The Regents of the University of California

COMMITTEE ON FINANCE
January 14, 1999

The Committee on Finance met on the above date at UCSF-Laurel Heights, San Francisco.

Members present: Regents Atkinson, Bagley, Connerly, Davies, Johnson, Khachigian, Leach, Lee, Miura, Parsky, and Willmon

In attendance: Regents Bustamante, Espinoza, Kozberg, Montoya, Preuss, Sayles, and Villaraigosa, Regent-designate Vining, Faculty Representatives Coleman and Dorr, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling Gomes, Hershman, and Hopper, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Dynes, Greenwood, Orbach, Vanderhoef, and Yang, Laboratory Director Tarter, and Recording Secretary Nietfeld

The meeting convened at 1:20 p.m. with Committee Chair Johnson presiding.

1. **CONSENT AGENDA**

A. ***Amendment of the Budget for Capital Improvements and the Capital Improvement Program***

The President recommended that the Committee concur with the recommendation of the Committee on Grounds and Buildings that the 1998-99 Budget for Capital Improvements and the 1998-2001 Capital Improvement Program be amended to include Office of the President: A. University of California, Washington, D.C. Center.

B. ***External Financing for the University of California Washington, D.C. Center, Office of the President***

The President recommended, subject to amendment of the Budget for Capital Improvements and the Capital Improvement Program to include the University of California, Washington, D.C. Center project, that:

(1) Funding for the Washington, D.C. Center be approved as follows:

Fund Source	Amount
Funds available to the President	$ 3,000,000
External financing	22,286,000
Total	$25,286,000

(2) The Treasurer be authorized to obtain external financing not to exceed $22,286,000 to finance the construction of the Washington, D.C. Center, subject to the following conditions:

a. Interest only, based upon the amount drawn down, shall be paid on the outstanding balance during the construction period;

b. With regard to the residential portion of the project ($14,523,000), repayment of the debt shall be made from net revenues of the University of California Housing System (UCHS) with the condition that so long as such portion of the debt is outstanding, the UCHS fees shall be established at levels sufficient to meet all requirements of the UCHS Revenue Bond Indenture and to provide excess net revenues sufficient to pay the debt service and related obligations of this portion of the proposed financing;

c. With regard to the non-residential portion of the project ($7,763,000), repayment of the debt shall be paid from Opportunity Funds available to the President; and

d. The general credit of The Regents shall not be pledged.

(3) The Officers of The Regents be authorized to provide certification to the lender that the interest paid by The Regents is exempt from gross income for purposes of federal income taxation under existing law.

(4) The Officers of The Regents be authorized to execute all documents necessary in connection with the above.

Upon motion duly made and seconded, the Committee approved the President's recommendations and voted to present them to the Board.

2. **REPORT ON 1999-2000 GOVERNOR'S BUDGET**

President Atkinson reported that Governor Davis and his staff had developed the Governor's Budget during the short time between the election on November 3 and the announcement of the budget on January 8. The President noted that he had had an opportunity to meet with Secretary of Education Hart to discuss The Regents' budget request. However, there had been no opportunity to meet with the Director of the Department of Finance or with the Governor. The Governor's Budget was framed by forecasts of slower economic growth for the State of California and projections that the State could face a deficit in excess of $1 billion if current spending policies are continued.

The budget represents good and bad news for the University. The good news is that the Governor has opened the door to negotiating a new compact between higher education and the State. Governor Davis is committed to maintaining the quality of higher education in California. In the introduction to his budget, the Governor stated that "the concept of a negotiated compact guaranteeing a predictable funding level for a number of years, and tied to measurable outcomes, is an important one."

President Atkinson reported that the Governor calls upon the three segments of higher education to view California education as a continuum from kindergarten through graduate school and to refocus their talents and resources on helping elementary and secondary students. Consistent with this charge, the Governor's budget provides the University with funding to support the expansion of professional development programs for teachers as well as teacher training programs. The University will have the responsibility for training 6,000 of the State's newest teachers during the summer to ensure their effectiveness in teaching reading in the early grades.

As requested by Governor Davis, the University will work closely with Secretary Hart and with Mr. Tim Gage, the new Director of the Department of Finance, to reach an agreement on a new compact during the spring.

President Atkinson reported that the University's share of the State's general fund budget is smaller than it was last year. However, the University has been assured by the new administration that the budget would be reconsidered as a new compact is negotiated over the course of the next few months.

While the Governor has asked the University to accommodate all eligible students without increasing general fees, he has also reduced the request for permanent State general funds by about $50 million. In addition, the University will lose all of last year's one-time funding of $70 million to support instructional technology, equipment, deferred maintenance, and libraries. The President stressed that the University will need to wait until May when the State has revised its revenue projections to get a better sense of what the State can afford. He was hopeful that the State's financial situation will improve, and along with it, the University's budgetary prospects.

Vice President Hershman reported that the University's administration stands ready to work with Secretary Hart and Director Gage to develop a new compact for higher education. He informed the Regents that the University's administration is disappointed with the proposed budget because the combination of the $50 million reduction from the Regents' workload budget and the loss of the one-time funding for some critical core needs will be detrimental to the University. With respect to the one-time funds, the University has been assured by Director Gage that this funding will be considered within the context of a new compact because he recognizes that the University needs to find a way to fund these core needs on a permanent basis.

Mr. Hershman recalled that at the November meeting he had shared findings from the legislative analyst that forecast economic growth, but at a slower rate than last year, and a projected deficit at the end of 1999-2000 in excess of $1 billion. While the Governor's budget starts with essentially the same economic and revenue projections as the legislative analyst, it eliminates the projected deficit and provides a reserve of about $400 million by taking a number of actions. The Governor's budget reduced the projected expenditures by about $600 million. The Governor's Budget also assumes that the State will receive about $560 million from the tobacco settlement in spring 2000.

With the actions proposed by the Governor, general fund expenditures will grow by about 3.8 percent in 1999-2000, representing an increase of $2.2 billion. This increase will be used to fund education, with about 90 percent going to K-12. The rest of the budget is a "zero-sum game" because increases in one area of the budget are offset by decreases in other areas. In addition, the budget must fund $600 million resulting from the permanent reduction in the vehicle license fee.

The funding proposed for K-12 education will provide sufficient revenue to fund projected enrollment growth of 1.4 percent, a 1.8 percent cost-of-living adjustment, and $444 million in initiatives to improve outcomes in K-12 schools. All of the funding provided to K-12 was mandated by Proposition 98. The community colleges are also receiving a workload budget in line with Proposition 98, which is sufficient to fund projected enrollment growth and a cost-of-living increase. The California State University is treated in a similar fashion to the University of California.

Health and welfare programs will end up with virtually no increase in funding. There are reductions in caseloads in some program areas, and on average the budget provides a 2 percent COLA for welfare programs. Under the Governor's budget, corrections will receive an increase of just under 2 percent. The budget also reserves a small amount of general funds to pay for salary increases for State employees in the current year and provides full-year costs and funding for an additional increase in 1999-2000.

Vice President Hershman referred to two tables which had been distributed to the Regents. The first displayed the expenditure plan approved by The Regents in November. There has been one significant modification to this budget plan. Based on fall 1998 enrollments, the University's enrollment projections increased from 4,000 FTE to 4,600 FTE, a growth of about 3 percent. The Department of Finance has accepted this change.

Mr. Hershman then referred to the second table, an overview of the increase in State general funds proposed in the Governor's Budget. The table shows that the University's permanent State general fund budget in 1998-99 is $2.356 billion. The $147 million base budget increase in The Regents' budget request was based on the assumption of a new compact. The Governor's Budget provides a $95.9 million increase, which is a reduction of $50 million.

The Governor’s Budget provides funding for unavoidable cost increases, including $8.5 million to pay for the increased costs of annuitant benefits. Revenue bond payments will be determined in May. The budget funds initiatives to improve public schools, including the K-3 Reading Development Institutes, with $700,000 to be spent in the current year through special funding by the Legislature and $12.3 million in 1999-2000.

The Governor’s Budget proposes a $118.5 million increase in State general funds for the University, which is an increase of about 5 percent. However, as the budget eliminates the one-time funds provided in 1998-99, the actual increase in State general funds is $46 million. This represents an increase of 1.8 percent over the total permanent and temporary State general fund budget. Mr. Hershman expressed the hope that the University and the State would be able to reach agreement on a more satisfactory budget through the May revision.

Vice President Hershman discussed ways in which the University might respond to the $50 million shortfall. He noted that the University must continue to fund the 1998-99 salary increases, to fund merit increases, to accept all eligible students, and to maintain student fees. While not proposing any responses at this time, Mr. Hershman noted that one option would be to eliminate all funding for deferred maintenance and to provide no continuing support for ongoing building maintenance, instructional technology, or instructional equipment. If the funding for all of these core critical needs were eliminated, there would be funding left to support a 1 percent cost-of-living increase for faculty and staff. A second option would be to have no COLAs for faculty or staff. In this case the University would be able to provide funding for some of its core needs such as deferred maintenance, instructional technology, and equipment. The best solution would be additional resources available in the spring. The Governor has indicated that education is his highest priority for funding should there be additional resources, and the University’s administration expects that higher education will be included. The Governor has made it clear that the State will provide the resources that the University needs but that the University must be accountable for its performance as it was under the previous compact.

Turning to capital outlay, Vice President Hershman reported that the Governor’s Budget includes $209.8 million in general obligation bonds for capital outlay. This is in keeping with The Regents' request and is funded by Proposition 1A. The capital budget provides funding for needed seismic improvements and projects to support enrollment growth, especially in engineering and science. The University has begun discussions with the Department of Finance to provide matching funds for the $42 million in FEMA awards for seismic repairs on the Berkeley campus.

Mr. Hershman concluded his remarks by reiterating the fact that no action is being recommended at today’s meeting. The administration anticipates requesting an increase in nonresident tuition. The Governor’s Budget suggests that nonresident tuition be increased by 10 percent instead of the 4.5 percent included in The Regents’ budget. The University administration will devote its effort this spring to negotiating a new compact as well as a budget that is more in line with The Regents' request.

In response to a question from Regent Connerly, Vice President Hershman stated that he did not believe that the funding level for the University in the Governor's Budget reflects any long-term philosophy of the Governor regarding the role of the University. He believed that the Governor is committed to the quality and accessibility of the University and that the budget reflects his response to a difficult fiscal situation. Mr. Hershman added that he had been led to believe that the University's funding will be increased if the State's fiscal situation improves between now and May.

President Atkinson pointed out that the Governor has on many occasions stated his commitment to education and to the creation of jobs. There is no question that the University of California is central both to the quality of education and to the creation of jobs. The President stressed that the Governor's Budget as proposed should not be considered the final version.

Regent Connerly observed that the University would be asked to accommodate increased enrollment without an increase in State funding and with no increase in student fees. Although he has opposed fee increases in the past, Regent Connerly believed that the time may come when the University would be forced to consider this option in order to preserve the quality of the institution.

In response to a comment from Regent Lee regarding increased enrollment, Vice President Hershman noted that he expects to present to the Regents at the February meeting a projected growth rate of about 3 percent per year between now and 2006-07. From discussions with the Governor and the Legislature, he believed that there is a commitment on the part of the State to fund enrollment growth. President Atkinson added that in his inaugural remarks the Governor had commented upon the importance of maintaining the quality of the faculty at the University by paying competitive salaries.

Regent Villaraigosa recalled that, as the Lieutenant Governor, Governor Davis had served as a member of the Board of Regents for many years and as a result he has an understanding of the University's needs that is second to none for an incoming governor. While Governor Davis has made a commitment to education, he has also made it clear that he intends the State to live within its means. He agreed with Vice President Hershman's expectation that the May revision to the budget could identify new revenue and reported that the Governor has stated his intention to reduce the gap between the general fund increase requested in The Regents' Budget and the increase granted in the January Governor's Budget. Speaking as the Speaker of the Assembly, Mr. Villaraigosa believed that the Legislature had demonstrated its commitment to the University, and he informed the Committee of his intention to work with the Governor and The Regents to provide adequate funding to permit the University to continue to be the greatest institution of higher education in the country. He observed, however, that it was evident that the Legislature would not vote to eliminate the vehicle tax cut which he had opposed in the previous session.

Regent Davies suggested that, if the May revision does not provide the University with sufficient relief, the Regents should be prepared to examine how the University should respond. He supported Regent Connerly's opinion that increasing student fees should be considered as an option. Vice President Hershman reported that this option is consistent with discussions that he has had with the Academic Senate.

Following up on the comments by Speaker Villaraigosa, Regent Bagley suggested that the Regents should advocate the repeal of the vehicle tax cut.

Regent Espinoza urged the Regents to view an increase in student fees as one of the last ways in which to respond to any loss in State support. He urged the Regents to lobby in Sacramento for increased support for the University.

Regent-designate Vining and Regent Johnson spoke in support of continuing to try to reduce the student-faculty ratio.

3. **AMENDMENT OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN -- CHANGE IN BENEFIT ELECTION PROVISIONS**

The President recommended that the University of California Retirement Plan (UCRP or Plan) be amended as set forth in Attachment 1 to alter procedures relative to the administration of the Plan as follows:

(1) Effective for a Retirement Date occurring April 1, 1999 or later, change the condition under which an election of Retirement Date, payment option, and designation of Contingent Annuitant becomes irrevocable to the later of the Retirement Date or 15 days following the date of the Plan Administrator's confirmation letter notifying the Member of the receipt of the Member's election.

(2) Effective for a cashout date occurring April 1, 1999 or later, change the condition under which an election of Lump Sum Cashout becomes irrevocable to the later of the cashout date or 15 days following the date of the Plan Administrator's confirmation letter notifying the Member of the receipt of the Member's election.

With these changes, certain existing Plan language would be repositioned for purposes of clarity as is reflected in Attachment 1.

Prior to her presentation, Associate Vice President Boyette introduced Mr. Bob Blum, a consultant with William M. Mercer, Inc., the University's independent third-party consultant on benefits and compensation issues. She informed the Committee that for the last year UC

Human Resources and Benefits has been engaged in a project to redesign, simplify, and streamline business processes associated with administering the retirement plan and to provide integrated systems support. Over the past decade, there has been a significant increase in the number of Plan participants and in the amount of benefits that are being paid. In addition, there has been a large increase in the number of active Defined Contribution Plan participants, growing from 823 in 1989 to 121,050 in 1998. This increase in the volume and complexity of benefits-related work led to the realization of the need for significant process re-engineering.

This major re-engineering project is know as UCBenS. Cross-functional teams of UCOP Human Resources and Benefits staff, campus Benefits Office staff, and consultants have completed the specifications for redesign of the UCRP's retirement and lump sum cashout application process and the annuitant health coverage continuation process. The implementation plan based on these specifications includes automation of data gathering and benefit calculations, development of electronic workflow, including document imaging, and consolidation of forms to create a more rapid, streamlined benefit election process for UCRP Members.

The new benefit election process reduces the number of steps required to process a lump sum cashout (LSC) or a retirement application by approximately one-half as a result of better data links, communications, and the restructuring of procedures. This process will be a significant improvement for retiring Members. The four- to six-week delay in the current process required to exchange, gather, and verify documentation will be eliminated. Amendments to the Plan document have been proposed to facilitate the technological improvements that are intended to make the benefit election process more efficient and streamlined.

Following receipt and processing of the LSC or retirement election, UC Human Resources and Benefits will mail a detailed confirmation letter to the Member that will verify the Member's election of a cashout date or a Retirement Date, payment option, and designation of Contingent Annuitant. In order to accommodate the time frames and technology used for this process, it is proposed that these components of the Member's benefit election become irrevocable the later of the cashout/retirement date or 15 days following the date of the Plan Administrator's confirmation letter.

Within that period, the Member may cancel or change his or her benefit commencement date, and if monthly retirement benefits are selected, the payment option and designation of Contingent Annuitant may also be changed as desired. This change will replace the current Plan language that states that irrevocability occurs on the later of the cashout or retirement date or the date the official election form is received by the Plan Administrator.

The confirmation letter will also provide a final disclosure of the data elements and calculations upon which benefit payments will be based, which the Member may appeal or challenge at any time. The Member will be clearly advised of deadlines and revocation requirements, not only in the confirmation letter but also in the counseling and other communications that will precede it as part of the benefit election process. These new communications will give the Member every opportunity to make an informed decision and to review data elements prior to electing either an LSC or retirement.

These amendments were endorsed by the University of California Retirement System Advisory Board at its April 28, 1998 meeting.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

4. **AMENDMENT OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN -- AUTHORITY OF THE PRESIDENT AS PLAN ADMINISTRATOR**

The President recommended that the University of California Retirement Plan, the Tax-Deferred 403(b) Plan, and the Defined Contribution Plan be amended effective January 1, 1999 as shown in Attachment 2, to expand the President's authority to make technical changes to these Plans.

Associate Vice President Boyette recalled that the University of California Retirement System (UCRS) Plans include the University of California Retirement Plan, the Defined Contribution Plan (DC Plan), and the Tax-Deferred 403(b) Plan (403(b) Plan). Current language in each Plan document provides that the President of the University shall administer each Plan under UCRS as the appointed Plan Administrator. In this capacity, the President has the authority to make appropriate changes to the UCRS Plans to accommodate changes in the Internal Revenue Code (IRC) and the United States Treasury Regulations to preserve the qualified status of the Plans under the IRC.

Occasionally, it is necessary to make technical amendments to the UCRS Plans to reflect more accurately certain operational procedures and to make certain Plan language more precise. Although such technical amendments do not reflect any policy changes and are generally cost neutral, they must be recommended by the UCRS Advisory Board and approved by The Regents. Due to the nature and urgency of other agenda items, action on these periodic technical amendments may be deferred until there is a sufficient number to warrant presentation to the UCRS Advisory Board and The Regents for approval. Consequently, there is often a delay in the revision of UCRS Plan documents. If the President had the authority to make technical Plan changes, delays resulting from the required recommendation by the UCRS Advisory Board and approval by The Regents would be eliminated. This amendment would ensure that UCRS Plan documents are updated in as timely a fashion as possible. The UCRS Advisory Board would be informed of any such technical changes.

This amendment was endorsed by the UCRS Advisory Board at its April 28, 1998 meeting.

Regent Leach pointed out that the President, in addition to being the administrator of the Plan, is also a Plan beneficiary. He believed that it would be unfair to ask the President, acting alone, to determine if a change to the Plan is a technical one, and suggested that the recommendation be amended to include the provision that any technical changes that are made are subject to the concurrence of the Chairman of the Board.

Upon motion duly made and seconded, the Committee approved the President's recommendation, as amended, and voted to present it to the Board.

5. **RESTORATION OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN MEMBERS' RETIREMENT BENEFITS**

President Atkinson recalled that Congress had imposed Internal Revenue Code limitations that were directed primarily at the private sector, particularly corporations, to limit pre-tax contributions to pension plans and increase tax revenues. When extended to the public sector, they limited pension benefits of Members of the UCRP. Recent changes to the IRC allow the University to mitigate these limitations. A number of the University of California's comparison institutions have already made changes to mitigate the IRC limits.

In response to a question from Regent Leach, the President stated that this matter would come to the Regents for action at the February meeting.

Associate Vice President Boyette reported that UCRP is designed to not differentiate among its members with respect to retirement income. UCRP is a tax-qualified retirement plan subject to the federal tax law in the administration of benefits accruing to its Members. Two federal tax limits can reduce the amount of UCRP benefits that can be paid to Members. IRC §401(a)(17) sets the maximum compensation that can be used for retirement calculations at $160,000 per year for UC employees who first became active UCRP Members after June 30, 1994. Therefore, certain faculty and staff cannot receive benefits on the full compensation that UCRP would otherwise use for benefit calculations. IRC §415(b) limits the amount of benefit paid by UCRP to a maximum per year based on age at retirement. Therefore, certain faculty and staff cannot receive the full benefit resulting from their UCRP benefit calculations. This limit is set at a maximum of $130,000 per year at age 65 for UC employees who became active UCRP Members after December 31, 1989 and is reduced for those faculty and staff retiring at an earlier age. UCRP is targeted for maximum pension benefits at age 60. Both sections employ grandfathering rules that may apply to certain faculty and staff who became Members before implementation of these rules.

It is important for the University to address these IRC limitations because they are becoming a significant deterrent to recruitment and retention of both faculty and staff, a problem that will worsen as the number of affected employees grows in the years ahead.

Most career employees of UC participate in the UCRP, a defined benefit plan. Their benefits at retirement are calculated using their age at retirement, their years of UCRP membership, and their Highest Average Plan Compensation.

As a result of federal tax law limits applying to UCRP, employees with different UC hire dates that are brought into similar jobs, at the same time, and at the same salary may be treated differently for their retirement income from UCRP. This lack of equity applies to faculty and staff across the UC system, including the Department of Energy laboratories.

It is estimated that over the next five years, about twenty UC faculty and staff retirees each year will be adversely affected by the §401(a)(17) limit on compensation covered for UCRP purposes. In ten years approximately 50 faculty and 75 staff retirees, including DOE laboratory scientists and engineers, will be affected. It is estimated that over the next five years, about 65 faculty and staff retirees each year will be adversely affected by the IRC §415(b) limits. Initially, twice as many faculty retirees as staff will be affected by the §415(b) limits each year, but by the tenth year approximately 50 faculty and 35 staff retirees will be affected.

The tax laws as they apply to UCRP will make recruitment more difficult as market salaries rise. Every new faculty and staff Member hired from outside the UC system will be subject to the most stringent limits under both IRC Sections 401(a)(17) and 415(b). Prospective new hires who are grandfathered in their current institutions will lose this status if they move to UC and therefore will forfeit the ability to earn full retirement benefits.

Another consequence is that retention, already an issue, will become more difficult. Several institutions have taken steps to solve the problems presented by IRC §401(a)(17) and §415(b). UC employees who are recruited by these institutions can be promised benefits that UC cannot currently match. In particular, long-term faculty and staff who cannot receive the full benefit earned and accrued under UCRP will have an incentive to go to institutions where they can accrue additional benefits.

A number of UC's comparison institutions have taken steps to address this problem. While many universities will not publicly disclose their benefits packages, William M. Mercer, Inc. has determined that at least 8 of the University's 26 comparison institutions have acted to restore retirement benefits. Now that more favorable tax laws have been established, additional universities will follow this trend. Mercer also believes that the University does not have complete information on its comparison institutions because private institutions as well as public institutions in other states are not required to disclose additional retirement benefits that they provide their employees. In some situations, they may be prohibited from disclosure by confidentiality rules that pertain to individual agreements.

Before the recent changes in the tax law, non-tax qualified restoration plans in the public sector were available only if participating employees were willing to be "at risk" for vesting. When vesting did occur, employees were taxed on the full present value of the benefit even if no assets had actually been paid to them. Recent changes in the tax law have provided public institutions with more attractive solutions for resolving both IRC Sections 401(a)(17) and 415(b) limits.

The proposed UCRP Benefit Restoration Plan consists of two parts, each designed to replace UCRP benefits lost due to the IRC limits. It is expected that the majority of UCRP Members will be affected by only one of the limits. Outside counsel has completed a favorable review of the concepts underlying the proposed UCRP Benefit Restoration Plan. Actuarial and legal considerations are being refined in coordination with the UCRP actuary, consultants, and counsel. In order to preserve the tax-qualified status of the retirement plan, the University will seek IRS review of the amendments to and structure of the Plan.

Restoring Benefits Subject to the Compensation Limits of IRC §401(a)(17)

It is proposed that benefits be restored for all faculty and staff who are limited in the amount of compensation that can be taken into account in calculating UCRP retirement income because of IRC §401(a)(17). These Members would receive a separate benefit to restore the loss to UCRP retirement income caused by the IRC compensation limit. This benefit would apply to both retiring and retired UC faculty and staff. Technically, this could be achieved by amending the UCRP to add a "pension equity" restoration benefit. Through this method, tax-qualified plan advantages would be given to the affected Member using existing UCRP assets to provide these benefits. This is the most cost-efficient way to provide these restoration benefits. The estimated annual benefit disbursements of projected IRC §401(a)(17) restoration benefits would start at about $20,157 for the 1999-2000 fiscal year. They are projected to increase to $1.5 million in the tenth year of benefit disbursements. Additionally, the cost to UCRP to make whole Members who were affected by the IRC §401(a)(17) limit before implementation is estimated at $100,000. This cost to the UCRP will not have a material effect on the Plan assets or liabilities, which as of July 1, 1998 were $27.1 billion and $20.6 billion, respectively.

Restoring benefits subject to the annual payment limits of IRC §415(b)

It is also proposed that benefits be restored for all faculty and staff who are unable to receive their full UCRP benefit due to the annual payment limits of IRC §415(b). The Small Business Job Protection Act of 1996 (SBJPA) allowed sponsors of governmental retirement plans such as UCRP to establish a non-qualified retirement plan to provide for the payment of accrued retirement benefits that would not otherwise be payable due to the limitations of IRC §415(b). Private sector plans have had this flexibility for years; the passage of SBJPA extends this ability to governmental employers.

These benefits would be restored for all affected faculty and staff, retiring and retired, through a non-qualified restoration plan specifically provided for in the federal tax law. Under the law, because this part of the restoration plan must be non-qualified, UCRP assets may not be used to provide the benefits. This non-qualified restoration plan can be designed to provide the best available tax advantages to the Members limited by IRC §415(b). Because of the potential adverse financial effects of large lump-sum payments, in most cases the restoration plan for IRC §415(b) benefits would be limited to annuity benefits, subject to a de minimus threshold.

The estimated annual benefit disbursements of projected IRC §415(b) restoration benefits would start at about $671,389 for the 1999-2000 fiscal year and increase to approximately $1.6 million in the tenth year of benefit disbursements. Additionally, the cost to restore UCRP benefits for the approximately 240 Members affected by the IRC §415(b) limit before implementation is estimated at $3.8 million. The Voluntary Early Retirement Incentive

Programs' transition assistance payments would not be restored because they were one-time payments designed to assist participating Members into an unplanned retirement.

Method of Funding for IRC Section 415(b) Restoration Plan

A hybrid approach is recommended for funding non-qualified restoration benefits that would involve annual assessments equivalent to the estimated cash payout for the year, plus an additional amount to fund the initial liability over a period of years. The amortization period could be thirty years, based upon typical retirement planning and financial reporting practices. However, the portion relating to benefits for employees at the DOE laboratories could be amortized over four years, as this coincides with the expiration date of the current contract with the DOE.

The following indicates the required level of funding on a prospective basis only ($ in thousands):

Fiscal Year	Campuses	Labs	Total
1999-2000 - 2002-2003 (cost per year)	$1,138	$795	$1, 933
2003-2004	1,138	60	1,198

This chart does not include the cost of retroactive restoration benefits for UCRP Members who were limited by IRC §415(b) before implementation. As the legislation allows for retroactivity, it will be recommended that this be done for UCRP Members who have already retired. The cost of providing retroactive restoration benefits is estimated to be $3.8 million: $2.9 million associated with campuses and the Office of the President and $843,630 associated with the laboratories. Funding for the campuses' and Office of the President's costs will come from a variety of sources. For example, to the extent that the IRC §415(b) costs can be attributed to salaries paid from special compensation plans in the health sciences, it would be appropriate to charge these costs to those plans. The general fund would not be used for these payments.

In 1993, the University established the Short Term Contingency Fund (STC). This pool has been used to provide funding for a variety of purposes including annual and one-time costs related to the University's management and oversight of the DOE laboratories as an alternative to charging these costs to the management fee or reducing discretionary research spending. The STC fund is composed of one-time allocations from the 1993 and 1994 indirect cost payments made to UC as well as Short-Term Investment Pool interest on the reserve liability funds associated with contract operations. The present STC fund balance is approximately $2.8 million and is deemed sufficient to cover the projected retirement restoration costs through the end of the current contract.

Faculty Representative Dorr noted that the proposal would be of interest to the Academic Senate's Committee on Faculty Welfare. She was interested in knowing about the level of salary paid to a long-term employee who was disadvantaged by the provisions of IRC §415(b). She also expressed interest in the job location and title of the one hundred people in each of the categories. Associate Vice President Boyette explained that an employee cannot know how much he or she will be affected by the limits until the time of actual retirement. The actuaries run projections in order to provide confidence that, out of the University's 115,000-person workforce, one hundred employees who will be affected by the limitations will retire. It is not possible to know in advance who these retirees will be.

Regent Leach spoke in favor of the proposal due to the need to recruit and retain the best people in high-level positions.

In response to a question from Regent Montoya regarding the identity of those affected by the IRS restrictions, Mr. Blum explained that the numbers move each year in ways that are not entirely predictable. Once a Member's date of retirement is set, a complex set of computer programs are run to see if the individual is affected by the limitations. The University's actuary, Towers Perrin, has estimated that about 40 percent of the people who will be affected by IRC §401(a)(17) are faculty, 40 percent are staff, and 20 percent are scientists and engineers at the Department of Energy laboratories. The §415(b) limit will affect one-third faculty, one-third staff, and one-third scientists and engineers.

Regent Kozberg asked that the administration profile for the Regents the 240 retired Members whose benefits will be restored. Regent Johnson asked that the information be provided to the Regents at the time when the item comes before the Committee for action.

Faculty Representative Dorr assured the Committee that by raising questions about the proposal she did not intend to criticize it, noting that highly compensated faculty are valuable members of the University community.

Associate Vice President Boyette reported that she had described the proposal to the Committee on Faculty Welfare and that the matter would come before the committee at its January meeting.

Regent Connerly raised the question of what would happen with respect to DOE laboratory employees were the University's contract with the federal government to manage the laboratories to end. Ms. Boyette stated, as noted above, that the proposal for the DOE laboratories is designed to cover the projected retirement restoration costs through the end of the current contract. Senior Vice President Kennedy continued that if the contract were to end, there would be negotiations between the DOE and the successor contractor about the future. Current employees would need to decide whether to remain within UCRP or transfer to a new retirement plan, which would be funded by the Department of Energy. The Member employees who had already retired would continue to be the Plan's responsibility.

In response to a question from Regent Bustamante regarding the profile of the individual whom the University is trying to recruit, President Atkinson explained that it could be a highly compensated orthopedic surgeon from another University. The University's retirement plan will be a positive benefit once the IRS limitations are lifted. Vice President Kennedy asked that Laboratory Director Tarter comment because the laboratories are competing with not with other universities but with other laboratories and with the private sector for outstanding scientists and engineers.

Lieutenant Governor Bustamante asked whether an engineer would be more interested in a larger housing allowance or a better retirement program. Director Tarter explained that salary and retirement benefits represent a significant part of the total package during the negotiations with a senior scientist whom the laboratory is attempting to recruit because the Department of Energy, as a public agency, does not offer extra benefits for its employees such as a housing allowance.

In response to a suggestion from Regent Bustamante that the University considering raising salaries to aid in recruitment rather than enhancing retirement benefits, Ms. Boyette explained that budgetary constraints prohibit this. One advantage of the proposal is that changes in the tax law will permit the University to use retirement plan resources to restore benefits to which Members are entitled.

Regent Connerly suggested that the administration should be able to profile the types of individuals that the University is attempting to recruit and retain who would be affected by the restoration of these benefits.

Regent-designate Vining pointed out that the general profile will be a self-selected profile of those individuals whom the University has been trying to recruit or retain over the past six months. This may bear little or no relation to the mix of employees at the University who will actually benefit from the proposal.

6. REPORT OF NEW LITIGATION

General Counsel Holst presented his **Report of New Litigation**. By this reference, the report is made a part of the official record of the meeting.

The meeting adjourned at 2:55 p.m.

Attest:

Secretary