will the amount that is transferred by each university be determined?

A. The UPP will determine the value of pension promises and compare that amount to the value of assets transferred to the UPP. Any shortfall will be fully borne by the University. This will be done on a plan by plan basis. This approach ensures that all pension promises from all universities are determined in the same way.

Q. Since I assume that the current plan assets are insufficient to support the existing pension promises, will the assets contributed exceed the current plan assets?

A. See #1 above. In the event that the value of the pension promises exceeds the value of the assets transferred, each university will be obligated to pay the amount of this shortfall over not more than 15 years. This set of payments will be fixed, and may not be reduced or eliminated until all amortization payments have been made, regardless of the financial experience of the UPP.

Q. Will the amount transferred be roughly equal to the current assets plus the going concern shortfall?

A. Yes, this is correct. See #2 above. The UPP will consider the University's obligation to eliminate the going concern shortfall as an asset upon transition to the UPP. As a result, all plans will be fully funded upon joining the UPP.

Q. Is the move to the JSPP a way to make the solvency shortfall go away?

A. Yes, this is correct. One of the central terms of the agreement to establish the UPP is the condition that solvency funding will not apply to it. This is consistent with all of the other Ontario jointly sponsored pension plans. The Ontario Government is aware of this condition and has not raised any concerns about it.