

The Regents of the University of California

**SPECIAL COMMITTEE ON COMPENSATION**

January 18, 2006

The Special Committee on Compensation met on the above date at the Price Center, San Diego campus.

Members present: Regents Dynes, Hopkinson, Juline, Parsky, Pattiz, Schilling, and Wachter; Advisory members Coombs and Oakley

In attendance: Regents Bustamante, Gould, Island, Johnson, Kozberg, Lansing, Lee, Lozano, Preuss, Rominger, Rosenthal, Ruiz, and Sayles, Regents-designate Ledesma and Schreiner, Faculty Representative Brunk, Secretary Trivette, General Counsel Holst, Acting Treasurer Berggren, Acting Provost Hume, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Foley, Gomes, Gurtner, and Hershman, Chancellors Bishop, Carnesale, Córdoba, Denton, Drake, Fox, Tomlinson-Keasey, Vanderhoef, and Yang, Vice Chancellor Burnside representing Chancellor Birgeneau, Acting Laboratory Director Kuckuck, Auditor Reed, and Recording Secretary Bryan

The meeting convened at 11:28 a.m. with Committee Chair Hopkinson presiding.

1. **REMARKS OF THE COMMITTEE CHAIR**

Committee Chair Hopkinson referred the members of the new Special Committee on Compensation to the recommendation to the Special Committee on Regents' Procedures entitled, *Establishment of the Special Committee on Compensation and Suspension of Relevant Bylaws Pertaining to Compensation Matters*, which describes the committee's charge. She noted that there were several other activities related to this committee's charge – the Kozberg-Hertzberg task force, the University audit, and an audit by the California Legislature. Those will be completed within a relatively short time for such significant matters, and their results will come to this committee. It is likely that there will be a major overhaul of policies and procedures, with the goal of developing a better, more transparent, clear, accountable system. She anticipated that there will be a lot of information for the committee members to absorb and expressed the expectation that they would set aside an appropriate amount of time to spend on the work of the committee.

2. **PENDING ISSUES ON COMPENSATION AND UPDATE ON ACTIONS ANNOUNCED BY THE CHAIRMAN**

Chairman Parsky reviewed the approach and the actions that had been taken prior to this meeting concerning issues on compensation. He recalled that The Regents had signed an agreement with PricewaterhouseCoopers to conduct an audit of ten-year practices and report its findings to the Regents directly. The firm's representatives will review the top

32 positions in the University for the past ten years; they will examine compensation for employees who hold or have held the 32 management positions from 1996 through 2005. There are approximately 60 current and former Officers who will be reviewed in the initial phase for compliance with the policies that were in place throughout that period. The positions include the President, Senior Vice Presidents, Vice Presidents, Chancellors, Principal Officers of The Regents, Laboratory Directors, and Medical Center Chief Executive Officers. Compensation in this engagement is very broadly defined to include remuneration to incumbents in the form of salary, bonuses, benefits, and all other perquisites. The Regents will interact directly with the consultant in this engagement.

Chairman Parsky reported that the first phase will include that examination. PricewaterhouseCoopers will undertake an assessment of the accuracy and completeness of the compensation information with which they will be provided. The consultants will interview individuals within that group to obtain confirmations from the individuals as to the total amount of compensation received during this period. They will review payroll and personnel records and will undertake other procedures that they deem necessary. A significant amount of the work of phase one should be accomplished by the end of January. Phase two of the engagement will entail the application of the same procedures for previous occupants of those 32 positions. In that exercise, because of the passage of time, not all data will be easily available; some procedures may need to be adjusted. That phase will be completed by the end of February. Phase three will include an examination of expenses reimbursed to or on behalf of all of that body of people, using an appropriate sampling technique and any other procedures that may be necessary to reach a reasonable conclusion as to the magnitude of the reimbursement, whether or how it was authorized, and whether it was done in accordance with procedures. That effort should be completed by the end of March. Based on what is obtained in phases one, two, and three, the Regents can request that the consultants perform additional analyses of compensation and other expenses. Chairman Parsky stated that PricewaterhouseCoopers will issue an independent report commenting on whether compensation to this incumbent group has been stated fairly in all material respects and was in compliance with existing policy.

Chairman Parsky reported that a second element was the establishment of the Special Committee on Compensation, which he believed would invigorate the Regents' commitment to oversight and assessment of compensation practices and policies. Based on actions taken at this meeting with respect to the Bylaws, at the March meeting the Special Committee will become a Standing Committee. He noted that, in coordination with the Office of the President, more information about compensation is being published on the internet. With recommendations or advice that will come from the third effort – the task force – more information will be included. The objective is to make sure that the compensation policies and practices are clear, comprehensible, transparent, and that there is accountability. In addition, the Legislature has indicated a desire to conduct hearings and potentially to obtain a State audit in this area. Chairman Parsky reported that he would be enthusiastic about testifying once the Regents have been given the opportunity to obtain the necessary data on which to report.

Chairman Parsky reported that a third element was to seek advice on what needs to be done for the future or how policies should be changed. In that connection, a task force was formed that is independently reporting to The Regents. This group, chaired by Mr. Robert Hertzberg and Regent Kozberg, will compare the University to other institutions. The task force's participants have broad experience in a variety of areas including business, public service, and media. Its intention is to take a fresh look at where policy stands and make recommendations for the future.

Regent Kozberg reported that the task force has held two meetings and will have its last meeting on February 28 in order to be ready for the Legislative hearings and for discussion with the Regents at the March meeting. The task force will not be taking independent action; its recommendations will be presented to the Regents. She reported that the group's membership includes Ms. Dede Albert, who is a former State Senator knowledgeable about K-12 and higher education and the Master Plan; Faculty Representative Brunk; Mr. Jim Duderstadt, former President of the University of Michigan, who has been working with the Association of Governing Boards on compensation for university presidents; Mr. Kip Hagopian, a managing partner of Apple Oaks Partners; Mr. Jay Harris, former publisher of the *San Jose Mercury News*, who now sits in the Wallis Annenberg Chair at USC and is the founding director of the Center for the Study of Journalism and Democracy; Regent Lozano, who approaches the subject with a news publisher's viewpoint as well as that of a Regent; and Mr. James Morley, President and CEO of the National Association of College and University Business Officers. At its first meeting the task force determined that its goal was to ensure that the University is a leader in terms of transparency and accountability and that there is a competitive structure going forward. The second meeting was spent on transparency issues. The importance of clarity, openness, and a sense of public understanding were discussed. Best models are being assessed and will be formulated into best practices, with the help of Deloitte and Touche. The task force's next meeting will be on governance and accountability: whether the appropriate systems are in place, whether the University is in compliance with its policies, where there are deviations from those policies. Its last meeting will be on competitive compensation. Once a full picture has been drawn, recommendations can be formed to be presented to the Regents and disclosed to the public.

Committee Chair Hopkinson emphasized that the report and the two audits undoubtedly will result in a major overhaul of policies and procedures.

### 3. **ADOPTION OF POLICY ON SEPARATION AGREEMENTS**

The President recommended the adoption of the following Policy on Approval of Separation Agreements, effective immediately:

#### PROPOSED INTERIM POLICY

All separation agreements involving individuals in the following positions shall be submitted to the Board of Regents for approval: Principal Officers of The Regents, President, Senior Vice Presidents, Vice Presidents, Chancellors, Department of Energy Laboratory Directors, and Medical Center Directors. In addition, separation agreements for all other employees involving consideration of \$100,000 or more shall be submitted to the Board of Regents for approval.

All other separation agreements involving consideration of less than \$100,000 shall be approved by the President. If the President determines that emergency circumstances require approval of a separation agreement involving consideration between \$100,000 and \$200,000, the Chairman of the Board and the Chair of the Special Committee on Compensation may approve such agreements as an interim action.

The authority of the President to approve separation agreements may be delegated to Chancellors and Department of Energy Laboratory Directors for campus and Department of Energy laboratory employees, respectively.

Prior to submission for approval by the Board of Regents or the President, all separation agreements shall be submitted to the General Counsel for review and comment. All such agreements shall include a release approved by the General Counsel.

The Regents shall receive an annual report of all separation agreements involving consideration of \$100,000 or more. This report shall be submitted concurrently with the annual report on senior management compensation and the annual report on senior management outside professional activities and related compensation.

“Consideration” as used in this Policy is defined as a monetary commitment on the part of the University, whether in the form of a lump sum cash payment or compensation for continuing services or ongoing University benefits (such as sabbatical leave, COBRA benefits, or other in kind benefits) and excludes other payments for previously earned benefits available to employees in the separate employee’s employment category (such as earned vacation leave).

General Counsel Holst recalled that recent attention has been drawn to agreements that the University has entered into with employees to effect their separation from the University (sometimes referred to as severance or termination agreements). Such agreements result from a determination by the University that the University’s interests would be best served by the employee’s removal from the current position or separation from University employment. Such agreements may provide for short term continuing service on special assignments before final separation from the University.

These agreements are intended to facilitate transition of such employees out of a particular position or out of University employment into new career opportunities. They

do not originate from a legal claim asserted by the employee; thus, the General Counsel has concluded that they do not constitute claims under the Policy on Settlement of Claims and Litigation. As a result, they have been treated as administrative matters for development and implementation at the Office of the President for Office of the President personnel or at a campus or Department of Energy laboratory in the case of campus or laboratory employees.

A decision to effect an employee's separation may in some instances result in a claim against the University. Typically the consideration paid to effect an employee's resignation does not include a significant amount related to such a claim. This circumstance is a further basis for the conclusion that these arrangements do not involve settlement of claims within the meaning of the Policy on Settlement of Claims and Litigation. In all instances, however, a legal release is obtained from the employee in return for consideration paid by the University.

The proposed Policy will serve as the basis for action on such agreements until any modifications are recommended by the Task Force on Compensation, Accountability, and Transparency or the projects to be undertaken by PricewaterhouseCoopers and Deloitte and Touche related to compensation and accountability issues or by the Special Committee on Compensation.

Committee Chair Hopkinson noted that violations of policy or illegal conduct resulting in separation will be the subject of a separate policy.

Chairman Parsky commented that several Regents had felt there was an inconsistency in what the Regents were required to approve. In the context of litigation, Regental approval was required for settlements, but outside of the context of litigation it was not. It was thought prudent to address this area without waiting for the recommendations coming from the task force and subsequently to revisit the matter.

Regent Ruiz believed that when people with extraordinary capabilities and qualities are brought in who fail to perform up to expectations, the situation must be addressed quickly in the best interest of the University. President Dynes agreed, noting that the policy will make it easier to recruit the best and move people to appropriate places within and outside the University, with the engagement of the Regents. The policy is temporary and will be rewritten or refined at the appropriate time. Committee Chair Hopkinson added that part of the challenge is that policies are difficult, unclear, divergent, and unorganized. President Dynes believed some were actually contradictory. The development of clearer, unequivocal policies will help those inside the University.

Regent Lansing emphasized the necessity of guidelines that are consistent, transparent, and have the full Board's approval. She asked when a final policy may be put in place. Committee Chair Hopkinson believed it would happen in stages; it will take at least six months to establish new, completely comprehensive, clear policies.

Regent Juline asked how this policy addressed or monitored terms of separation in circumstances where they have been discussed at the time of engagement. General Counsel Holst believed such circumstances to be very limited. Terms established at the beginning of service would be a part of compensation and would be treated as required under compensation policies, and they would be part of the action that would authorize the appointment. To the extent they fell within the Regental level of authorization, those cases would come to The Regents. They would be acted upon by the President when within his authority. Regent Juline was assured that this element of compensation would be addressed when submitting a final policy.

Regent-designate Schreiner believed the policy was good as an interim measure. He was concerned, however, that it may not provide sufficient flexibility. He recalled that the stickiest situations often involve the most money. While he acknowledged the Board's wish to discuss the most sensitive items, he hoped that the final policy would accommodate both the concerns for predictability and consistency as well as the flexibility that might be required under certain circumstances.

Faculty Representative Oakley noted that the explanatory statement lumps together two different categories of employees whom the University might wish to separate from its service expeditiously. One category has some form of tenure or other job security, which the employee in question is being asked to relinquish, and therefore payment of consideration to give up those vested rights often without normal exhaustion of remedies is appropriate. There is a second category of employee who works at will, possibly in high administrative office, where there is no associated faculty position or job security. There would be no reason to make a payment in that second category but for the relinquishment of that person's possible legal claim rather than job security claim. He believed that in that second category, however phrased, a separation agreement is a settlement of litigation and ought to be treated differently in the policy. His second proposal was to take care to define what counts as consideration. The interim policy indicates that being offered another job is consideration, but it should define the term, "separation." Otherwise it will be difficult to know, when someone is offered a new job for giving up an old one, whether that is a separation covered by the policy or is simply a promotion or transfer, given that employment wages are included in what the document defines as consideration. He proposed that as the policy is refined, appropriate consultation be held with the University Committee on Planning and Budget of the Academic Senate, since it involves allocations of University funds.

Regent Rominger supported the idea of the interim policy and a permanent policy that includes Regental involvement. He noted that concerns about having sufficient flexibility had been expressed, but he believed that the need for speed may be mitigated by the likelihood that the person would be on paid or unpaid leave while the issue is brought to the Regents.

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

4. **APPROVAL OF SALARY STRUCTURE AND OVERVIEW OF JOB SLOTTING FOR ALL DESIGNATED OFFICER POSITIONS AND FOR CAMPUS AND OFFICE OF THE PRESIDENT POSITIONS WITH CURRENT SALARIES ABOVE THE INDEXED COMPENSATION LEVEL**

The President recommended adoption of the base salary structure described in Exhibit 1 (attached) establishing salary grades and ranges for use in administering base compensation for the Senior Leadership Compensation Group (SLCG), which includes positions occupied by incumbents whose salaries exceed the Indexed Compensation Level (ICL), which is \$168,000 per annum, and certain designated Officer positions.

The salary structure will be reviewed annually and adjusted by the Regents as appropriate, based on an assessment of changes in the market.

[Note: Not included in this recommendation and scheduled for action by The Regents at the March meeting will be the compensation structures for the Offices of the General Counsel, the Secretary, and the Treasurer and slotting for the campus counsels, Lawrence Berkeley National Laboratory positions below the director, medical center positions, and the deans of medicine.]

The Committee was informed that the following two principles drive the compensation plan for the SLCG:

- (1) The procedures that govern the administration of the compensation plan for the SLCG must be clear, equitable, transparent, and accountable to The Regents and the public in accordance with the principles approved by the Board of Regents on November 16, 2005.
- (2) The quality of the academic, management, and staff personnel is essential to maintain the excellence of the University of California and its ability to contribute to the health and vitality of the State of California. The strategy is to attract and retain the highest quality academic, managerial, and staff talent by offering competitive total remuneration.

The recommendation is for base salaries only and does not include recurring payments such as bonuses, car allowances, and housing allowances. This information, while important, has not yet been systematically collected for the purposes of reporting. Data on these non-salary items is being assembled as part of several audit efforts under way and will be presented to the Regents in the near future. Additionally, compensation information from the academic comparative institutions is generally available only for base salaries, and it is therefore very difficult, if not impossible, to make comparative analyses for compensation purposes on other than base salaries.

At the March meeting, priorities for the use of available funds and the specific placement within the salary ranges of each of these individuals as well as all the individuals in the SLCG will be scheduled for action.

At the November 2005 meeting, The Regents approved a policy that a salary structure be established, subject to the approval of The Regents, within which salaries for all SLCG positions will be administered. The structure is to be based on the recommendation of an external consultant and will consist of salary ranges that provide salary opportunities competitive with those offered by other employers with which UC competes for SLCG employees. Each SLCG position will be assigned to the appropriate salary range based on external competitive salary data and internal equity considerations. There are 284 positions that have been assigned to salary grades and for which approval is sought in this action, and approximately 135 additional positions will be presented at the March meeting, of a total University full-time employment of approximately 120,000. There are a number of related positions at the Los Alamos National Laboratory and the Lawrence Livermore National Laboratory that will not be slotted, given the structural changes that have occurred or likely will occur.

### ***Salary Structure***

Working with the Office of the President and the chancellors, Mercer Human Resource Consulting (Mercer) has developed an executive salary structure based on the following design principles:

- To establish salary ranges that are aligned with the rates paid in the competitive markets within which UC competes for SLCG employees.
  - The competitive market data are typically based on the levels of cash compensation prevailing among a select group of 26 higher education institutions that report salary data annually to the College and University Professional Association (CUPA).
  - Where the competitive market is not adequately defined by the higher education institutions participating in the CUPA study, additional market competitive data are collected from surveys of salary levels in general industry conducted by Mercer and other consulting firms.
- To create a logical structure within which salaries for SLCG employees can be managed by the system, campus, or department with clear oversight by The Regents.
- To provide a structure that enables incumbents to receive compensation commensurate with specific job responsibilities, qualifications, experience, and performance.

- To group together jobs with similar levels of responsibility for ease of administration and to maintain appropriate internal salary relationships systemwide.

### ***Salary Grades***

Establishing grades for the positions that are the subject of this recommendation is consistent with accepted compensation practices and with other positions within the University of California. This proposed Salary Structure is comprised of 16 salary grades each of which has a unique salary range associated with it. The spread from the minimum salary level to the maximum salary level within each grade varies between 50 percent and 60 percent, which is somewhat narrower than those typically found in the market for positions at these salary levels, reflecting a conservative approach by UC in differentiating individual salary based on difference in individual qualification, experience, and performance. The difference between grade midpoints, or the "Increment," is proposed at 12 percent, which is also consistent with practice.

### ***Job Slotting***

The approval by The Regents of individual SLCG positions to specific salary ranges is the subject of a separate Regents item. This section provides an overview of the process that was used to assign the positions to the salary ranges.

With Mercer's assistance, UC has slotted affected SLCG positions into the salary structure using the following criteria and process:

- Appropriate market data were collected from salary surveys for the SLCG positions under consideration that are commonly found in the market.
- Positions normally were assigned to the grade that had a salary range midpoint closest to the indicated median of the market data. The range around the midpoint allows individuals to be paid higher or lower to recognize individual qualifications, experience, and performance.
- For department head jobs with incumbents across multiple campuses:
  - Competitive market ranges were determined to encompass the 10<sup>th</sup> through the 90<sup>th</sup> percentiles of the market data.
  - Within the larger competitive ranges, narrower salary ranges were used in order to recognize differences across campuses based upon differences in relative size and complexity, academic prominence, and other relevant factors.

- A grade structure with the maximum grade differential for multiple incumbent department head jobs was used to identify relative differences in size, complexity, academic prominence, and other relevant factors and place them appropriately within the broader competitive range. The structure provides for considerable overlap in the salary ranges while encompassing the full range of competitive market rates.

The criteria for slotting jobs into a specific grade within the larger competitive range included relative size and complexity within UC, academic prominence, and other relevant factors, including internal equity and reporting relationships. In addition, adjustments have been made to recognize “priority” positions that require a higher salary range in order to be able to fill the position with a more qualified candidate.

In assigning positions to salary grades, the following criteria were used also:

- The position, not the incumbent, was considered in assigning grades.
- Unique positions within UC Office of the President or the campuses were slotted based on their individual market data, where these data were available. Positions where no relevant market data were available were slotted into grades based on their relative similarity to other positions in the campus and/or system.
- Once the positions were slotted, current individual base salaries were compared to the salary ranges, and those that are below range minimum or above range maximum have been noted. Future adjustments to each individual’s salary will be viewed relative to the salary ranges, considering the incumbent’s experience and performance.

The process to complete the overall position slotting included:

- Initial assignment of job slotting was completed by UC Office of the President and Mercer.
- The initial slotting was reviewed by the Chancellors for completeness, accuracy, and internal grade relationships, and then updated.
- The updated slotting was reviewed by the Senior Management Advisory Committee (SMAC), which reviewed the results systemwide and recommended final job slotting to the President.
- The final, individual recommendations are being submitted by the President to the Special Committee on Compensation and to The Regents for review and approval in a separate Regents item.

Committee Chair Hopkinson provided some context for the President's recommendation, recalling that there are approximately 800 positions in the Senior Leadership Compensation Group whose salaries are in excess of \$168,000. Setting salaries for these individuals has been done on an ad hoc basis; there is no apparent structure or consistent analysis for these positions when they come to the Regents for individual action. The Regents need to oversee what is happening with these individuals in the context of the University and its competition and how policies are being implemented. The objectives of the President's recommendation are to implement procedures for determining compensation for senior leadership which were approved at the November 2005 meeting as part of RE-61, *Policies on Universitywide and Senior Leadership Compensation, and Procedures for Senior Leadership Compensation*, that are clear, comprehensive, and accountable. These interim procedures will be revised within six months after the Kozberg-Hertzberg study and the audits have helped to create more accountability and clarity.

Regent Hopkinson recalled that RE-61 provided that the Regents will establish salary ranges for the 800 senior management positions, based on a study by an external consultant, that are competitive with the University's comparative institutions. The recommendation at this meeting is to approve those ranges; no salary increases are proposed. RE-61 requires that the Regents approve annually the 32 top positions, all the funds to be used for salary increases for these positions, the priorities for these funds, and all salaries that place a salary above the midpoint, and that the Regents receive a comprehensive report on all 800 positions to include the individuals in those positions, their ranges, and their compensation. She indicated her intention to propose some changes to RE-61 on an interim basis.

Committee Chair Hopkinson noted that the second step to be taken at this meeting was to set 284 positions within the ranges. Also recommended are three additional requirements for Regental involvement and that priorities be set for using the funds available for increases for these 284 positions. She outlined the additional requirements that are recommended: that on an interim basis for 2005-06, all salaries in excess of \$200,000 for the SLCG be approved by The Regents; that any salary increase in excess of 7.5 percent for 2005-06 be approved by The Regents; and that positions included in the proposed Legislative audit that are not in the annual report required by RE-61 be included in that report at least for the interim. Those positions are vice provost, executive vice chancellor, vice chancellor, associate vice chancellor, and assistant vice chancellor. The funds for salary increases and the priorities for the use of these funds are to be established by The Regents. In 2005, The Regents approved a 4 percent salary increase pool for faculty and staff. Most of this \$261,035,000 has been distributed to faculty and staff. The Regents also approved a 2.5 percent salary increase pool for the SLCG. For the 284 positions that will be slotted in ranges, at their current salary the total 2.5 percent increase was \$1,238,000. The Regents now need to set the priorities for the remaining 1.5 percent to be used for the 284 positions. This additional money for the SLCG represents \$770,000 for the total fiscal year 2005-06. At the March meeting, The Regents would be prepared as required under these controls to approve where this \$770,000 is

spent. The recommended priority is to address the positions further below parity for those whose performance warrants adjustment. The actions required of the Regents on specific increases using the \$770,000 will be recommended in March. The gap currently for the 800 SLCG when compared to the proposed ranges that are recommended as part of this item places them, on average, at 84.3 percent of the median for those ranges. Allocation of the additional \$700,000 in accordance with priorities to be established by the Regents would bring this to 85.4 percent of the median. In the coming months, the additional positions will come forward for Regental action. The ones that are not included in addition to the 284 are the Office of the General Counsel, Office of the Secretary, Office of the Treasurer, all the medical centers, and two of the three laboratories. The third laboratory, Los Alamos, will be removed from this program because it will be handled by the LLC independently and will no longer be part of the SLCG. Moving forward, the new compensation committee will be challenged to address many issues as a result of the work of the task force and the audit. Its charge is to assure fairness, transparency, and oversight. This program is an interim way to accomplish that goal.

Mr. Bob Miller, of Mercer Human Resource Consulting, discussed the process that was used to establish the 17 ranges that are proposed. He commented that the overall goal was to streamline the procedures that have been used for the 800 SLCG while still maintaining full oversight responsibility at the Regental level. For the President, Secretary, designated Officers, Senior Management Group, and the other employees whose salaries exceed the current indexed compensation level of \$168,000, The Regents will approve the salary structure and all job slotting within the salary structure. Individual salary actions at the level of the President and Secretary will be developed and approved by The Regents independently. For the designated Officers, the President will make salary increase recommendations to The Regents, which will approve each of these individually. For the next two groups, the SMG and the others who are above the indexed compensation level, salary actions will be taken within guidelines that The Regents approves, and all of those actions will be reported regularly. Within those guidelines, the salary actions can be taken by the President and reported to The Regents. Any exceptions to those guidelines will require individual approval by The Regents. The jobs that are being considered currently for job slotting include the President, chancellors, senior vice presidents, vice presidents, laboratory directors, everyone at the campus level except the campus counsels and medical centers, the two laboratories, and the deans of medicine. The remaining jobs – the Secretary, Treasurer, General Counsel, medical center CEOs, medical centers, campus counsel, the two laboratories, and deans of medicine – will be done in March. This meeting will cover 284 jobs.

Mr. Miller explained that a salary structure is comprised of a series of salary grades that are made up of a group of jobs that have approximately the same value when looked at in the competitive market setting. Each grade has associated with it a salary range. The spread in the range is the percentage increase from the minimum to the maximum. The ranges that are proposed for approval have spreads that start at 50 percent from minimum to maximum in the lowest grades, gradually increasing to 60 percent in the highest

grades. As noted, these are narrower than in private industry for executive level positions. Salary grade midpoint is the point that is used to determine what grade a job will be slotted into. The midpoint of the grade that is closest to the median in the marketplace will generally drive the slotting of a job. In the proposed structure, the midpoints increase by increments of 12 percent. The campuses and OP currently have six grades with range spreads of 125 percent, which is very broad. There is considerable overlap. Because there are so few ranges, there are very large steps between ranges – as much as 36 percent from one range to the next. This current structure does not provide much in the way of constraint, at least structurally, on how pay would be administered. The Regents are looking at each of these people individually and attempting to constrain salaries or manage salaries appropriately, but the structure itself does not provide the same kind of constraints that the new structure will. The idea is to provide ranges that align opportunities for people at UC with salaries that are paid in the competitive marketplace for similar jobs so as to provide a logical structure within which people who are administering the system can make pay decisions that are aligned with the market but still continue to have very clear oversight by The Regents. A structure would be provided that would allow for differences among pay for individuals, first by specific job responsibilities, which is reflected in the salary grade to which the job is assigned, and then within the salary range for that grade based on qualifications, experience, and performance. Jobs that have similar value in the marketplace are grouped together so that they can be administered consistently and so that there is an internal relationship from one job to the next of similar value that assures the same salary opportunities. In the initial slotting process, market data were collected for jobs that are included in the sample of 284. Most of these jobs are comparable to other jobs in higher education institutions. Data were used from The Regents' select group of 26 comparison institutions; where there were jobs that had other comparative markets, general industry was used. Positions were assigned to the grade that had the midpoint closest to the market median. In doing that, the job and not the incumbent was examined. Where there were no market data available, jobs were slotted into grades based on their internal relationships to jobs that could be slotted against the market data. For jobs across campuses, competitive ranges were determined that included the 10<sup>th</sup> to the 90<sup>th</sup> percentile of the market. Then UC's narrower salary ranges, which span only about the 25<sup>th</sup> to the 75<sup>th</sup> percentile, were used to reflect differences across campuses based on the compensable factors, which are relative size and complexity, relative academic prominence, any special priority that may exist for developing a specific school or function, internal equity, and reporting relationships. The initial slotting was completed by UCOP with the assistance of Mercer to provide the market data. These slottings were reviewed by the Chancellors and changes were made based on their input. The overall results were reviewed by the Senior Management Advisory Council, which made adjustments to reflect internal equity, then made final recommendations to the President.

Mr. Miller noted that for ongoing administration for the longer term, The Regents will approve any increase of 15 percent or more in salary that would take a salary over the midpoint for the individual's grade; any increase that would place a salary over the range maximum; any change in job slotting, including reevaluation of a job, an addition of a

new position that was not approved initially, or a salary grade adjustment based on priority funding for a specific position. The Regents will set goals for getting funds, prioritizing them, and directing them to various groups; will set an annual budget for salary increases; and will receive reports on all of the increases and salaries for all of the positions. The President, Senior Management Advisory Council, and the chancellors working together can then approve salary recommendations within the established grades and guidelines and provide the ongoing administration of the program. The monitoring reports that will come to the Regents at least annually will include how salary increases overall are comparing to the salary increase budgets approved by the Regents, by campus, and by UCOP; how the salary increases were distributed by percentage increase; whether they are reflecting a broad range of performance; the actual salaries and salary range midpoints compared to the market medians; how the resulting salaries and the structure look against the market; how the salaries actually compare to the midpoints; and where people are paid in the University relative to the structure established by The Regents. Regental approval will be obtained any time there is a salary action for a designated Officer, any increase that exceeds the approved guidelines, and any new or changed salary grade assignments.

Mr. Miller recalled that for 2005-06, it has been proposed that The Regents approve all salary actions for individuals with total cash compensation, salary plus bonuses and stipends, over \$200,000 and any increase in base salary that is at or above 7.5 percent. These guidelines may be proposed to be changed after the audits and reviews of these procedures have been completed.

Regent Bustamante asked whether qualifications, experience, and performance would carry equal weight in the grading of employees. Mr. Miller responded that the job responsibilities would put the job in the grade; where a person gets paid within that salary range would be based on the three factors mentioned. The weights assigned to each factor will be a matter of judgment. For an employee in a new range, for instance, qualifications and experience might carry more weight than performance. Over time, performance would come to play a more prominent role. More emphasis would be placed on performance at senior level jobs, which is one reason why the ranges get slightly broader moving up in the structure.

Faculty Representative Oakley reported that the Academic Senate's University Committee on Planning and Budget, which exists with an express charge under the Standing Orders to advise the President on budgetary matters, has made a request, endorsed by a substantial majority of the Academic Council, that the Regents delay action on the President's recommendation, believing that setting up a structure for salaries and deciding how to map that structure across campuses seem within the purview of the traditional domain of shared governance, which has not extended traditionally to administrative as opposed to academic salary decisions or personnel decisions. There is concern about how different campuses will be treated and how plus and minus evaluations made. The Committee on Planning and Budget has not been able to weigh in on this matter. He noted that Regent Hopkinson had stated that the proposal was an

interim measure, a fact he suggested be included in the recommendation language in order to assure that any subsequent evaluation by Planning and Budget would not be after the fact.

Faculty Representative Oakley asked for clarification regarding the individual evaluations. Mr. Miller reiterated that the placement of the job is based on the duties of the job and its comparison to external market data. A higher grade than the position would demand will not be assigned because of good performance or higher qualifications. Once the job has been slotted and the University starts to administer individual pay within that range, then those factors that are unique to the individual – qualifications, experience, and performance – will account for how quickly someone would move to a range and where he would get paid within the range. Professor Oakley commented that the University Committee on Planning and Budget would like a voice in this process at the point where positions and not incumbents are being dealt with.

Faculty Representative Oakley noted that there are judgments being made that involve some academic considerations about relative size, complexity, and academic prominence of campuses. He was concerned that the chain of review from the initial proposal to the present point has involved administrative but not academic stakeholders. He advocated adopting the express statement that the recommendation is an interim measure that will be subject to finalization after normal channels of review have been exhausted. Committee Chair Hopkinson suggested adding the word “interim” to the recommendation in a way that related to the whole process.

Faculty Representative Brunk noted that the President’s recommendation is to approve a matrix of salary scales without any attempt to put either positions or individuals onto that. The item to be taken up in Closed Session will do the latter. He emphasized that Mr. Miller and the Mercer Group had presented this item – the formation of this matrix – to the Budget and Planning Committee of the Senate, which endorsed the general proposal. The reservations center around the actual placing of different positions and individuals within the matrix and not simply the formation of that matrix.

In response to a question asked by Regent Kozberg, Committee Chair Hopkinson reported that the faculty had been briefed on the recommendations. Senior Vice President Mullinix added that there had been a significant number of presentations made on the issue. He suggested that there may have been some mis-communication that had led to misunderstandings about the recommendation.

In response to a question asked by Regent Juline about the midpoint of the range and any correlation it may have with market medians or averages, Mr. Miller reported that if someone is being paid at or around midpoint, he is being paid at or around the median. The salary range has up to a 50 percent spread that could allow for a salary below median for someone who was new to the job or not a strong performer, or above median for a strong performer or someone with excellent qualifications. The actual relationship to the

medians on the proposed slottings will be discussed when the slottings have been reviewed and approved.

Committee Chair Hopkinson moved the following amendment to the recommendation:

The President recommends adoption of the base salary structure described in the attachment establishing interim salary grades and ranges for use in administering base compensation for the Senior Leadership Compensation Group (SLCG), which includes positions occupied by incumbents whose salaries exceed the Indexed Compensation Level (ICL), which is currently \$168,000 per annum, and certain designated Officer positions. The salary structure will be reviewed annually and adjusted by The Regents as appropriate, based on an assessment of changes in the market.

Implementation of this structure shall be conditioned on the following:

- (1) All salaries in excess of \$200,000 for the Senior Management Group (SMG) in 2005-06 be approved by The Regents.
- (2) Any salary increase for the SMG in excess of 7.5 percent in 2005-06 be approved by The Regents.
- (3) Positions included in the proposed Legislative audit be included in the 2005-06 annual report to The Regents. The positions are Vice Provost, Executive Vice Chancellor, Vice Chancellor, Associate Vice Chancellor, and Assistant Vice Chancellor.
- (4) The President's recommended priority for these funds is to use them to address the positions furthest below parity for those whose performance merits adjustment.

[For speakers' comments, refer to the minutes of the January 18<sup>th</sup> and 19<sup>th</sup> meetings of the Committee of the Whole.]

The motion was duly seconded. The Committee approved the recommendation as amended and voted to present it to the Board.

5. **TREASURER'S OFFICE COMPENSATION: ANNUAL INCENTIVE PLAN METHODOLOGY**

Chairman Parsky noted that there are two elements to compensation for the Office of the Treasurer: salary levels and incentives. At previous meetings, Regents requested more information on the methodology used in connection with the incentive component.

Mr. Tom Richards of Richards & Tierney, Inc., The Regents' investment consultant, reviewed the nature of the annual incentive compensation plan. He discussed the background of the compensation proposal process, key elements of the plan, an overview of how the plan works using an example of a hypothetical managing director within the Treasurer's Office to see how the actual compensation is calculated, and finally some cost benefit relationships. He recalled that in 2004, Mercer was commissioned by the Treasurer and the Office of the President to evaluate total compensation for the Treasurer and the investment staff. The objectives were to attract and retain qualified people, offer total compensation at or near the median for similar positions in other organizations, and induce controlled risk-taking behavior on the part of the investment staff. Each person in the Treasurer's Office was matched to a specific position in McLagan Partners' Investment Management Survey. A blended peer universe was developed for each senior investment position, based on a combination of salary and total compensation data from investment organizations and endowments. These data were used to support recent the salary and incentive increases for the Treasurer. Chairman Parsky, the Office of the President, and Mercer then developed the proposal approved in November to attract and retain qualified people, increase selected salaries for senior staff and incentive target and maximum percentages for all Treasurer's staff, and accomplish the objective of risk-control behavior.

Mr. Richards listed key elements of the incentive compensation plan. The first is performance objectives. He noted that these objectives are based on the investment policy, the asset allocation, the investment objectives, and the risk tolerances that have been approved by the Regents. The plan is designed to encourage limited investment risk taking and discourage excessive risk taking. The second element is that there are multiple components. There is a quantitative component that is based on value-added performance of the total fund or entity, which amounts to approximately \$67 billion, as well as value-added performance for the various asset classes and investment sectors for which the investment staff are responsible. Value-added performance is based on the difference between the actual results and the benchmarks that have been established. As such, it is relative rather than absolute. The qualitative component is based on a subjective assessment of the individual's contribution to the group. This component is contingent

on the total fund's or entity's meeting a threshold performance level. If that does not occur, the individuals are not eligible for any qualitative incentive compensation. The third element is the issue of earned versus paid; that is, one-third of the amount earned in any given year is paid in the current year, and two-thirds of what is earned is deferred to the subsequent two years and thus is subject to the future performance of the fund and is at risk. The deferred amount can be forfeited if future performance does not reach a threshold level or if the employee leaves. The incentive plan is not a bonus plan in that the compensation is not guaranteed and is at risk. Using a simulated sample employee, Mr. Richards described in detail how the plan could work for a specific individual.

Mr. Richards noted that if the Treasurer's Office achieves a targeted performance, the value added is approximately \$160 million annually. If the maximum performance is achieved, the value added or enhancement to these assets is \$380 million. With respect to cost, if the target performance is achieved, the cost would be expected to be about \$2.3 million that would be paid in the form of incentive compensation. If the maximum performance is achieved, the cost would be about \$4.6 million. That cost as a percentage of the value added is 1.46 percent at target level and 1.16 percent at maximum level. Another way to calculate the cost benefit relationship is to determine what the payback is per dollar of fee that is being paid. The payback per dollar of incentive compensation is 68 times at target and 86 times at maximum level. As a percentage of assets under management, if targeted performance is achieved as a percentage of the amount of assets it is about 1/3 of a basis point; maximum performance is about 2/3 of a basis point.

Regent Lee asked how the salaries and bonuses compared to those of other universities, particularly in light of the collapse the "dot com" bubble and its resurgence. Mr. Richards responded that the intent of this plan was to allow the individuals who achieve targeted performance to be at the median of a peer group universe. He believed that the University has a strong group in the Treasurer's Office. Chairman Parsky noted, however, that a number of the University's staff are being offered salaries by for-profit organizations that the University is unable to match.

Regent Pattiz noted that the University has \$67 billion invested. He believed that it is essential for the University to reach the point where it can pay competitive salaries. Senior Vice President Mullinix commented that the base salaries are more in line than the incentive program, which has some very conservative features not typically seen in performance programs, including the at-risk provision and the claw-back provision, under which deferred incentive compensation will be forfeited if performance is below threshold level.

Committee Chair Hopkinson asked for a comparison of the past five years under the new formula versus what employees really received, or how the Treasurer's Office performed based on the benchmarks. She asked how often the benchmarks set by The Regents are reviewed. Chairman Parsky responded that it is policy to examine them annually, although he noted that this needs to be done more consistently prior to the beginning of the fiscal year.

Regent Sayles asked about the rationale for the claw back. Chairman Parsky explained that it was thought prudent to examine performance over more than a one-year period. Without the claw-back provision, an employee who over-performed in year one and “earned” a significant incentive but under-performed in years two and three would have been paid. Regent Sayles suggested the claw back could be a deterrent to new hires. Chairman Parsky acknowledged that the arrangement is not favored by the Treasurer’s Office; however, a balance needs to be found in order to increase salaries and compensation. Regent Sayles suggested that in the longer term providing a three-year incentive program may be a better approach.

Regent Bustamante asked for a percentage of what the University’s employees make in comparison to the private sector. Senior Vice President Mullinix responded that the University typically pays less than the private sector. The largest spreads are in the incentive compensation range, where the University is substantially behind. The comparison is closer when compared to the public sector. Chairman Parsky recalled that a presentation at the November 2005 meeting provided specific information on the subject.

The Committee recessed at 1:10 p.m.

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The Committee reconvened at 2:10 p.m.

6. **AMENDMENT OF THE UNIVERSITY OF CALIFORNIA RETIREMENT PLANS TO FACILITATE THE TRANSITION OF THE LOS ALAMOS NATIONAL LABORATORY TO THE LOS ALAMOS NATIONAL SECURITY, LLC, AND AMENDMENT OF THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN TO CLARIFY THE FIDUCIARY OVERSIGHT STRUCTURE**

The President recommended that:

A. Effective March 31, 2006, or as soon as administratively feasible, the President, with the concurrence of the Chairman of the Board and the Chair of the Committee on Finance, be authorized to amend the University of California Retirement Plan (UCRP) to:

- (1) Spin off liabilities and assets for active, inactive, and retired members who are or were employed at the Los Alamos National Laboratory (LANL) to a UC-sponsored plan (UCRP-LANL Plan) that provides for the same monthly retirement benefit formulas as the UCRP, subject to approval by the Department of Energy (DOE). Assets will continue to be managed by the Office of the Treasurer under the investment policies

approved by The Regents, and trustee duties will continue to be performed by The Regents.

- (2) Retain the Capital Accumulation Payment (CAP) benefit for LANL members in the UCRP or spin it off to another plan, if necessary, to facilitate obtaining a favorable Internal Revenue Service (IRS) determination letter on the UCRP-LANL Plan, subject to DOE approval.
  - (3) Under a reciprocal arrangement to be negotiated with the Los Alamos National Security, LLC (LANS) and the DOE, allow certain service and compensation accrued while employed at UC and at LANL under the LANS to be considered, but not double counted, in determining a member's final retirement benefits payable under UCRP and/or the new site-specific defined benefit pension plan maintained by the LANS (Corporate Plan). The Corporate Plan, which is described in the LANL Request for Proposal (RFP), will incorporate key provisions of UCRP.
  - (4) Incorporate the provisions of paragraphs (3), (4), and (5) from Section B. below into UCRP, if the UCRP-LANL Plan is not approved.
- B. If the UCRP-LANL Plan described in Section A. above is approved, incorporate into the plan document all applicable UCRP provisions as well as certain additional provisions, including authority to:
- (1) Provide an alternative to the CAP benefit provisions in UCRP, if necessary, to prevent a delay in the IRS's issuing a favorable determination letter on UCRP-LANL Plan.
  - (2) Allow certain service and compensation accrued at LANL while employed by the LANS and certain service and compensation accrued while employed by UC to be considered, but not double counted, in determining a member's final retirement benefits payable under the UCRP-LANL Plan and/or the Corporate Plan under a reciprocal agreement to be negotiated with the LANS and the DOE.
  - (3) Transfer assets and liabilities to the Corporate Plan attributable to certain active LANL employees who transfer employment to the LANS, provided the Corporate Plan has received all necessary and appropriate rulings.
  - (4) Arrange for interim funding for retirement benefits of LANL employees who retire after May 31, 2006, but prior to the final transfer of assets and liabilities to the Corporate Plan.
  - (5) Permit eligible LANL employees who are in the process of a buyback or who are within the three year buyback eligibility window to establish or

re-establish service credit for eligible leaves or prior periods of UC employment, prior to the termination date of their UC employment.

- C. If the UCRP-LANL Plan is approved, effective March 31, 2006, or as soon as administratively feasible, the University of California 415(m) Restoration Plan (415(m) Plan) be amended to extend eligibility to employees who retire from the UCRP-LANL Plan and otherwise satisfy the eligibility requirements of the 415(m) Plan.
- D. If the UCRP-LANL Plan is approved, effective March 31, 2006, or as soon as administratively feasible, the UC Retirement Savings Program plans be amended to:
  - (1) Provide that LANL employees whose mandatory participation in the University of California Defined Contribution Plan is defined with respect to a membership category in the UCRP also be defined with respect to a membership category in the UCRP-LANL Plan.
  - (2) Permit rollover contributions between the UCRP-LANL Plan and the UC Retirement Savings Program plans to the same extent as permitted between the UCRP and the UC Retirement Savings Program plans.
- E. The President be delegated the authority to (i) amend UCRP to clarify the fiduciary obligations of UC Human Resources and Benefits (HR/Benefits), the Office of the Treasurer, and The Regents with respect to the UCRP similarly to the action previously taken by The Regents with respect to UC's defined contribution plans (the UC Retirement Savings Program), (ii) incorporate similar fiduciary language in the UCRP-LANL Plan, if approved, and (iii) if the UCRP-LANL Plan is approved, implement any necessary amendments to the 415(m) Plan and the UC Retirement Savings Program plans to reflect the changes described herein.
- F. The President be delegated authority to implement the amendments described above, other than those described in Sections C., D., and E., subject to the approval of the Chairman of the Board and the Chair of the Committee on Finance.

It was recalled that on April 30, 2003, the U.S. Secretary of Energy Spencer Abraham announced that the DOE would open to competition the management and operations contract for LANL that will take effect after the DOE's contract with UC expires on May 31, 2006. UC announced on May 11, 2005 that it had entered into an agreement with Bechtel National, Inc. (Bechtel), a global engineering, construction, and project management company, to prepare for the Request for Proposal competition. The DOE issued the final RFP on May 19, 2005, and at its meeting on May 26, 2005, The Regents authorized UC to participate in submitting a proposal. On July 19, 2005, the limited

liability corporation (LLC) formed by UC, Bechtel, Washington Group International, and BWX Technologies, Inc.(the LANS) timely filed its response to the RFP. The DOE and National Nuclear Security Administration announced on December 21, 2005, that the UC-Bechtel team was chosen as the future manager of LANL.

The RFP requires the LANS to operate and manage LANL as a separate corporate entity. Further, the RFP states that the LANS must sponsor a site-specific defined benefit pension plan that incorporates key provisions of the UCRP for certain transferring LANL employees (the Corporate Plan). Assets and liabilities attributable to the benefits of LANL employees who accept employment with the LANS and participate in the Corporate Plan will be transferred from the UC-sponsored pension plan (the UCRP-LANL Plan, if approved, and otherwise, the UCRP) to the Corporate Plan when both plans have obtained the necessary and appropriate approvals.

The terms of the RFP that require the LANS to be a separate legal entity with site-specific plans reflect the DOE's desire to establish separate administration for NNSA-funded retirement plans. In order to ensure that the retirement program for LANL retirees and inactive members can be maintained by UC in accordance with the DOE's objectives and to fulfill its closeout responsibilities in the most timely and efficient manner, UC is proposing to spin off all assets and liabilities of LANL active, inactive, and retired members to a cloned plan (the UCRP-LANL Plan) prior to May 31, 2006.

The initial spin off to the UCRP-LANL Plan will facilitate the ultimate transfer of assets and liabilities for active employees to the Corporate Plan of the LANS when all appropriate and necessary rulings have been obtained. Retired members and inactive members of the UCRP-LANL Plan will remain in the UC-sponsored plan, and their retirement benefits will be paid from the related trust.

#### ***Support for the UCRP-LANL Plan Proposal***

In addition to meeting the DOE's objective of separate administration for NNSA-funded plans, the UCRP-LANL Plan will provide the following advantages:

- It will allow for a separate and more efficient annual actuarial valuation applicable only to LANL members. Assumptions can be based on LANL experience.
- It will enable UC to separate the cost of pension administration services reimbursable by the DOE/NNSA from the cost of providing administrative services for other UCRP members.
- A separate plan limited to LANL members that does not incorporate certain problematic UCRP provisions, such as the CAP benefit described below, could help to accelerate the regulatory review and approval process that is a prerequisite to the transfer of assets and liabilities to the Corporate Plan.

For all the reasons cited above, a similar model further refined by the LANL experience could be used when the Lawrence Livermore National Laboratory management contract is put out for bid, which the DOE/NNSA have indicated will occur in 2006 or 2007.

***Proposed Spin Off to UCRP-LANL Plan***

DOE Approval: Under the current LANL contract, UC is required to obtain DOE approval of any changes that are specific to a laboratory and could increase costs, in order to be certain that the costs are allowable. On December 12, 2005, representatives from LANL and staff from the HR/Benefits and Laboratory Administration units met with the NNSA to discuss the proposed UCRP-LANL Plan. NNSA has taken the proposal under consideration.

[NOTE: Subsequent to the Regents' January meeting, NNSA clarified its view of the December 12 meeting as involving only notification of the University's intent to go forward with this Regents' item and that no substantive discussion of or negotiation related to the University's plans occurred.]

Plan Document: If UC obtains DOE approval to establish the UCRP-LANL Plan, the applicable provisions of the UCRP will be duplicated in the new plan in all material respects, except possibly the CAP credits. UC HR/Benefits would have ongoing oversight responsibility for administration. Similarly to UCRP, the assets of the UCRP-LANL Plan would be managed by the Office of the Treasurer, and The Regents would serve as trustee of the related trust.

Separation of Assets: In a spin off, the assets and liabilities attributable to the benefits of a specific group of members of a retirement plan are calculated and transferred either to a new plan or to another preexisting plan. The transferee plan is then responsible for providing all future benefits to the members whose assets and liabilities were spun off. Under the proposal, UCRP is the transferor plan, and the UCRP-LANL Plan is the transferee plan.

Initially, members in the UCRP-LANL Plan will include all current and former UCRP members who are currently working at LANL or who have retired or terminated employment from LANL. After termination of the current contract occurs, the UCRP-LANL Plan would provide retirement benefits for all existing annuitants and for those who retire or elect inactive status before June 1, 2006. Active LANL members who transfer employment to the LANS and begin participation in the Corporate Plan on June 1, 2006, will receive their benefits from the Corporate Plan subject to the potential interim funding arrangements described below.

Actuarial Valuation: In order to determine the appropriate assets and liabilities to spin off to the UCRP-LANL Plan, a special actuarial valuation will need to be performed based on March 2006 data. The valuation will be performed in consultation with the DOE, internal and external counsel, and the UC actuaries. Spinning off assets to the

UCRP-LANL Plan before the termination of the current contract will allow UC to come to agreement with the DOE as soon as possible concerning the appropriate methodology and actuarial factors.

Internal Revenue Service Determination: The UCRP-LANL Plan document and supporting data will be submitted to the IRS as soon as administratively possible after the UCRP-LANL Plan is established, with a request that the IRS issue a favorable determination that the form of the plan meets the tax qualification requirements. The determination process is often lengthy. It is hoped that an early request for a determination will accelerate the date on which the final transfer of assets to the Corporate Plan may be made and thus facilitate the transition for continuing LANL employees.

### ***Final Spin Off to Corporate Plan***

If the UCRP-LANL Plan is approved, a second spin off of assets and liabilities will occur when the UCRP-LANL Plan and the LANS's Corporate Plan have obtained all necessary or appropriate regulatory approvals. The second spin off will affect only those LANL members who transfer employment directly from UC to the LANS and participate in its Corporate Plan.

The methods and assumptions involved in the second spin off could be subject to a more regulated environment because the transfer will be between a governmental plan (the UCRP-LANL Plan) and a non-governmental plan (the Corporate Plan) rather than between two governmental plans. Those issues are under review by UC staff and will be reported to The Regents at a later date. Retired and inactive LANL members will remain in the UCRP-LANL Plan after the current contract is closed out.

Regardless of who had won the management contract and become LANL's successor contractor, a spin off of applicable assets and liabilities to the successor contractor's plan would have been required. Thus, if the UCRP-LANL Plan is not approved, assets and liabilities for the transferring employees who participate in LANS's Corporate Plan will be spun off directly from the UCRP to the Corporate Plan.

### ***Policy Issues for Consideration***

Capital Accumulation Payment (CAP): The IRS considers the CAP to be a type of cash balance formula and is unlikely to issue a favorable determination letter on a plan with a cash balance feature. Since a favorable determination letter on either the UCRP or the UCRP-LANL Plan is likely to be a prerequisite to the transfer of assets and liabilities to the Corporate Plan, the CAP issue must be resolved quickly.

Interim Funding for Retirements: It is expected that a process will need to be established for paying benefits of employees of the LANS who are covered under its Corporate Plan and retire or otherwise become eligible for benefits after May 31, 2006, but prior to the

transfer of assets and liabilities from the UCRP-LANL Plan or the UCRP, if the UCRP-LANL Plan is not approved.

***Recommended Additions to the UCRP-LANL Plan or UCRP***

Reciprocity: The President proposes that certain service and compensation accrued at the LANS and at UC be recognized for determining and/or calculating retirement benefits under the UC-sponsored defined benefit plans and the Corporate Plan, but in no event double counted. Providing reciprocal benefits would affirm UC's relationship with an affiliated laboratory and its employees. It would also remove a significant barrier to the movement of individuals between the two institutions, which will advance the important scientific work and mission of the laboratory.

Buybacks: The President recommends, for those employees affected by the timing of the transition to the LANS, that the buyback rules for the UCRP-LANL Plan (or UCRP, if the UCRP-LANL Plan is not approved) be expanded to permit the after-tax lump sum buyback option for LANL employees who are involuntarily terminated from UC employment as a result of the LANL transition and who are either in the process of a buyback or who are within the three year buyback eligibility window to establish or re-establish service credit for eligible leaves or prior periods of UC employment. Payment must generally be completed prior to the date of termination of UC employment.

***Fiduciary Oversight***

Based on consultation with the Office of General Counsel and an independent review by external counsel Orrick, Herrington & Sutcliffe, LLP, the President proposes to amend UCRP (and to include similar provisions in the UCRP-LANL Plan, if approved) to clarify the distinction between primary fiduciary responsibility for investment management and administrative functions and secondary fiduciary responsibility, which encompasses ongoing monitoring of the performance of those with primary fiduciary responsibility.

Primary authority for implementing investment policy is assigned to the Office of the Treasurer. Primary authority for administrative functions is assigned to the Associate Vice President– Human Resources and Benefits. The Regents and its respective Committees will continue to determine investment policy and will continue to retain broad oversight responsibility for those who have been allocated primary responsibility for the investment and administrative functions of the UCRP and the UCRP-LANL Plan, if approved. A similar clarification regarding fiduciary oversight for the Retirement Savings Program was approved by The Regents at the March 17, 2005, meeting.

Further, as part of the clarification of the fiduciaries' roles, it is proposed that specific provisions governing the trust that is part of UCRP be incorporated in the plan documents for UCRP, with similar provisions for the UCRP-LANL Plan, if approved, and that UCRP be amended to remove specific references to advisory groups not included in the fiduciary oversight structure.

### ***415(m) Restoration Plan***

As of July 1, 2005, there are five UCRP retired members associated with LANL whose UCRP benefits are reduced by the limits imposed by Section 415 of the Internal Revenue Code (415 Limit) who are receiving restoration benefits as participants in the 415(m) Plan. There are approximately 125 active members employed at LANL who could retire with limited benefits in the future and thus become 415(m) Plan Participants, based on a ten-year projection.

If the UCRP-LANL Plan is approved, it is proposed that the 415(m) Plan be amended to cover eligible members of the UCRP-LANL Plan whose benefits would otherwise be reduced by the 415 Limit.

### ***Implementation***

It is proposed that the delegations be granted to amend the plans as described previously, effective March 31, 2006, or as soon as administratively feasible. If, in the course of obtaining the necessary and appropriate governmental rulings for the actions described above, it becomes necessary or desirable to make additional amendments to UCRP, the 415(m) Plan, the Retirement Savings Program plans, and/or the UCRP-LANL Plan (if approved) to facilitate the LANL transition, further interim action may be necessary. It is recommended that authority for such interim action, if necessary, be delegated to the President with the concurrence of the Chairman of the Board and the Chair of the Committee on Finance. The Regents will continue to be updated concerning the LANL transition and any interim action.

The University will take appropriate action concerning proposed changes that may trigger notice, consultation, and meeting and conferring obligations under the Higher Education Employer-Employee Relations Act and UC policy.

Associate Vice President Boyette reported that many of the proposals are required as part of the University's contractual closeout responsibilities and/or are related to the LANL transition to LANS. The Office of the President has identified approximately 800 tasks that must be completed in order to close out the human resources area of the previous contract. Regental approval is sought to amend UC retirement system plans to facilitate the transition of Los Alamos to the new contractor and to spin off liabilities and assets for active, inactive, and retired members who are or were employed at LANL to a new UC-sponsored plan that provides for the same benefits and retirement formulas as under UCRP. She emphasized that the action, if approved by The Regents, will be subject to negotiation with the Department of Energy and to rulings by the Internal Revenue Service, the Department of Labor, and any other interested agencies. It is also proposed to amend the retirement plan to clarify the fiduciary oversight structure. This action parallels the structure that was approved by the Regents in 2005 for the retirement savings program, which includes the three defined contribution plans, and would include the same provisions.

Ms. Boyette reiterated that the new contract awarded by the DOE requires LANS to maintain at least two separate, stand-alone pension plans for continuing Los Alamos employees. As specified by the DOE, one of those plans has to provide benefits that incorporate the key features of UCRP for certain transferring employees and will require a transfer of UCRP assets and liabilities attributable to those employees. The other plan would be a new market-driven plan to cover new employees, rehired UCRP retirees, and those transferring employees who elect to become inactive UCRP members. As specified by the DOE, all non-vested Los Alamos employees who continue employment with LANL will be automatically covered by the pension plan that is to be similar to the UC Retirement Plan. Employees who are vested in UCRP and continue employment at LANL have a choice of either participating in the LANS corporate plan or the LANS market-driven plan. There will be many decisions for employees who have the choice of retiring, electing inactive membership, or terminating employment. It is important to note that a Los Alamos employee who chooses to retire under UCRP may be offered a job by LANS, but the RFP provides that there does not have to be a guaranteed offer of employment. On the other hand, a Los Alamos employee in good standing who simply elects inactive participation in the UC Retirement Plan would be entitled to a guaranteed offer of employment from LANS. There are about 6,000 employees at Los Alamos who are eligible to elect either inactive or retirement status. They will receive counseling and support when making their decisions.

Ms. Boyette commented that the transfer of assets and liabilities is a requirement of the existing contract. The amount of assets that would be transferred to the LANS retirement plan depends on the final elections of Los Alamos employees and how many choose to transfer and continue participating in the new LANS plan versus retiring or electing to be inactive under UC's plan. It is recommended that The Regents delegate authority to the President, with the concurrence of the Chairman of The Regents and the Chairs of the Committee on Finance and the Special Committee on Compensation, to place UCRP assets and liabilities of active, inactive, and retired LANL employees into a separate pension plan, subject to concurrence of the Department of Energy and following an Internal Revenue Service ruling on the process.

Ms. Boyette noted that an additional request addresses arranging funding for retirement benefits for Los Alamos employees who retire under the LANS plan after May 31, 2006 but prior to the final transfer of assets and liabilities, because it may take some time for the actuaries of UC and the DOE to complete their work. It is also proposed that current buyback rules be modified for Los Alamos employees who are able to buy service back to provide a lump sum, provided that the buybacks fall within the existing UC Retirement Plan rules in order not to disadvantage these employees, who would not have had the normal time period to initiate or repay a buyback because their employment will be terminated with UC in the transition. Authority is sought also to investigate and consider adding a limited reciprocity provision that would eliminate a significant barrier to the movement of individuals between UC's other locations and LANS and from LANS to Livermore and would advance the important scientific work and mission of the laboratory

by allowing that possibility. Adding such a provision would require negotiation with the DOE, followed upon approval by IRS negotiations.

Senior Vice President Mullinix noted that the Regents had been provided with the latest actuarial valuation that was done for the LANS portion of the retirement plan that UC provides to the DOE annually. UC-managed laboratories receive separate evaluations. The valuations are referenced in the contract for which the University is liable relative to these employees. While technically not required under the contract to do this first separation into the parallel LANL plan, UC is doing it to facilitate the second separation because the final split will not be known until the formation of the new assets and it will be important to transfer assets expeditiously. Also, it allows for establishing what assets are related to LANL. In that way it may be possible to reduce any long-term issues or concerns with the DOE relative to the existing and new LANL retirement plans.

Faculty Representative Oakley believed that members of the Academic Senate were not apprised that there would be a two-step bifurcation of assets. He believed that the greatest problem with transition from a benefits standpoint was unfunded retiree health care, not the funded UCRP liability. He noted that the University's actuary has indicated that the amount of assets and liabilities to be transferred to the successor contractor's defined benefit plan is not known. It is not known how many current LANL employees will decide to keep working there as LANS employees, and those are the employees who will have a set of earned benefits that will be transferred as liabilities of LANS and will have to be funded with a transfer of assets. The actuary indicated also that the methodologies and assumptions that would be used to calculate the amounts, if any, to be transferred are not yet determined. The process will need to be invented. Professor Oakley believed that as fiduciaries operating in uncharted territory the Regents may be concerned that the extent of the authority being delegated is not clear. He urged the Office of the President to consult the Task Force on Investment and Retirement of the Faculty Welfare Committee before proceeding further. Faculty Representative Brunk agreed that consultation with the Academic Senate would benefit all parties.

Regent Rominger asked about the rationale for transferring the assets and liabilities of the retirees from Los Alamos, who were employees of the University who happened to be working at that laboratory. Senior Vice President Mullinix responded that there are two potential issues that may need to be discussed with the DOE. The first is a relatively immediate one – what assets should be transferred into a new LANS plan. There is no final legal determination as to the appropriate amount. The University believes, however, that it has an agreement in principle, based on the current contract. The second portion is the amount of assets that currently support the liabilities associated with the LANL employees who are retired. In that area, it would be beneficial to the University and to all the employees in the retirement plan to have a clear separation of the assets associated with the LANL plan. If at some point the DOE believed that the returns on that plan have been excessive, it might attempt to make a claim against the plan. If on the contrary UC found out that even after careful and prudent management of that plan there were insufficient assets to pay the retirees, UC would seek reimbursement from the DOE. By

separating the assets at a time when there appears to be agreement on what the actuarial split of assets and liabilities are, based on the annual report, the possibility of a difficult situation with the DOE in the future could be avoided.

Regent Juline acknowledged the complexity of this series of transactions and expressed concern about the degree of delegation being proposed. He asked about movement between retirement plans. Senior Vice President Mullinix reported that it is intended that there be flexibility to allow the transfer of employees between plans and to have specific provisions for those transfers and the associated transfers of assets and liabilities. The DOE appears to believe that would be advantageous. Regent Juline endorsed Mr. Mullinix's statements concerning the desirability to separate the assets for the two plans. Associate Vice President Boyette recalled that under the contract the University has provided the actuarial reporting over the years. That is an agreement that was made with the DOE regarding the assumptions that would be used. In the contract itself it is stated that when it comes to the point of transferring assets and liabilities, the University will seek rulings from the appropriate agencies, because there likely has not been a transaction like this. Having rulings from the Internal Revenue Service and the Department of Labor is important to protect the University. That is why the actuarial report states that the methodology is not certain. Mr. Mullinix added that the University does have some experience in splitting retirees out of governmental plans and bringing them back in.

Regent Juline asked for an explanation of the capital accumulation payment issue. Mr. Mullinix responded that in lieu of salary increases, the University segregated some assets in the retirement plan based on a percentage of pay for two years as a separate cash payment available to employees. Ms. Boyette noted that the IRS has suspended rulings on cash balance plans because of the reports that a number of large plans totally ceased future benefits under their defined benefit programs and switched to a cash balance. The University's CAP accounts were small, add-on benefits. If the University were trying to obtain a determination letter from the IRS on transferring to LANS with those accounts, it may not be able to get through the regulatory process in the appropriate way.

Senior Vice President Mullinix reported that until the contract was awarded, the Office of the President was reluctant to discuss with the faculty the University's strategy for handling retirement benefits. It was discussed with the UCRP Advisory Board, however, which expressed support for this strategy.

Committee Chair Hopkinson suggested it could be appropriate to approve only the framework to be established. Associate Vice President Boyette indicated that she required the authority of The Regents to go forward into discussions with the Department of Energy and the Internal Revenue Service. Also, employees must be informed about the situation pertaining to buybacks. Committee Chair Hopkinson suggested approving the recommendation with the understanding that at some point the Regents would receive a status report and be apprised of any changes, and as soon as possible the Faculty Welfare Committee would be consulted.

Given the complicated nature of the proceedings and that the matter is at the heart of Regental fiduciary responsibilities, Chairman Parsky wished to emphasize that the recommendation does not call for the Regents to delegate their responsibilities to the President. It gives the authorization for the staff to proceed along this conceptual line, with consultations as indicated, and to seek further recommendations from the Regents when the arrangements become more formal. The issue of delegating authority always needs careful consideration. Senior Vice President Mullinix emphasized that the portion of the President's recommendation concerning the buyback provision requires amending the retirement plan. Associate Vice President Boyette explained that this action is necessary because employees have only until they terminate employment with UC. If they intend to exercise this provision, they must do it by May 31. That needs to be communicated to them and the buybacks completed by that time.

Committee Chair Hopkinson suggested that the President's recommendation be amended so as to authorize the administration to proceed, with the condition that the Faculty Welfare Committee be consulted, and to require that approval of any changes, modifications, or differences from this concept, other than the fact that specific authorization is being given to proceed with the buyback element, be brought to the Regents. Chairman Parsky summarized the amendment as authorizing the Office of the President to proceed with the buyback separately and authorizing the administration to proceed conceptually with what is described in the item but without delegating authority with respect to the implementation of the other elements. Following approval by the Board, Los Alamos employees will be able to be informed that the buyback plan is proceeding.

Committee Chair Hopkinson moved the following amendment:

- A. ~~Effective March 31, 2006, or as soon as administratively feasible, the President, with the concurrence of the Chairman of the Board and the Chair of the Committee on Finance, be authorized to amend~~ The Regents shall amend the University of California Retirement Plan (UCRP) to:
- (1) Spin off liabilities and assets for active, inactive, and retired members who are or were employed at the Los Alamos National Laboratory (LANL) to a UC-sponsored plan (UCRP-LANL Plan) that provides for the same monthly retirement benefit formulas as the UCRP, subject to approval by the Department of Energy (DOE). Assets will continue to be managed by the Office of the Treasurer under the investment policies approved by The Regents, and trustee duties will continue to be performed by The Regents.
  - (2) Retain the Capital Accumulation Payment (CAP) benefit for LANL members in the UCRP or spin it off to another plan, if necessary, to facilitate obtaining a favorable Internal Revenue Service (IRS) determination letter on the UCRP-LANL Plan, subject to DOE approval.

- (3) Under a reciprocal arrangement to be negotiated with the Los Alamos National Security, LLC (LANS) and the DOE, allow certain service and compensation accrued while employed at UC and at LANL under the LANS to be considered, but not double counted, in determining a member's final retirement benefits payable under UCRP and/or the new site-specific defined benefit pension plan maintained by the LANS (Corporate Plan). The Corporate Plan, which is described in the LANL Request for Proposal (RFP), will incorporate key provisions of UCRP.
  - (4) Incorporate the provisions of paragraphs c and d from Section (2) below into UCRP, if the UCRP-LANL Plan is not approved.
- B. If the UCRP-LANL Plan described in Section (1) above is approved, incorporate into the plan document all applicable UCRP provisions as well as certain additional provisions, including authority to:
- (1) Provide an alternative to the CAP benefit provisions in UCRP, if necessary, to prevent a delay in the IRS's issuing a favorable determination letter on UCRP-LANL Plan.
  - (2) Allow certain service and compensation accrued at LANL while employed by the LANS and certain service and compensation accrued while employed by UC to be considered, but not double counted, in determining a member's final retirement benefits payable under the UCRP-LANL Plan and/or the Corporate Plan under a reciprocal agreement to be negotiated with the LANS and the DOE.
  - (3) Transfer assets and liabilities to the Corporate Plan attributable to certain active LANL employees who transfer employment to the LANS, provided the Corporate Plan has received all necessary and appropriate rulings.
  - (4) Arrange for interim funding for retirement benefits of LANL employees who retire after May 31, 2006, but prior to the final transfer of assets and liabilities to the Corporate Plan.
  - (5) ~~Permit eligible LANL employees who are in the process of a buyback or who are within the three year buyback eligibility window to establish or re-establish service credit for eligible leaves or prior periods of UC employment, prior to the termination date of their UC employment.~~
- C. If the UCRP-LANL Plan is approved, effective March 31, 2006, or as soon as administratively feasible, the University of California 415(m) Restoration Plan (415(m) Plan) action be brought to The Regents for amendments to extend eligibility to employees who retire from the UCRP-LANL Plan and otherwise satisfy the eligibility requirements of the 415(m) Plan.

- D. If the UCRP-LANL Plan is approved, effective March 31, 2006, or as soon as administratively feasible, action will be brought to The Regents to amend the UC Retirement Savings Program plans be amended to:
- (1) Provide that LANL employees whose mandatory participation in the University of California Defined Contribution Plan is defined with respect to a membership category in the UCRP also be defined with respect to a membership category in the UCRP-LANL Plan.
  - (2) Permit rollover contributions between the UCRP-LANL Plan and the UC Retirement Savings Program plans to the same extent as permitted between the UCRP and the UC Retirement Savings Program plans.
- E. ~~The President be delegated~~ The Regents shall retain the authority to (i) amend UCRP to clarify the fiduciary obligations of UC Human Resources and Benefits (HR/Benefits), the Office of the Treasurer, and The Regents with respect to the UCRP similarly to the action previously taken by The Regents with respect to UC's defined contribution plans (the UC Retirement Savings Program), (ii) incorporate similar fiduciary language in the UCRP-LANL Plan, if approved, and (iii) if the UCRP-LANL Plan is approved, implement any necessary amendments to the 415(m) Plan and the UC Retirement Savings Program plans to reflect the changes described herein.
- F. ~~The President be delegated authority~~ bring action to The Regents to implement the amendments described above, other than those described in Sections C., D., and E.
- G. The Regents shall receive status reports at appropriate points in the implementation process. Any changes to the approved plan shall be presented to the Regents' Committee on Compensation for approval. Consultations shall be conducted with members of the Committee on Faculty Welfare.
- H. Effective January 19, 2006, the President be authorized to permit eligible LANL employees who are in the process of a buyback or who are within the three year buyback eligibility window to establish or re-establish service credit for eligible leaves or prior periods of UC employment, prior to the termination date of their UC employment. Any such buybacks will be reported to The Regents.

[For speakers' comments, refer to the minutes of the January 18<sup>th</sup> and 19<sup>th</sup> meetings of the Committee of the Whole.]

The amended motion was duly seconded. The Committee approved the President's recommendation as amended and voted to present it to the Board.

The meeting adjourned at 2:55 p.m.

Attest:

Secretary