The Regents of the University of California

COMMITTEE ON FINANCE

February 18, 1999

A Special Meeting of the Committee on Finance was held on the above date at UCSF-Laurel Heights, San Francisco.

Members present:	Regents Atkinson, Bagley, Davies, Johnson, Khachigian, Miura, and Parsky; Advisory member Taylor
In attendance:	Regents Eastin and Nakashima, 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, and Gurtner, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Dynes, Orbach, and Vanderhoef, Executive Vice Chancellor Simpson representing Chancellor Greenwood, Laboratory Director Shank, and Recording Secretary Nietfeld

The meeting convened at 2:27 p.m. with Chairman Davies presiding.

RESTORATION OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN MEMBERS' RETIREMENT BENEFITS

The President recommended that:

A. Approval be granted to establish plans, effective January 1, 2000, to restore to University of California faculty and staff, including Department of Energy Laboratories scientists and engineers, the University of California Retirement Plan (UCRP or Plan) benefits earned but denied due to Internal Revenue Code (IRC) limitations.

B. These UCRP benefits also be provided to affected UCRP members who retired before the effective date of the restoration plans.

C. Implementation of the restoration plans be delegated to the President, with the concurrence of the Chairman of the Board and the Chairman of the Committee on Finance.

The Committee was informed that the University of California Retirement System Advisory Board endorsed these restoration plans at its January 27, 1999 meeting. The plans, which are subject to Internal Revenue Service (IRS) approval, would apply to faculty, staff, and retirees from the date of implementation. The item submitted to The Regents in January 1999 included the cost of restoring these benefits retroactively for current retirees; upon further examination, retroactivity was judged to be inappropriate.

It was recalled that several years ago Congress modified the IRC to limit pre-tax contributions to pension plans. These limitations, directed primarily at the private sector, resulted in the imposition of certain limits on pension benefits in public institutions as well. Recognizing the negative impact of these limitations in the public sector, Congress recently enacted revisions to the IRC that make it possible for public institutions, including the University of California, to mitigate them. At the January 1999 meeting, the Regents were presented with information on the problems created by the IRC limitations and on plans to address them.

IRC §415(b) limits the amount of benefits that can be paid by UCRP to a maximum per year; IRC §401(a)(17) sets the maximum compensation amount that can be used for retirement calculations. These IRC limitations are a significant deterrent to recruitment and retention of faculty, staff, administrators, scientists, and engineers. This problem will worsen as the number of affected employees grows in the years ahead. Various UC sites have reported an increasing employee awareness of both the personal impact of the IRC limitations and the actions other institutions have taken to mitigate the impact. To remain competitive in the recruitment and retention of employees, many of whom are highly specialized, it is imperative that UC offer similar solutions.

Due to the IRC limits and special grandfathering rules, faculty and staff employees with different UC hire dates who are later brought into comparable jobs at the same time and at the same salary may be treated differently for their retirement income. Regardless of salary level, an employee affected by either or both of the IRC limits will have a lower percentage of retirement income provided by UCRP than an employee retiring at the same age with the same service who is not affected by the limits. Restoring lost benefits due to these limits will result in fair and equitable treatment of all employees. Further, employees who have entered University service based upon representations of UCRP retirement income may have a basis to claim that they are not being treated fairly if they are unable to receive their earned benefits due to the IRC limitations. The restoration plans would eliminate this problem by restoring their UCRP benefits.

Most career employees participate in UCRP, a defined benefit plan. UCRP is based on the principle that all career employees will be treated equitably and receive benefits based on (1) their age at retirement, (2) their years of UCRP service credit, and (3) their Highest Average Plan Compensation. UCRP is a tax-qualified retirement plan subject to federal tax laws in the administration of benefits accruing to its members. As noted above, two federal tax limits can reduce the amount of UCRP benefits paid to members upon retirement. Because IRC §415(b) limits the amount of benefits that can be paid by UCRP to a maximum per year, based on age at retirement, certain faculty, staff, scientists, and engineers cannot receive the full benefits resulting from their UCRP benefit calculations. For UC employees who became active UCRP members after December 31, 1989, this limit is set at a maximum of $130,000 per year at age 65 and is reduced for those retiring at an earlier age. For example, the maximum benefit these members can receive from UCRP is $57,783 per year at age 55 and $41,295 per year at age 50.

IRC §401(a)(17) sets the maximum compensation amount 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.

As a result, certain faculty, staff, scientists, and engineers cannot receive benefits based on the full compensation that UCRP would otherwise use for benefit calculations. It is estimated that 367 members will be affected by the IRC §415(b) limit over the next ten years. This group consists of 178 faculty and 189 staff employees, including management, and scientists and engineers at the Department of Energy laboratories. The average age of the affected faculty member is 60.9 years, and the average income is $177,044 annually. Ninety-seven percent of the members have twenty or more years of service credit. This group includes 108 medical school professors.

The average age of the affected staff group is 55.6 years, and 94 percent have more than twenty years of service credit. The average salary is $167,578. More than half of this group are employed at the Department of Energy laboratories.

IRC §415(b) employs grandfathering rules that can make a significant difference in the benefits that can be paid to UCRP members, depending upon their UCRP membership date.

It is estimated that 144 members will be affected by the IRC §40l(a)(17) limit over the next ten years. This group consists of 33 faculty and 111 staff, including management, and scientists and engineers at the laboratories. In the affected faculty group, the average age is 54.2 years and the average income is $186,202 annually. Eighty-eight percent of the faculty have less than five years of service credit. The average age of the affected staff group is 51.4 years, and 89 percent have less than five years of service credit. This group, which has an average salary of $192,286, includes scientists, engineers, and staff physicians. IRC §401(a)(17) employs grandfathering rules that can make a significant difference in the benefits that can be paid to UCRP members depending upon their hire date.

Benefit restoration plans will replace UCRP benefits that are not currently paid because of the IRC limits. It is expected that most of the UCRP members involved will be affected by only one of the limits. Outside counsel has completed a review of the proposed benefit restoration plans. Actuarial and legal considerations have been refined in coordination with the Plan's actuary, consultants, and counsel. For employees covered by the Higher Education Employer Employee Relations Act , these changes may be subject to labor relations requirements such as notice, meeting and discussing, consulting, or conferring.

All affected faculty, staff, and retirees will receive a separate benefit to restore the amount that the IRC annual limit now prevents them from receiving. This will be done through a "non-qualified" plan that is specifically provided for in federal tax law. The annual disbursements of projected IRC §415(b) restoration benefits are estimated to be $670,000 in the year 2000 and will increase to approximately $1.7 million in the tenth year.

Benefits will be restored for all affected faculty, staff, and retirees. This will be done by amending UCRP to add a provision to restore benefits that may be lost due to IRC §401(a)(17), using existing UCRP assets. Providing restoration of benefits through UCRP is contingent upon IRS approval. The annual disbursements of projected IRC §401(a)(17) restoration benefits are estimated to be $8,500 in the year 2000 and will increase to approximately $580,000 in the tenth year. This cost to 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. Due to a recent IRS notice that an annual cost-of- living adjustment can be applied to the grandfathered IRC §401(a)(17) limit that applied prior to July 1, 1994, the cost of this provision is lower than was indicated in the January Regents item.

Under the law, UCRP assets cannot be used to provide the benefits provided in a "non-qualified" plan. The method for funding the non-qualified IRC §415(b) restoration plan benefits will involve assessments on a quarterly basis 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 will be thirty years, based upon generally accepted retirement planning and financial reporting practices. However, the portion relating to benefits for employees at the DOE laboratories will be amortized over 11 quarters, which coincides with the expiration date of the current contract with the DOE. The following indicates the estimated level of funding ($ in thousands).

Fiscal Year	Campuses	Laboratories	Total
1999-2000	$ 569	$ 578	$1,147
2000-2001	1,138	1,156	2,294
2001-2002	1,138	1,156	2,294
2002-2003	1,138	334	1,472
2003-2004	1,138	60	1,198

Funding for the campuses' and Office of the President's costs will come from several sources. For example, to the extent that the IRC §415(b) restoration plan 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. To fund the ongoing cost of the restoration plan, an assessment of campuses and UCOP will occur on a quarterly basis for the amounts shown above, plus a small amount to cover the administrative cost of the plan. State funds 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 comprised 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.

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

The meeting adjourned at 2:28 p.m.

Attest:

Secretary