The Regents of the University of California

SPECIAL COMMITTEE ON COMPENSATION
July 20, 2006

The Special Committee on Compensation met on the above date at UCSF–Mission Bay Community Center, San Francisco.

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

In attendance: Regents Blum, Gould, Island, Johnson, Ledesma, Marcus, Ruiz, and Schreiner, Regents-designate Brewer and Bugay, Faculty Representative Brown, Acting Secretary Shaw, Acting General Counsel Blair, Chief Investment Officer Berggren, Provost Hume, Senior Vice President Darling, Vice Presidents Broome, Foley, Gomes, and Hershman, Chancellors Córdova, Drake, Fox, Tomlinson-Keasey, Vanderhoef, and Yang, Acting Chancellors Abrams and Blumenthal, University Auditor Reed, and Recording Secretary Bryan

The meeting convened at 8:50 a.m. with Committee Chair Hopkinson presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

   Upon motion duly made and seconded, the minutes of the meeting of May 18, 2006 were approved.

2. **READING OF NOTICE AND STATEMENT OF SERVICE THEREOF**

   For the record, it was confirmed that notice was served in accordance with the Bylaws and Standing Orders for a Special Meeting of the Special Committee on Compensation, to run concurrently with the regularly scheduled meeting, for the purpose of receiving an update on the status of reinstatement of contributions to the University of California Retirement Plan.

3. **REGENTAL PLAN FOR REFORMS IN RESPONSE TO INTERNAL AND EXTERNAL AUDIT REPORTS, AND STATUS UPDATE OF IMPLEMENTATION OF RECOMMENDATIONS OF THE TASK FORCE ON COMPENSATION, ACCOUNTABILITY, AND TRANSPARENCY**

   Committee Chair Regent Hopkinson recommended that the Special Committee on Compensation recommend to The Regents the adoption of the recommended actions shown in Attachment 1 in response to the audit recommendations of the Bureau of State Audits, PricewaterhouseCoopers, and the University Auditor related to University compensation and travel and entertainment.

It was recalled that in January 2006, Chairman Parsky retained PricewaterhouseCoopers (PwC) to conduct an independent audit of compensation and employment arrangements of the University's top 32 management positions over a 10-year period, encompassing more than 60 current and former UC employees. PwC released its audit findings and recommendations on April 24, 2006.

Also in January 2006, the Joint Legislative Audit Committee asked the Bureau of State Audits (BSA) to conduct its own audit of UC senior management compensation practices, focusing on 100 highly compensated faculty and administrative positions at the campuses and the Office of the President. The BSA audit report and recommendations were released on May 2, 2006.

At the May 2006 meeting of The Regents, the University Auditor presented the findings and recommendations from UC's internal audit of compensation for the employees in the University's Senior Management Group not already reviewed by PwC in its audit. Both the University Auditor's report and PwC's audit also examined travel and entertainment expenses for select UC management positions.

Taken together, these three audits represent one of the most thorough and rigorous reviews of UC executive compensation ever conducted. As with the issues raised by the independent Task Force on UC Compensation, Accountability, and Transparency, in order to address many of the recommendations made in the three audit reports, a complete rethinking of University compensation policies, practices, and procedures is required at all levels on the campuses, at the medical centers, at the national laboratories, and in the Office of the President. Undertaking actions to implement these reforms must be guided by the principles of public accountability and disclosure, effective governance and oversight, individual and institutional accountability, and institutional competitiveness.

The Implementation Committee and workgroups appointed by President Dynes and composed of campus, medical center, and Office of the President personnel have begun working to implement the Task Force recommendations. In addition, the committee and workgroups are poised to implement those audit recommendations ultimately adopted by The Regents.

Attachment 1 displays the recommended actions and estimated timelines for responding to each recommendation in the three audit reports.

Attachment 2 provides a status update on the implementation of actions in response to the Task Force recommendations.

Regent Hopkinson emphasized that the focus has been on corrective actions as well as establishing new procedures. A comprehensive update to be provided at the September meeting will disclose details of the actions that have been taken.

Chairman Parsky thanked Regent Hopkinson for her extensive work on the compensation issues. He emphasized that the recommendations of the task force relating to compensation included a reference to the fact that the definition of compensation should confirm the 1993 principles and be all inclusive. The list of positions that required Regental approval in 1993 has been expanded from 32 to 264. In addition, The Regents will continue to have approval authority for any employee with a salary of over $200,000. Regent Hopkinson noted that the original 32 positions are considered by The Regents in Open Session and the remainder in Closed Session, although the actions on those are announced publicly immediately following approval.

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

Regent Hopkinson provided an update on the status of implementation of the recommendations of the Task Force on UC Compensation, Accountability, and Transparency, which were adopted by the Board at the May meeting. She stated that the compensation issues that the audits and task force review surfaced have eroded the public's trust in the University. The Regents are committed to restoring that trust. In addition to their obligation to the public, they are obligated to treating employees fairly and to enacting sound policy. While the reviews have revealed some individual cases where the actual compensation received by the employee was inappropriate, the vast majority of the issues involved a lack of adherence to internal approval and disclosure processes, not overall compensation levels being excessive. Thus, the principal task is to see if the compensation is appropriate and, if so, to give approval that should have been received originally. It is critical to analyze the facts and circumstances of each case and make sure the action is the appropriate remedy and that cases are treated consistently. At this month's meeting, the Regents will address suggested policy and operational reforms that respond to the recent compensation and audit task force findings, suggested compensation and personnel actions related to the audit and internal reviews, restructuring the Office of the President including adding senior level positions to strengthen oversight and business operations, and slotting the medical center deans and other select positions into the interim SLCG compensation structure.

Regent Hopkinson reported that measurable progress is being made toward the policy and operation reforms needed to prevent repetition of recent problems. After receiving the audit and task force reports, a steering committee was established to oversee and coordinate the needed reform work. Smaller working groups were created to tackle specific reforms under the general oversight and direction of the steering committee. This has allowed for the advance of reforms on multiple parallel tracks simultaneously. It will be proposed to make the Special Committee on Compensation a permanent standing committee in order to help ensure sufficient Regental oversight and involvement in compensation matters.

4. OVERVIEW OF UNIVERSITY OF CALIFORNIA HOME LOAN PROGRAMS

Provost Hume discussed the importance of the University's loan programs, which he observed had made a profound difference to the strength of the University. The loan programs' primary mission is to provide financial and programmatic tools to support the recruitment and retention of key faculty and other designated employees in order to maintain the University's position of preeminence in the academic community. There are three key drivers for the programs. The first is institutional growth and faculty recruitment. The University hires between 530 and 550 faculty a year. The second driver is the absolute home prices near UC campuses. With the aid of slides, Provost Hume illustrated the degree to which California price increases far outstrip the national average. Home prices near the campuses are much higher still, indicating that the University's employees and potential employees and those working to recruit them face some of the highest costs in the state. The third driver is home prices near UC campuses compared with those of its comparison and competitor institutions. He showed data for a specific single-family home in each campus area to demonstrate the relatively high cost of homes near UC campuses. Each of these drivers, coupled with faculty salaries that have often lagged behind those of comparison institutions, has required aggressive pursuit of additional solutions to address affordability of homes within a reasonable distance of the campuses. To be successful, the programs must support certain goals, including providing loan terms and rates to help junior faculty and first-time buyers enter the housing market. Many young recruits do not have sufficient family resources to meet normal down payment requirements. Also, the programs must offer financial support to enable the recruitment of senior faculty and other staff in the face of vigorous competition. Many of these senior hires coming from other places lack sufficient equity for conventional loan programs. The programs must also provide stable and predictable funding and other program support necessary for successful recruitments over time. Sometimes it takes several years to negotiate a key recruitment. Once the recruit has arrived, it may take time for him or her to enter the housing market. The University must be able to know there will be a program in place that can help meet the needs of these recruits. Surveys have shown that the programs are very important and that they work.

The director of loan programs, Mr. Steve Mathews, provided an overview of the program components and their use. He reported that the University has two loan programs authorized by The Regents: the Mortgage Origination Program (MOP) and the Supplemental Home Loan Program. Both are directed primarily to members of the Academic Senate and the senior management group. There are provisions for approving exceptions. The funding source for MOP is the University's Short-Term Investment Pool (STIP). Funding for the Supplemental Home Loans comes from seed money loaned by the President to the campuses in 1982 and from other campus non-State fund sources.

Mr. Mathews showed slides to display a summary of the program parameters for MOP. The MOP loans are variable rate. The interest rate is designed to mimic the rate of return of STIP plus an administrative fee to cover program costs. A reserve fund has been established to capture the excess earnings of the MOP portfolio – that is, the portion of any monthly loan portfolio rate of return that is greater than STIP. It also transfers to

STIP monthly any deficit earnings to ensure that the STIP rate of return is not affected adversely by this use of funds. During the past 22 years of operation of MOP, the reserve fund has experienced a net gain in excess earnings. Since 1984, the loan rates in this program have been as high as 11.2 percent and as low as 3.6 percent. The current rate is 4.25 percent. On August 1, the rate will be adjusted to 4.45 as it tracks STIP. The loan to value ratios are indexed each year by the change in the All Campus Purchase Price Index. Prior to 1995, all MOP loans could be made at 90 percent regardless of loan amount. Overall, the program underwriting is more liberal than most institutional lenders, but that is counterbalanced by the fact that over 95 percent of all monthly payments are collected by payroll deduction. In November 2001, The Regents approved a new graduated payment MOP product, which was a key recommendation of the UC Housing Task Force, to provide a vehicle for campuses to offer an initial interest rate reduction to the standard MOP rate. The floor for that rate reduction is 3 percent, and the reduction amount decreases annually until the standard rate is achieved, normally over an 8-to-12-year period. As each loan is made, the campus sets aside funds that are transferred to STIP monthly to make up any interest differential. If a loan pays off early, the balance of that obligation is cancelled. Depending upon the interest rate market, this loan type can add greatly to the affordability of getting into a housing market near a campus.

Mr. Mathews reported that the second program, the Supplemental Home Loan Program, was designed to provide flexibility to allow campuses to meet needs not addressed by MOP. Within the parameters approved by The Regents, campuses may tailor loans to meet specific needs. At many campuses, these loans are used primarily for down payment assistance in second or third deed of trust loans behind either MOPs or conventional loans. In some cases, the Supplemental Home Loan is used as the primary loan in order to provide financing with a fixed rate, a variable rate, or some other loan option not available under MOP. Most of these loans have been made with fixed or variable interest rates of 3 percent or more. Fewer than 1 percent of these loans have been made as shared appreciation mortgages, which have a very low initial interest rate but are coupled with a contingent interest payment which is made when the loan is paid off, that is based upon a defined, specified percentage increase in the value of the house over the time the loan is held. The average portfolio rates of return for the shared appreciation loans that have paid off thus far at the two campuses that have used this product have been 5.5 percent and 8.75 percent, with a range of 4 percent to 12 percent. Mr. Mathews showed the number and dollar value of loans made under these two programs through June 30, 2006, noting that to date over 4,500 loans totaling $1.3 billion have been made. During the most recent fiscal year, there were 259 MOP loans totaling $154 million and 49 Supplemental Home Loans totaling $8.1 million. Over 94 percent of the loans of the combined programs have gone to Academic Senate members. Over the past ten years, 40 percent to 50 percent of all faculty new hires have received a loan under one or both of these programs. In 2002, the University began to sell large numbers of these loans to outside investors. Thus far, it has sold 295 MOP loans totaling $700 million and 156 Supplemental Home Loan Program loans totaling $15 million.

Mr. Mathews reported that while the primary purpose of these programs is to assist the identified eligible participants with the purchase of their first home, the programs have defined processes for approving certain exceptions. There are three exception categories. The addition of each of these categories was approved by The Regents in response to needs identified over time to address myriad situations that can arise in a program of this magnitude and widely varying individual situations. The program parameters delegate these decisions within specified limits to each chancellor. To date, 309 such loans, or about 8.5 percent of all funded loans in an aggregate amount of $138 million have been made, the total allowance for such loans being $232 million. Added in 2000, the second category exceptions consist of actions that have been delegated to the President. For MOP and Supplemental Loans, this category includes approvals of exceptions to title to address needs related to highly sought after non-Senate academic and non-senior management group staff. Exception to title requests for MOP loans have been approved 54 times, with 38 of those approvals resulting in funded loans to date, or about 1 percent of all loans funded. The numbers are similar – 42 and 40 – for the Supplemental Home Loan Program, or about 4.5 percent of those loans funded. Another Presidential exception is in the Graduated Payment Mortgage Program, providing for approval of exceptions to the maximum initial rate reduction amount and the annual adjustments to that reduction. Seven approvals have been granted for non-standard rate reduction parameters and four have been funded thus far. The third category of exceptions consists of concurrence actions requiring the approval of the President, the Chairman of the Board, and the Chair of the Special Committee on Compensation. To exceed the loan-to-value limits for the MOP program or the Supplemental Loans requires such concurrence. No such approvals for this type of exception have been granted under the MOP program; three have been granted under the Supplemental program.

Since 2000, any MOP loan in excess of $1 million has required the approval of the President and the concurrence of the Chairman of the Board. To date, one such approval has been made resulting in a funded loan; however, three MOP loans slightly in excess of $1 million were made prior to establishment of this approval limit. Additionally, 63 MOP loans over $1 million have been made, which is the maximum allowed without such additional approvals. Under the Supplemental Home Loan Program, there is no such requirement for additional approvals for loans of $1 million and above. One $1 million loan and four loans in excess of $1 million have been made under that program. The addition of each of these defined categories was approved by The Regents in response to needs identified over the long-term operations of these programs.

Regent Hopkinson noted that the presentation indicated that loans over $1 million require approval by the President and the Chairman of the Board. She emphasized that, in fact, the policies now require that the Regents approve loans to people earning more than $200,000 in total compensation, as they must approve all elements of benefits and compensation. Those recommendations are presented to The Regents unless they are part of interim action items. The loan approval is not done as a separate action.

Regent Lozano acknowledged the importance of the programs, but she expressed concern about granting exceptions. She suggested that the policy governing exceptions be reviewed by the Special Committee so as to understand the rationale and practice and to determine whether those exceptions should continue. Chairman Parsky noted that what had been a much broader ability to use exceptions has been narrowed significantly because of the large number of people whose compensation now must be approved by The Regents.

Chairman Parsky emphasized that with respect to the MOP program, which uses some State funds, both objective and practice have been to provide to the overall funds the same or a higher rate of return than would have been earned had the money stayed in the Short Term Investment Pool. Mr. Mathews reported that a monthly analysis is done of the portfolio versus STIP. If the portfolio outperforms STIP, that amount of difference is kept in a reserve fund. If it underperforms it, funds are transferred into STIP. The money is earning, in effect, the same rate of return, but it is benefitting the recruiting effort and maintaining the quality of the University's faculty.

Faculty Representative Oakley commented that entry level assistant professors cannot afford even median-level home prices in most of California. The loan program is indispensable to the recruitment of faculty at all campuses. He reported that his participation on the Task Force on Compensation, Accountability, and Transparency had shown him there was a pressing need to distinguish between the MOP program, which is self-financing, costs the University nothing, and is essential to recruitment, and the Supplemental Home Loan Program, which is intended primarily to help recruits who are starting families and careers produce a down payment. He believed that the Supplemental program, more than the MOP, requires a certain level of scrutiny, because it is financed from non-State funds, principally from campus foundations, so there is the potential of using it as a form of deferred income. He agreed with the suggestion that the policy governing loan exceptions should be reviewed.

In response to a question asked by Chairman Parsky about selling the loans, Mr. Mathews reported that it is done periodically and the cash that is achieved replenishes STIP through that process. Regent Ruiz expressed the hope that the University is very selective in choosing the companies to which it sells loan packages. Some companies may be overly aggressive with penalties and defaults and foreclosures for slight transgressions. Mr. Mathews reported that sales had been limited to six institutional investors, all of which are regional banks and savings and loans throughout the country. There are strict confidentiality agreements in place. These institutions and the University are regulated by the Gramm-Leach-Bliley Federal Act on privacy and disclosures. In addition, the University retains the servicing of the loans. Regent Hopkinson noted that the performance rate on these loans is exceedingly high, which is one reason they are so marketable. Faculty Representative Oakley remarked that MOP loans are marginally lower than other adjusted rate mortgage products at most times because the payment history of University faculty is very good and the University continues to service the loans and guarantee payment, so they can be resold on very favorable terms, but they are not low interest in the sense of some kind of subsidy; they are simply a product that the market values at such a rate that they are attractively priced.

5. **RECOMMENDED COMPENSATION AND PERSONNEL ACTIONS RELATED TO INTERNAL REVIEWS AND AUDIT FINDINGS**

Corrective Actions – Compensation and Personnel

It was recalled that at the July 19 meeting, The Regents were asked to approve the first group of corrective actions related to the PricewaterhouseCoopers LLP (PWC) audit to be brought to The Regents for action. Several additional items will be brought forward at coming meetings that will address the compensation and related issues identified in the audits conducted by PWC, as well as the Bureau of State Audits (BSA), the University Auditor, and internal management reviews. The corrective actions include those for senior managers in the top 32 positions, which were the focus of the PWC audit, as well as actions for other employees related to findings of the BSA audit, internal audits, and other University reviews. In accordance with the Principles for Review of Executive Compensation adopted by The Regents on November 19,1993, final approval of compensation items recommended as a result of the audit and review findings for any of those officers named in the Principles (President, Vice Presidents, Chancellors, Treasurer, Associate Treasurer, General Counsel, and Secretary) will occur under the Supplemental Compensation Report.

The actions to be presented to The Regents are consistent with the Guidelines for Resolution of Compensation and Personnel Issues Resulting from the Findings of Audits and Management Reviews, which were approved by The Regents in May. The procedures contained in the Guidelines will be used to resolve the remaining exceptions for various individuals identified in the audits and management reviews. Further corrective actions related to findings of the BSA and the internal audit and management reviews, which will primarily focus on the members of the University's Senior Management Group, will be addressed at the September Regents meeting.

As has been discussed previously, The Regents will continue to review the results of the various audits and reviews to determine what violations occurred, why they occurred, and who was responsible. With full knowledge of the facts, The Regents will continue to consider appropriate personnel actions as a part of their oversight process and in accordance with University personnel policies.

Correction Actions - W-2c

At its May 17, 2006 meeting, The Regents approved the reimbursement of tax preparation fees, Internal Revenue Service interest, and penalties related to Forms W-2c (corrected Wage and Tax Statement) issued in response to the PWC Examination of Compensation and Other Employment Arrangements of selected University employees for the period January 1, 1996 through December 31, 2005. Employees selected for examination generally included individuals who hold or have held one of the top 32 senior management positions or another selected position for at least six months during the period of the audit.

Recently concluded audits conducted by the BSA, the University Auditor, and other reviews conducted by University management have identified compensation received by several other employees that was omitted from their Forms W-2 (Wage and Tax Statement) in one or more years. Under regulations issued by the Internal Revenue Service, the University is required to provide these employees with a Form W-2c showing the wages that should have been reported for each year requiring a correction.

It was determined that certain employees were provided with incorrect Form W-2s. It is believed that the actions taken to date represent all outstanding issues related to incorrect Form W-2s for members of the University's Senior Management Group. Since the University incorrectly issued the W-2s, it is proposed that the University also reimburse these employees for applicable tax preparation fees, IRS interest and penalties, if any, and any incremental taxes associated with such reimbursements, as evidenced by receipts or other documentation. No income or employment taxes owed by employees related to the additional income reported on the Form W-2c itself would be reimbursed by the University.

6. **RESTRUCTURING OF THE OFFICE OF THE PRESIDENT, INCLUDING REVIEW OF POSITION DESCRIPTIONS FOR THE UNIVERSITY'S SENIOR BUSINESS, FINANCE, AND COMPLIANCE OFFICERS**

The President recommended that the Special Committee on Compensation recommend to The Regents that, as part of the restructuring of the Office of the President, the following be approved:

A. The following titles for the positions indicated:

- Executive Vice President–Academic and Health Affairs and Provost
- Executive Vice President–Business Operations
- Executive Vice President–Chief Financial Officer
- Executive Vice President–University Affairs
- Vice President–Chief Compliance and Audit Officer

B. The following position description for Vice President–Chief Compliance and Audit Officer:

Primary Purpose
This position directs the University's systemwide Compliance and Audit programs applicable to the ten campuses, five medical centers, the national laboratories managed for the Department of Energy, the Office of the President and all related University activities.

Reports to
The position reports directly to The Regents and receives administrative supervision from the Executive Vice President–Business Operations.

Functional Oversight and Management
The specific functions managed by this position include:

- Compliance and Ethics Training
- Compliance Standards and Procedures
- External Audit
- Internal Audit
- Investigation
- Monitoring and Communications
- Program Evaluation
- Regental and UC Policy Compliance
- Reporting Mechanisms
- Risk Assessment
- Special Area Compliance (Athletics, Research, Hospital, Environmental Health and Safety)
- Statutory and Regulatory Compliance

Essential Duties and Responsibilities
- Establishes and maintains ongoing ethics and compliance oversight and audit programs for the entire University, including Regental and Universitywide policies.
- Communicates directly with the Board of Regents and the Regents Committee on Audit regarding all elements of meaningful compliance and audit programs, including providing annual reports on compliance with applicable laws, regulations, and University policies
- Directs the University's internal and external audit functions to ensure compliance with University policies and procedures.
- Conducts internal audits and facilitates audits by the University's external auditor to monitor compliance with applicable statutes and policies and to identify, for corrective action, instances on noncompliance.
- Directs the development and implementation of communication and reporting mechanisms with executive leadership at the Office of the President and campuses, academic medical centers, and laboratories to ensure appropriate compliance and audit programs are implemented systemwide.

- Develops periodic goals in ethics and compliance on the basis of risk assessment for the UC system generally and for the Office of the President.
- Works with UC location audit and compliance functions to establish periodic goals at each location.

Budget Responsibilities

- Supervises planning for and monitors annual departmental operating budget.

External and Internal Liaison and Advisor

- Coordinates activities of the offices of Compliance and Audit with the large number of existing functions that are already in place, such as the Office of the General Counsel, Risk Management, Controllers, Human Resources (including training), Research Compliance, Environmental Health and Safety, and hospital/health services functions.
- Guides and assists the campuses and other entities in establishing and maintaining appropriate compliance and audit monitoring programs and oversight at the operating unit level.
- Establishes and seeks guidance and input from an Ethics and Compliance Advisory board that will provide advice and support for the Office of Compliance and Audit.
- Works with appropriate UC leadership to develop and implement training in Ethics and Compliance.
- Oversees the review of results of audits conducted at the campuses, medical centers, Department of Energy laboratories, and other entities to monitor the quality of local audit procedures and to detect trends that might require systemwide audits or other interventions.
- Develops and maintains relationships with other entities including institutions of higher education, private and publicly-traded companies to ascertain and evaluate best practices in this field.
- Acts as the University's senior compliance and audit representative with all external groups including legislators, local communities, media and UC alumni/donors.
- Serves as the senior source of advice, counsel, and support in all areas of compliance and audit for the campuses, medical centers, Department of Energy laboratories, and the Office of the President.

Special Projects/Initiatives Leadership

- Establishes and implements a plan of action for the Board of Regents itself and for the UC system, to identify existing compliance audit functions and to recommend development of new functions and governance models to improve the governance of the University and compliance with its established policies.

Qualifications

- Minimum Education: Bachelor's Degree or equivalent experience
- Minimum Experience: 10 years
- Preferred Education: CPA designation and/or a law degree
- The successful candidate must have significant experience in audit and compliance issues in large and complex organizations.
- Compliance and audit experience in higher education, including academic medicine, is highly desirable.

Committee Chair Hopkinson observed that events over the last year have exposed certain weaknesses in the University's management and oversight structures. As one part of examining where opportunities exist for improvement, a review of the structure and performance of the Office of the President was initiated by Chairman Parsky. The recommendations of the Committee to The Regents reflect The Regents' commitment to strengthening the administrative structure of the University and reinforcing its academic excellence.

Chairman Parsky commented that as a result of issues raised during the past nine months, The Regents had committed to taking action that would, in the short term, strengthen the management and financial capabilities within the Office of the President, and in the medium term consider reorganization of the Office and the relationship between it and the campuses. The Regents committed also to not relying in the future on voluntary compliance with policy. Compliance with University policy and transparency to the public consistent with University policy are essential elements of Regental oversight. The actions proposed respond to both of those commitments and include the establishment of four executive vice president positions, two of which are positions that are currently occupied – the Executive Vice President–Academic and Health Affairs and Provost, and the Executive Vice President–University Affairs. Recruitment will be undertaken for two additional executive vice president positions: Executive Vice President–Business Operations and Executive Vice President–Chief Financial Officer. The Regents will lead the effort to recruit these people. Chairman Parsky reported that he would chair the search committees, which will include the President, a Faculty Representative, and other Regents. In addition, a Vice President–Chief Compliance and Audit Officer will be established. The objective is to have this officer report directly to The Regents, giving The Regents direct oversight for all internal and external audit and compliance functions. Included in the functions will be random internal audits throughout the University as well as coordination with the University's external auditor. The action is meant to send a clear signal that the Regents were not pleased with the way in which compliance and audit has been handled in the past. Finally, Chairman Parsky reported that he was working closely with President Dynes to assist in bringing the kind of strength to the Office that is necessary for a large, complex organization managing a very large budget with direct responsibility to the public. In that connection, the Regents will have reporting directly to them a Chief Compliance and Audit Officer, a General Counsel, a Chief Investment Officer, and a Secretariat. With that array of direct support, the Regents can carry out the responsibilities to which they have committed.

Regent Johnson asked when job descriptions would be available for positions A. through E., above. Committee Chair Hopkinson believed that they would be disclosed at the September meeting and that the Regents would be informed of the general functions for the two positions that are unfilled.

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

7. **AMENDMENT OF THE BYLAWS AND STANDING ORDERS REGARDING TREASURER OF THE REGENTS**

The President recommended that the Special Committee on Compensation recommend to The Regents that, following service of appropriate notice:

A. Bylaws 20 and 21 be amended as shown in Attachment 3.

B. Standing Orders 100.4 and 101 be amended as shown in Attachment 4.

The Committee was informed that the proposed Bylaw texts clarify the current duties and responsibilities of the Treasurer by confirming in Bylaw 20 and 21 the change in title from Treasurer and Vice President for Investments to Chief Investment Officer and Vice President for Investments.

The proposed amendments also remove from Bylaw 21 the responsibilities of the Treasurer that have been assumed by the Office of the President. Specifically, by amendment to these same Bylaws at the May 2000 meeting, The Regents moved the debt financing and non-investment related real estate functions and responsibilities from the Treasurer to the Office of the President. In February 2002, by letter agreement between the Treasurer and Vice President-Financial Management, the banking and cash management responsibilities were transferred from the Treasurer's Office to the Office of the President. The Regents also approved Real Estate as a separate asset class for the University of California Retirement Plan and the General Endowment Pool, and the Bylaws have been changed in subparagraphs (n), (o) and (p) to reflect the Treasurer's continued responsibilities for gifts of real estate. The guidelines for Real Estate Investments can be found in the Investment Policy Statement approved for both the University of California Retirement Plan and the General Endowment Pool.

The Treasurer's functions and responsibilities for and over the University's investments have remained with the Treasurer (now Chief Investment Officer). The proposed amendment to Bylaw 21 deletes these former functions as described and does not result in any substantive change in the current division of those responsibilities.

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

8. DISCUSSION OF INTERIM JOB SLOTTING RECOMMENDATIONS FOR THE DEANS OF MEDICINE AND MISCELLANEOUS CAMPUS POSITIONS

It was recalled that at the July 19, 2006 meeting, The Regents approved the individual salary grades for the Deans of Medicine (five positions), and nine campus positions (see below) within the salary range structure approved for all Senior Leadership Compensation Group (SLCG) positions, i.e., positions occupied by incumbents whose salaries exceed the Indexed Compensation Level (ICL), which is currently $168,000 per annum.

The campus positions include:

- Vice Chancellor - Equity and Inclusion, UCB
- Associate Director - Clinical Services, UCLA
- Vice Chancellor - Finance, Budget and Capital Programs, UCLA
- Vice Provost - Intellectual Property & Industry Relations, UCLA
- Associate Vice Chancellor - Chief Information Officer, UCM
- Associate Vice Chancellor - University Development and Alumni Relations, UCSD
- Assistant Vice Chancellor - Campus Chief Information Officer, UCSF
- Associate Vice Chancellor - Academic Affairs, UCSF
- Dean - Graduate Division, UCSF

At the November 2005 meeting, The Regents approved a policy that a salary structure be established, subject to their approval, within which salaries for all Senior Leadership Compensation Group positions will be administered. The structure is to be based on the recommendation of an external consultant and consists 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.

At the January 2006 and the March 2006 meetings, The Regents approved the salary ranges and the initial slotting of 402 positions at the campuses, the Office of the President, the Medical Centers, Secretary of The Regents, the Treasurer's Office, and the Berkeley and Livermore national laboratories. At this July meeting, 14 additional positions have been slotted, bringing the total positions slotted to 416 from a total of approximately 120,000 University full-time employees.

The slotting is by base salary only. Total cash compensation (base salary plus any additional recurring annual payments such as bonuses and health sciences compensation) has been considered and evaluated for each position where market data on total cash compensation were available. On average, variances in total cash compensation and the market data tracked very closely with the variances between the base salaries and market data.

This study does not include other special compensation such as car allowances, stipends, and housing allowances. Compensation information from the comparative institutions is generally available for base salaries and total cash compensation only. The University has begun exploring the feasibility of gathering the information necessary in order to value these additional forms of compensation and provide meaningful competitive value comparisons.

Assignment of Individual Salary Grades

UC in consultation with Mercer has slotted affected SLCG positions into the salary structure using the following criteria and process:

- Appropriate market data were collected from surveys of base salary and total cash compensation (base salary plus annual bonuses) for SLCG positions under consideration that are commonly found in the market.

- Positions normally were assigned to the grade that had a base salary range midpoint closest to the indicated median base salary of the market data. The range around the midpoint allows individuals to be paid a base salary higher or lower to recognize individual qualifications, experience, and performance.

- Total cash compensation was also considered when slotting positions into the appropriate salary grade. On average, variances on total cash tracked very closely to variances on base salary.

- Other factors considered in slotting all of the positions include internal equity and reporting relationships.

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

- The positions, not the incumbents, were considered in assigning grades.

- Once the positions were slotted, current individual base salaries, if available, were compared to the salary ranges, and those that are below range minimum or above range maximum were noted. Future adjustments to each individual's salary will be viewed relative to the salary ranges, considering the incumbent's experience and performance.

The review process to complete the overall position slotting included these steps:

- Initial assignment of job slotting was completed by UCOP, in consultation with Mercer, using market data analyzed by Mercer.

- The initial slotting was reviewed for completeness, accuracy, and internal grade relationships and then updated.

- System positions were reviewed by UCOP and the Senior Management Advisory Committee.

- All campus slottings, including the Deans of Medicine, were reviewed by the campuses, including the Chancellors and the Senior Management Advisory Committee.

- The final proposal has been submitted by the President to the Special Committee on Compensation and The Regents.

SLCG positions not included for approval at this time are:

- The General Counsel's Office and related campus counsel positions.

- The senior Business, Finance and Compliance Officer positions.

Regent Johnson requested that the job slotting process continue to be evaluated and changes made over time to bring it more into conformance Universitywide.

Faculty Representative Oakley agreed with Regent Johnson's suggestion. He reported that the faculty has expressed concern about job slotting and has asked the President to constitute a task force to bring the faculty's expertise to bear on establishing appropriate job slotting procedures.

9. **STATUS UPDATE ON HUMAN RESOURCES ACCREDITATION AND ASSURANCE**

It was recalled that, as reported at the January 17, 2006 meeting of the Committee on Audit, the Human Resources and Benefits Department is involved in a pilot accreditation program based on a Human Resources policy assurance model that includes a single point of accountability. The implementation of the accreditation program will provide assurances that the HR policies and practices are being appropriately applied and complied with at the local level.

Senior Vice President Darling reported that the University is joining the National Academy of Public Administration (NAPA) in the development of the pilot HR accreditation program. The pilot HR accreditation process will include standards in broad practice areas of assurance and operations, and service areas, including compensation and benefits, employment and career management, training and development, and employee and labor relations. In addition to assisting with the validation of the HR standards, NAPA will act as the external peer reviewer and make recommendations on further implementation of the HR accreditation process at other UC locations beyond the pilot program. The project will be undertaken initially at four locations: Lawrence Berkeley National Laboratory, the UCSF campus, UCSF Medical Center, and the Office of the President. Another campus may soon be added. The University needs to improve its human resources operations and to enhance its stewardship of its human capital because it is undergoing a major transformation in its workforce driven by the impending retirement of a large segment of faculty and staff and a surge in the decade's college population that is projected to increase undergraduate enrollments by 43 percent. Coupled with the growth in the University's research programs and patient care volume at the medical centers, substantial hiring of faculty and staff will be required.

The HR accreditation program will require rigorous self-assessment and peer review. It is intended to improve efficiency and effectiveness in HR operations and oversight to ensure consistency in HR policy interpretation, implementation, and assurance. The self-assessment phase of the program will begin in fall 2006 at the four UC pilot sites.

Associate Vice President Boyette recalled that the pilot design was a product of several years' work. It includes having a single point of accountability for HR policy assurance. Executive Director Scott reported that the project will provide a model for standards of practice for human resources at the University. These standards are being validated by the National Academy. The accreditation process is intended to be aligned with the scope and long-term direction of the human resources policy review that was adopted by The Regents in January. The ultimate outcome will support The Regents' objectives of increased transparency and accountability of UC HR practices. The Academy is assisting in the validation of the standards, will act initially as an external peer review body, and will make recommendations on how the accreditation should be implemented at other UC locations. The National Academy has implemented the pilots in close cooperation with HR-Benefits. He called upon Mr. C. Morgan Kinghorn, President of the National Academy of Public Administration and Mr. Frank Thompson, National Academy chair for the project, to provide further detail.

Mr. Kinghorn believed that through its partnership it could help the University create a methodology to enable it to provide assurance that HR policies and practices are compliant and appropriately consistent. The end product will enable UC to acquire and retain the best talent possible. He reported that the Academy is a Congressionally chartered national resource non-profit organization. Its charter requires it to provide advice to the public sector. The Academy fellows come from all sectors of business.

Mr. Frank Thompson, chair of the Academy panel that will produce the study, commented that the project is the first to accredit the human resource function in a university or in national, state, or local government. The ultimate test of the project will be whether it serves the core academic mission of the University. The panel is establishing and validating standards through groups of experts. University segments will undergo a readiness review, followed by a panel review of the progress report from the staff. In January 2007, the formal self-assessment of HR at the four sites will take place. The model issues of scoring and weighting will be developed, followed by a review of the progress by the panel. Ultimately, there will be a test of external peer review applied to the sites. The Academy will work with the campuses to arrange external reviewers and to then make the assessments of this exercise. The final outcome should be a model that will serve the University system well in its human resource function, assuring compliance and cutting edge innovation in best practice standards.

Committee Chair Hopkinson commented that the effort will be of value not just to the University but to academic institutions across the country.

In response to a question asked by Faculty Representative Brown, Mr. Kinghorn reported that every area of human resources will be addressed, starting with compensation processes and including job descriptions, performance review, and career development discussions with employees and staff. The effort outlined is to establish the expected practice and provide a way of assessing compliance.

Regent Marcus noted that the recruitment of talent has become critical. He asked how much attention would be spent on crafting a procedure in which the University will be the leading institution in the world to recruit the best and the brightest. Mr. Kinghorn reiterated that the panel will address all aspects of workforce planning, including talent management, succession planning, and career management. Associate Vice President Boyette added that it is hoped that the standards that are established will allow the University to confirm that it is comparing itself with the very best that is available. Mr. Thompson noted that one of the elements in the standards deals with the degree to which the human resource professionals are benchmarking and looking externally to best practice wherever they can find it.

Regent Ruiz asked about the process for keeping the Regents informed of measurable progress. Mr. Kinghorn recalled that the process was begun with a report to the Committee on Audit, which was followed by two further reports to the Regents. There will be a complete reporting to the Board and its appropriate Committees on the progress through the end of the pilot to address plans for implementation. The pilot is to conclude in June 2007. Once the pilot is complete, a timetable will be established for full systemwide implementation.

10. **PROCEDURES FOR SETTING COMPENSATION IN 2006-07 FOR THOSE CLASSIFIED IN THE SENIOR LEADERSHIP COMPENSATION GROUP AND OTHER SPECIFIC NON-FACULTY EMPLOYEES**

The President recommended that the Special Committee on Compensation recommend to The Regents that the two procedures for determining compensation for Senior Leadership Compensation Group (SLCG) positions adopted by The Regents as part of RE-61 in November 2005 which expire June 30, 2006 be extended to apply to FY2006/2007. All other aspects of these procedures have no expiration date. Additionally, it is recommended that these provisions and the two extensions below be applicable to all non-faculty employees whose cash compensation levels fall within these guidelines (herein defined as "Other Specified Employees" (OSEs)). The two procedures recommended for extension are:

A. Salary actions during FY2006/2007 for SLCG members and OSEs that would result in base salary, plus any bonus or stipend, exceeding $200,000 shall be individually approved by The Regents.

B. Any increase in base salary in excess of 7.5 percent for SLCG members and OSEs shall be individually approved by The Regents.

It was recalled that at the November 2005 meeting, The Regents approved a policy that a salary structure be established within which salaries for all Senior Leadership Compensation Group positions will be administered. The Senior Leadership Compensation Group was defined to include certain designated Officer positions (the President, General Counsel, Treasurer, Secretary, Chancellors, Senior Vice Presidents, Vice Presidents, Chief Executive Officers of the Medical Centers, and Laboratory Directors) and those management positions whose compensation exceeds the Indexed Compensation Level (ICL). The ICL that was used for 2004-2005 was $168,000. The ICL is to be adjusted annually based on CPI and is to be reported annually to The Regents in accordance with Regental Bylaws regarding approval of compensation. The indexed base salary amount for 2004-2005 of $168,000 was modified by The Regents for one year, FY2005-2006, to be $200,000 total cash compensation.

The salary structure used by The Regents is based on the recommendation of an external consultant and consists 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.

In accordance with the procedures previously adopted in November for 2005-2006, The Regents have continued to approve individually:

- All salary actions for the 32 Designated Officers (the President, General Counsel, Treasurer, Secretary, Chancellors, Senior Vice Presidents, Vice Presidents, Chief Executive Officers of the Medical Centers, and Laboratory Directors).

- Salary increases of 15 percent or more that take an SLCG employee's salary over the salary range midpoint of the grade for the employee's position.

- Salary increases that place an SLCG employee's salary above the salary range maximum for the employee's position.

- Any future adjustments to job slotting for the SLCG, including the addition of new positions.

- Annual goal setting for obtaining, prioritizing, and directing funds to achieve market comparability for all groups of employees.

- Determination of annual salary increase budget for the SLCG, including priorities for addressing specific groups of employees.

In addition, procedures provide that The Regents will receive and review annually:

- Total compensation for each of the SLCG positions.
- Data on all salary actions for the SLCG, including the overall salary increases compared to budget and the distribution of increases by percent of increase.
- Overall position of salaries for the SLCG relative to the salary range midpoints.

Also, as part of the administration of the salary structure, The Regents will establish procedures for reviewing UC and competitive practices for other non-salary elements of total compensation such as bonuses, car allowances, housing subsidies, University-provided housing, and one-time payments such as relocation allowances.

Following the recent completion of audits and the ongoing reviews of executive compensation procedures, recommendations may be made to revise these guidelines in the future as a part of the review process by The Regents.

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

11. UPDATE ON THE STATUS OF REINSTATEMENT OF CONTRIBUTIONS TO THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN

Senior Vice President Darling observed that the purpose of restarting employee contributions to the UC retirement plan is to assure the long-term financial viability of the retirement system so that the University can fulfill its pension obligations to current and future retirees.

Associate Vice President Boyette reported that resuming UC and employee contributions is necessary to preserve the sustainability of the retirement plan. The analysis and consultation process within the UC community continues.

Ms. Boyette addressed some misconceptions that may be concerning employees. She reported that in May The Regents stated the intent to restart contributions in July 2007, subject to availability of funding, the budget process, and collective bargaining for represented employees. This step will allow contributions to start small and increase gradually over time, thereby lessening the initial financial impact on employees. There is no intention to start employee contributions at 8 percent of pay nor to cut anyone's pay to fund UCRP contributions. UC and employees will both contribute to the plan; the share that each will be required to make has not been decided. Most employees will not see a change in their take-home pay because the initial contribution will be the amount employees currently contribute to the Defined Contribution Plan.

Ms. Boyette commented about a report provided to The Regents and the public by Venuti and Associates, an outside actuarial firm commissioned by a coalition of unions representing UC employees to write an actuarial report on the necessity of making contributions to the retirement plan. In June, UC representatives met with representatives of Venuti to discuss the need to restart contributions. The Venuti report has been reviewed by UC's actuary, The Segal Company. The report implies that accepted actuarial guidelines have not been met by The Regents, which is not the case. The report ignores The Regents' stated policy of gradual increases in UCRP contributions, refers to select historical returns – for instance, 12.3 percent over the last twenty years of investment returns – and suggests that potentially high future investment returns could eliminate the need for new contributions. The Venuti report also proposes that The Regents should take such optimistic assumptions into consideration in developing a schedule of contributions for UCRP. The University's actuary has advised that managing the UCRP based on optimistic assumptions such as 12.31 percent would be irresponsible and contrary to the fiduciary obligations the Regents must fulfill. Segal has advised that the information from The Segal Company upon which the Regents have made their judgments is based on accepted actuarial principles and complies with all governing actuarial standards of practice. Segal will compare a complete comprehensive response to the Venuti report.

Committee Chair Hopkinson believed that it would be irresponsible of the University to make the assumption that there will be a 12 percent return on the retirement fund. Chairman Parsky agreed, noting that it is imperative to maintain the retirement plan's strong position.

Regent Schreiner asked how quickly the University could respond to the Venuti report. Mr. Drew James, of The Segal Company, reported that an outline of the response has been created. One complication is that in dealing with another member of the actuarial community, which operates under the code of professional conduct, any response must be carefully crafted, but he believed a response would be prepared within a few weeks.

Regent Blum viewed the Venuti report as misleading and unprofessional. The success of pension funds that have flourished during the last few years has been based on returns from real estate, private equity, and other areas that have done well. Even the past assumptions of 7 percent to 9 percent, however, which have been met by most pension funds, are no longer attainable. Global liquidity has driven interest rates down.

Faculty Representative Oakley referred to a memorandum dated May 25 that had been distributed widely in which the Academic Council had expressed the view of experts and had attempted to respond to the misconceptions that have been propagated. The faculty believes that the pension system is a jewel that must be preserved. He noted that just to maintain a steady state with an assumed 7 percent rate of return would require contributing 16 percent of the University's payroll each year, which would total over $1 billion. Contributions must be resumed before the plan dips under fully funded status.

Noting that the facts are on the University's side, Regent Pattiz encouraged Mr. James quickly to construct a measured response to the Venuti report.

12. **REMARKS CONCERNING SUPPLEMENTAL COMPENSATION FOR CERTAIN EMPLOYEES AT THE LOS ALAMOS NATIONAL LABORATORY**

Chairman Parsky reported that at a special meeting on June 2, the Special Committee on Compensation approved providing supplemental compensation for certain members of the Los Alamos laboratory, primarily individuals who had transferred from the Livermore laboratory. The Committee attached a condition to providing these funds, which are paid from the net management fee the University receives in connection with its award of that contract, that supplemental compensation provided by its corporate partners would be identified and provided to the Board of the LLC. He reported that an agreement had been reached with the corporate partners that the information would be provided at the September meeting and annually thereafter. To date, approximately $511,000 of supplemental compensation out of the fee has been provided to four individuals identified at the June meeting.

The Committee adjourned at 10:20 a.m.

Attest:

Acting Secretary