The Regents of the University of California

COMMITTEE ON FINANCE
May 17, 2007

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

Members present: Regents Blum, Dynes, Gould, Hopkinson, Island, Parsky, and Wachter; Advisory members Bugay and Oakley, Staff Advisors Brewer and Miller

In attendance: Regents Coombs, Johnson, Ledesma, Lozano, Marcus, Pattiz, Ruiz, Schilling, Schreiner, and Varner, Regents-designate Allen and Brewer, Faculty Representative Brown, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Provost Hume, Executive Vice Presidents Darling and Lapp, Vice Presidents Broome, Foley, and Sakaki, Chancellors Birgeneau, Drake, Fox, Kang, Vanderhoef, and Yang, Acting Chancellors Abrams and Blumenthal, University Auditor Reed, and Recording Secretary Smith

The meeting convened at 10:05 a.m. with Committee Chair Gould presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of January 18, 2007 were approved.

2. **UPDATE ON GOVERNOR'S PROPOSED MAY REVISION TO THE 2007-08 BUDGET**

President Dynes gave an oral presentation to update the Board on the effect of the May Revise on the overall State budget and the proposals related to the University of California’s budget. He stated that the Governor honored the Compact with the University in that the revision contains funding for student enrollment growth, faculty and staff compensation increases, inflationary adjustment, and The Regents’ key priorities. The revision also continues to include the Governor’s research and innovation initiatives, which invest in UC research through the Energy Biosciences Institute at UCB, the Helios Project at the Lawrence Berkeley National Laboratory, the California Institutes of Science and Innovation, and the Federal Petascale Supercomputer Project, should UC win the competition.

The President reported that UC will continue to work with the Legislature and the Governor to achieve all of UC’s budget objectives, including funding for the labor research program and academic preparation programs. Another budget issue is funding pension benefits. Unlike most organizations, UC and its employees have enjoyed the privileged position of not having to pay into the UC pension plan, which is considered by many to be the gold standard for pension programs, for over a decade and a half. Circumstances require that contributions be made to the pension fund imminently. President Dynes asserted that restarting contributions before UCRP becomes underfunded is not only important for the plan's overall health, but also allows contributions to be initiated at a low rate and gradually increased over time. Such an approach lessens the financial impact on employees, the University, and the State, and also helps preserve employee salary gains. Due to the financial constraints of the State, UC will not receive funding in order to restart contributions on July 1, 2007, as originally planned, so restarting contributions will have to be rescheduled. However, the May revision did contain proposed language conveying that, as contributions are reinstated in the future, the State intends to fund fully its share of the cost for UC's contribution to UCRP consistent with the State's approach to funding CalPERS. Under the current plan, State funding for CalPERS is approximately 11 percent and employees pay 5 percent; UC is aiming for the same arrangement. The public will be kept apprised of the budget discussions on the pension plan. The President pointed out that the issue of employee contributions to UCRP is also subject to collective bargaining.

Chairman Blum commented that it will always be politically expedient to never ask for retirement contributions from employees, but that option is fundamentally irresponsible.

Provost Hume pointed out that there has been an augmentation to the May Revise of $2 million to the Tobacco-Related Disease Research Program, funded by the tobacco tax.

Regent Ledesma asked for further pressure on the Legislature to include funding for academic preparation programs and the labor center in the base UC budget. President Dynes responded that it had been his belief that the issue had been resolved last year, and that it had been agreed that UC only needed to report on progress. He stated that UC will continue to push for these programs to be included as a line item in UC's budget.

3. RESULTS OF DEBT CAPACITY STUDY

Vice President Broome reported on the debt capacity study that the University conducted with Lehman Brothers, and presented the *Annual Debt Capital Report*, which will be issued to The Regents annually. Areas of the study included external debt strategies, University debt capacity, internal debt policies such as affordability and repayment sources, financing growth rate assumptions, and a review of the University's current guidelines.

Ms. Broome recalled that the debt capacity study revealed that the University has additional debt capacity between $9 and $11 billion. This debt capacity was developed with the assistance of Lehman Brothers by looking at the full credit spectrum of the University. New borrowing vehicles have been introduced and credit rating strategies have been reassessed. A two-tiered assessment process was developed in order to facilitate access to the debt capacity and address how campuses will afford the debt. First, each project must have financial feasibility and pay for itself through an income-stream approach. Second, a template has been tailored for campuses to assess affordability through the projection of various debt scenarios and projects.

The financial feasibility model has been updated so that it is more dynamic in relation to changing interest rates and pro-forma assumptions. Overhead for private grants has been added as an additional pledge source, totaling approximately $850 million. A third-party scoring system has been developed so that, while third-party debt will always be included in the University's balance sheet, it will not count fully against the University's credit. Other projects are also under way, including analyzing the debt of the Short Term Investment Pool.

Ms. Broome explained that the annual debt capital report will include information on outstanding debt, new money to be issued, debt capacity, and the impact of new debt. In relation to outstanding debt, a new structure has been developed to allow more flexibility and more capacity. All University debt is rated "AA." General revenue bonds, which are used to fund the projects tied to the core mission of the University, have been separated from limited project revenue bonds, which will be used for auxiliary projects. Revenues from the medical centers have been pooled, providing more capacity and eliminating many of the restrictions that were incurred when they were separate. A financing trust structure has also been included for third-party debt. The old types of credit are being phased out by not issuing them and by refunding that debt for better rates and savings when financially feasible. Hospital revenue bonds are going to be refinanced in the near future, when financial markets are favorable. Ms. Broome explained that the State Public Works Board debt is issued by the State on behalf of the University. The University is given funds to pay the lease project bonds. This credit usually does not count against the University's credit, particularly in good economic times.

The Regents have approved $750 million of new money debt issuances, which include $350 million for general revenue bonds and $400 million for limited project revenue bonds. In addition, $770 million was approved for FY 2009-10. Analysis of debt capacity will be updated each year to assess the position of the University's debt in relation to the current market environment and the capital needs of the University.

Regent Parsky noted the need to understand the relationship between the incurrence of debt and the priorities set by the State or Regents' budgets, and asked how decisions to incur debt will be made. Ms. Broome explained that a process exists for a five-year capital plan, which is brought to The Regents through the Committee on Grounds and Buildings. As projects mature and detailed information becomes available, each project is brought to the Committee on Grounds and Buildings where the debt portion of the financial requirements is approved. The total debt that has come through the Committee on Grounds and Buildings is shown in the debt capacity report, including when the project will be completed and the debt issued. The University's incremental capacity to issue debt is between $9 and $11 billion over the next five years, which is in addition to the $8 billion that is currently outstanding.

Ms. Broome extended her thanks to the Advisory Committee and the planning and budget offices of each individual campus, all of which gave thoughtful input, worked very hard, and provided a valuable resource for this work.

Regent Ruiz stated the importance of continuing to be conservative in relation to the use of debt service. Committee Chair Gould made the distinction between being aware of the University's debt capacity and identifying key projects that need to move forward. This capacity will not be absorbed quickly, but rather the University will proceed in a thoughtful manner. Ms. Broome added that the analysis is updated annually with regard to the markets and investor relationships. Chairman Blum reiterated that while each project will be carefully assessed, key opportunities such as important scientific endeavors might be lost if the University is not able to move forward. For example, approval of funding for the Helios project was a key factor in obtaining the BP grant for the Energy and Biosciences Institute. Regent Island added that the debt capacity work is an important planning tool that can be used carefully and to its fullest extent.

4. **ORGANIZATIONAL ASSESSMENT AND RESTRUCTURING OF THE UNIVERSITY'S ADMINISTRATIVE FUNCTIONS**

Chairman Blum and President Dynes provided an overview of the University's organizational assessment and restructuring of the University's administrative functions. President Dynes recalled that, after extensive discussions with Chairman Blum, the University would benefit from an outside review and assistance in thinking about the structure of the University in order to save resources to use for the University's educational priorities. After interviewing several consultants, the Monitor Group was contracted to conduct the analysis.

Areas under consideration include:

- where functions should occur
- duplications or inefficiencies
- the roles and responsibilities of Regents, the Office of the President, and the campuses

Chairman Blum stated that the organizational assessment and restructuring of the University's administrative functions are part of an overall strategic plan to solve the University's key pressing issues, which include salaries at every level, class size, and the ability to fund new facilities. The University has not been evaluated from top to bottom on a systemwide basis in approximately 40 years. Policies, procedures, and staffing inconsistencies are major concerns. Part of this evaluation includes Provost Hume's discussions with deans regarding their academic plans and how the University can deliver on those plans in a sensible way. Eventually, more business and financial talent will be added to the pool of talented people already working for the University. Everyone's cooperation will be needed to assess ways to make the University more effective.

Mr. Doug MacKenzie, from Monitor Group, gave an overview of the objectives and outputs of the assessment, which include looking for redundancies throughout the system to maximize effectiveness and efficiency, such as the payroll system. The early stages of the work have revealed the enormous integration costs that are incurred when coordinating the various functions of the University.

Over the next year, the Monitor Group's assessment will involve:

A. Diagnostic Phase: Diagnosis of the problem by collecting information regarding where administrative and finance functions occur and the dollars and number of people involved. Based on the information gathered, the areas that offer the biggest opportunities to save money and improve the effectiveness of the service provided will be selected. This phase will last approximately three months.

B. Design Phase: Monitor Group will be working with people throughout the system to redesign and reconfigure the aspects that will best improve the overall UC system. The result of this phase will be a long and a short list of items to address over a six month period. A menu of opportunities will be generated, from which the Steering Committee, comprised of senior officers in UC, will select a portfolio that consists of cost savings and opportunities for performance improvement. One major output will be how the Office of the President should be designed and configured, including organizational structure and support.

C. Implementation Phase: Implement changes that the University teams identified, led and facilitated by Monitor Group, to ensure changes get captured and implemented in the system.

A specific output of the assessment will be a map of the University system to see where its resources are spent.

Regent Hopkinson commented that The Regents approved only the first phase of this effort, and asked for more information regarding this phase. President Dynes stated that decisions will be made at each phase as to whether the work will continue. Phase One is the accessing and data gathering phase, to be completed on July 26, 2007, which will be a decision point.

Regent Hopkinson expressed her unease at one item in the presentation that referred to the best role for the Office of the President. She asserted that this is an issue that involves policy matters and discussions at all levels of the University, and is not for a consultant to decide. Executive Vice President Darling stated that the consultant contract includes the appropriate responsibilities and authority of The Regents, the Office of the President, and the campuses. The intent was never that the consultants would decide upon the role of the Office of the President, but rather that the consultants would lay out the issues and options for consideration by the University. Regent Hopkinson requested that the presentation by Monitor Group be changed to reflect the clarification.

Regent Island expressed concern that the University not engage in a trade-off between efficiencies and quality. In particular, in the focus on cost savings, Regent Island requested that those activities be bounded by a requirement that the quality of the University be a primary aim.

Regent Schreiner pointed out that alumni should be added to the list of nine constituent groups. Regent-designate Brewer agreed that alumni are concerned about the rising costs of education and are reluctant to donate without knowing that the University is seeking ways to control rising costs.

Regent Hopkinson asked if a subcommittee of Regents will be convened to provide input into the process. Executive Vice President Darling noted that the Steering Committee includes chancellors, Regents, members of the Office of the President, and representatives from the Academic Senate. Regent Hopkinson suggested that a group of Regents be consulted regularly about issues and processes. Regent Gould noted that a resource group of Regents will be available for comments and observations as the project progresses. Regent Allen requested that those consultations include the Student Regent, Alumni Regents, Faculty Representatives, and Staff Advisors.

5. APPROVAL OF 2007-08 BUDGET FOR THE OFFICE OF THE PRESIDENT

Committee Chair Gould recalled that when budget information regarding the Office of the President (OP) was reviewed last year, it was found that the information was insufficient for a full understanding. A process was conducted, with assistance from outside groups, in order to provide for more transparency and clarity regarding OP’s functions and funding sources. Committee Chair Gould stated that this was accomplished, and that the President made a decision to slow down changes within OP and ensure that funding remains for merit, inflation, and changes previously considered and approved by The Regents. The effort continues to be a work in progress, and improvement will be made as it moves forward, particularly based on the work of Monitor Group.

Vice President Broome explained that OP is comprised of several core administration and support areas that provide services to the University system in order to meet its teaching, research, and public service mission. For the purposes of this report, a distinction has been made between Core Administration and Systemwide Support Functions. There are also a number of Academic and Systemwide Administered Programs presented in this report for which OP is either responsible or associated with funding oversight, but may or may not be physically located at OP.

Ms. Broome explained that previously the OP budget would have been approved in the context of the overall UC Budget. The FY 2007-08 OP budget was presented at this meeting in accordance with the *Policy Regarding Approval of Annual Budget for the Office of the President*, approved at the November 2006 meeting, which requires that the OP budget be approved annually by The Regents. The proposed budget was based on funding allocations and staffing levels consistent with 2006-07 levels adjusted for inflationary increases, and included special augmentation in four units largely based on Regental priorities. The marginal adjustments in the budget reflect salary merit increases in accordance with a proposed Systemwide process, approved equity increases, a corresponding change in benefits, and an inflationary adjustment to operational budgets. No additional increases are projected for Core Administration and Systemwide Support Functions. It was noted that OP units have not received an increase in operational funds for several years. Ms. Broome explained that this budget is a moderate approach to funding for FY 2007-08 OP positions pending the upcoming comprehensive organizational review by Monitor Group.

Potential savings initiatives offer proposed target areas that can achieve both costs savings and cost avoidance for OP. Potential savings can be redirected to other needs. It is planned that these efforts will be undertaken in parallel with the restructuring project being conducted by Monitor Group in order to achieve new efficiencies and cost savings while effectively supporting the academic and research mission.

A brief description of the overall reduction plan for the National Laboratory Management unit within OP was included in the budget, together with a targeted staffing reduction and corresponding decrease in funding.

Ms. Broome offered the following budget highlights:

- The FY 2007-08 projected budget for UCOP Core Administration totals $89 million. The funding for UCOP Systemwide Support Functions is budgeted at $76 million, for a combined total of $165.5 million.

- The difference from FY 2006-07 funding levels for Core is $5.6 million, of which approximately 50 percent is due to inflationary adjustments. The other 50 percent of the increase is attributable to project and staffing augmentations previously authorized by The Regents.

- The total FY 2007-08 budgets for four units include the following special augmentations: the President's Immediate Office, the Secretary and Chief of Staff to the Regents, the Chief Investment Officer, and the Business and Finance Immediate Office. These augmentations, totaling $2.8 million, apply to specific projects and staffing augmentations and have been previously authorized by The Regents.

- The proposed FY 2007-08 budget for UCOP Systemwide Support Functions has been moderately decreased, even after consideration of inflationary adjustments, as a result of the reduction in the staffing and funding of National Laboratory Management.

- National Laboratory Management staffing will be reduced to 16.4 in 2007-08, down from 45 in 2004-05. A projected core staffing level of 15.4 is planned for 2008-09. The 15.4 core staff level has been determined by OP to be the minimum requirement necessary to sustain the University's continuing oversight responsibilities. Costs have declined from $7.5 million in 2005-06 to $4.8 million in FY 2007-08.

- The FY 2007-08 projected budget for Academic and Systemwide Administered Programs totals approximately $261 million. The range of functions among these areas is diverse and represents significant academic, research, and student-centered activities, programs, and projects, as well as substantial public service.

- The funding sources for Core Administration are derived primarily from three funding sources: State General Fund – 26.5 percent, UC Common Fund – 43.3 percent, and UC Asset Fund – 23.6 percent.

- UCOP Systemwide Support Functions are funded from four primary sources: State General Fund – 10.1 percent, UC Common Fund – 10.5 percent, UCRS – 31.3 percent, and a series of varied funding sources and service reimbursements.

- Approximately 60 percent of the projected funding for Academic and Systemwide Administered Programs is allocated from State General Funds and Designated Special State Funds. The majority of the funding is directed to or allocated for specific research projects and academic programs. Other programs are either funded from a series of special funds or are self-sustaining.

- Potential savings initiatives include expansion of the recently initiated "Payroll Cluster" to all Divisions within OP and centralization of accounts payable and purchasing functions for OP.

Regent Parsky stated that progress is being made on OP's budget, and that it is important that a detailed budget be presented annually in an appropriate way. He suggested that, while the intent is not to halt progress being made, more work needs to be done in several areas before the July Regents' meeting. Regent Parsky stressed the importance of understanding the detail with respect to funds that are available; in particular, funds that are only available for the functions described in comparison with funds that are available for other priorities that could be established. The extent to which choices can be made is not clear; if choices exist, The Regents should know that the choices are made annually. Regent Parsky put forth the following resolution:

The Committee recommends that:

A. The President and the Office of the President shall have the authority to expend funds up to the date of the July 2007 meeting of the Board of Regents related to the operations of the Office of the President for purposes and in amounts consistent with the prior fiscal year. Upon approval by the Chairman of the Board of Regents or the Chair of the Committee on Finance, additional resources may be expended prior to the July meeting for the Systemwide Presidential Fellowship Program, the Office of the Ombudsman, the Office of the Secretary and Chief of Staff to The Regents, the Foundation Performance Reporting requirements, and the Business, Finance, and Compliance functions.

B. The President and the Office of the President shall, during the first half of FY 2007-08, develop a budget process for the Office of the President that will fully evaluate annually the fiscal needs of each Office of the President program and allow review of proposed resource allocations to maximize use of resources to serve the educational, research, and community service missions of the University of California. In developing the budget process, the President and the Office of the President shall consider the organizational assessment under way by the independent consultant under contract with the University.

C. The President and the Office of the President shall present a progress report at the July 2007 meeting of the Board of Regents, including a timeline for further development of the budget process and planning changes in key program areas, including management oversight of the Department of Energy laboratories in light of recent changes to the organizational and contractual status of the laboratories.

In response to a question from Regent-designate Allen, Regent Parsky clarified that the funds received from the laboratories come from both the Department of Energy and from fees. He stated that if UC's role has shifted in the oversight of the laboratories, and if the fee is separate from any money available from the Department of Energy, that fee income should be devoted to science and research. Exceptions should be made only with the approval of The Regents.

Regent Pattiz felt it important to reiterate that, due to the change in status in the management of the laboratories, the size of the laboratory management in OP has gone from 45 FTE to 14 FTE. President Dynes stated that a presentation will be made in July regarding what this reduction is comprised of.

Regent Island concurred with Regent Parsky in the desire for Regents to participate in setting goals and making choices when choices can be made, particularly in the case where particular functions and positions may be overfunded.

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

6. **APPROVAL OF INDEMNIFICATION TERMS IN CERTAIN LIMITED AGREEMENTS IN SUPPORT OF RESEARCH**

The President recommended that he be given authorization to permit execution of contracts with indemnification provisions (a) in material transfer agreements to transfer tangible research product into the University, (b) in research or training or public service agreements with nonprofit or governmental entities, and (c) in land access agreements, all in the furtherance of research, training, or public service that might require assumption by the University of third-party liability as a result of or arising out of University acts or University contract performance, an action for which approval by The Regents is required under Standing Order 100.4(dd)(9).

Tangible Research Product

As research has progressed in biotechnology and related fields, the tangible research product (e.g., newly developed biological material) resulting from such research has become a unique resource to further later research. Consequently, University researchers are constantly seeking to obtain from other research organizations such tangible research products through agreements typically called material transfer agreements (MTA). MTAs coming into the University are seen in the thousands each year and provide a critical component of proposed University research. There is usually no charge or a charge at cost for the tangible research product being transferred, with active interactions into and out of the University reflecting and helping to maintain the cutting-edge nature of the University's research. A typical MTA has provisions addressing liability, to

assure that the provider of the tangible research product will not be held liable for acts or omissions resulting from or arising out of the recipient's use of the tangible research product.
For example the decade-old "uniform biological material transfer agreement" that NIH encourages nonprofit entities to use states: "Unless prohibited by law, recipient assumes all liability for claims against it by third parties which may arise from recipient's use, storage, or disposal of the Material, except that, to the extent permitted by law, the provider shall be liable to the recipient when the damage is caused by gross negligence or willful misconduct of the provider." Other typical provisions have indemnification, defense, and hold harmless duties by the recipient to the provider specified for any liability resulting from or arising out of recipient's use of the tangible research product.

Such tangible research product is usually accompanied by disclaimers such as: "understood to be experimental in nature and may have hazardous properties" or "is a product of research with unknown properties" in order to make it clear that the recipient assumes all liability of whatever kind from recipient's use.

These provisions have become the accepted norm in MTAs. As the provider is typically gaining little or no advantage from supplying its tangible research property, there is little possibility of negotiating a material change in the language. Also, when the University transfers tangible research product to other researchers, it gains the benefit of such provisions. Declining to agree to the liability language would lead to many University researchers' not receiving tangible research product needed for their research.

Given the high level of skill of University researchers in daily handling the tangible research products in their areas of research and the limited damages expected from research scale work under these provisions, it is felt that the chance of the University's actually having to bear third party liability is slight. Approval for the President to permit agreement to these liability provisions in the transfer of tangible research product is recommended.

Research or Training or Public Service Agreements

Often nonprofit or governmental research or training or public service sponsors are unable or unwilling to agree to the University's normal position of not accepting sponsored research or training or public service agreement provisions that could result in the University's assuming responsibility for third-party liability in violation of Standing Order 100.4(dd)(9). In many cases where the sponsor is not performing actions under the proposed contract other than supplying funding, these contracts do contain indemnification clauses and the like to shift the risk of the proposed University research completely or almost so to the University, utilizing wording such as, "the University indemnifies, defends, and holds the sponsor harmless from any liability resulting from or arising out of the proposed University research or training or public service." It is frequently the

case that such sponsors will not vary materially, if at all, from their standard terms and conditions. Such research sponsors are a significant source of University research or training or public service funds for many in the University.
It was felt that the risk is slight to the University of assuming third-party liability from sponsored research or training or public service contracts where the sponsor's duties under the contract amount substantially to supplying the funding and receiving reports of the University activities. This request does not include the University's assuming liability for sponsor intellectual property infringement, other actions of the sponsor in using the result of the University's research, training, public service, or arising out of challenges to the sponsor's authority or propriety to enter into the sponsored agreement. Approval for the President is recommended to permit agreement to these liability provisions in sponsored research contracts where the sponsor is not conducting the prospective research, training, or public service under the contract.

Land Access Agreements

On occasion, University researchers need to gain access to land in order to conduct research, such as observing transient natural phenomena when they are occurring. In many cases the land owners require an agreement for access to their land and facilities that could result in the University's assuming responsibility for third-party liability in violation of Standing Order 100.4(dd)(9). Often, these proposed contracts do contain indemnification clauses and the like to shift the risk of the proposed University research activity on their land completely or almost so to the University, using wording such as that cited above. It is frequently the case that such land owners will not negotiate on their standard terms and conditions. Usually, the land owner is gaining nothing from the University research activity, while the University researcher is able to acquire research data otherwise largely or completely unavailable. The University's researchers involved typically are, or are under the direction of professionals experienced in obtaining the needed data safely under applicable field conditions.

Risk to the University is slight in assuming third-party liability from land access agreements due to the research activities of the University on land that is subject to such an agreement. Approval is recommended for the President to permit agreement to these liability provisions in land access agreements where only the University is conducting the prospective research addressed under the agreement.

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

7. **ESTABLISHMENT OF AN IRC SECTION 115 TRUST TO SUPPORT NEW GOVERNMENTAL ACCOUNTING STANDARDS BOARD REPORTING OF RETIREE HEALTH BENEFIT OBLIGATIONS**

The President recommended that the President be granted authority to establish an IRC Section 115 trust to facilitate the University's administrative compliance with the Governmental Accounting Standards Board financial reporting requirements applicable to the University's retiree health benefit program, effective July 1, 2007, with The Regents serving as trustee of the trust and the Office of the Treasurer managing the investments, if any, consistent with policies established by The Regents.

In June 2004, the GASB issued Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, which will substantially change the financial reporting for and disclosure of OPEB costs in the University's audited financial statements. It will affect not only the University's consolidated financial statements, but also the statements of all University and affiliate locations that issue separate audited financial statements, such as the University's medical centers, the Continuing Education of the Bar, University of California Press, Associated Students-UCLA, and others (referred to in aggregate as the "Carve Out Locations"). For this reason, the University's implementation strategy must broadly consider the potential operational concerns, administrative costs, and financial reporting implications for the Carve Out Locations, as well as the University as a whole. The University must implement the GASB financial reporting changes starting with the fiscal year beginning July 1, 2007. In order to implement the new GASB requirements with the most administrative efficiency, the University has determined that an adoption of a trust as an administrative payment conduit would be the preferred method of implementation.

University-Specific Goals for the Trust

The University-specific goals for a trust to respond to the GASB requirements are to:

- Maintain consistency with the University's systemwide cost sharing of benefit costs approach for pensions and retiree health benefits;

- Allow management flexibility to define the level of required contributions using a common assessment approach similar to the current process;

- Capitalize on existing administrative systems and capabilities by aligning the OPEB process with the operational processes associated with the University of California Retirement plan (UCRP) and Retirement Savings Program plans; and

- Minimize the potential administrative requirements and financial reporting implications to locations that currently issue audited financial statements separate from the University's consolidated financial statements.

Locations that continue to pay on an actual cost rather than cost-sharing basis, currently expected to be Lawrence Berkeley National Laboratory and Lawrence Livermore National Laboratory as a result of the contract language with the Department of Energy, would be treated as having individual OPEB costs and liabilities based on a separate actuarial valuation conducted for each of these two entities. The Hastings College of the Law, an affiliate of the University that participates in all of the University's employee benefit programs, has indicated it prefers the cost-sharing approach, in part to maintain administrative efficiency for its organization.

Significant Trust Provisions

In order to achieve the flexibility and administrative efficiencies available to cost-sharing employers, the GASB requires that the funding vehicle meet three requirements. It must provide that contributions will be irrevocable, assets accumulated in the vehicle will be used only to provide benefits to participants and beneficiaries, and assets will be legally protected from creditors. To satisfy the GASB requirements, as well as the goals listed in the prior section, and based on the advice of internal and external legal counsel, it was determined that the most appropriate vehicle would be a tax-exempt grantor trust described in Section 115 of the Internal Revenue Code. Key features of the trust document to include the following:

- Participation in the trust is limited to the University's current cost-sharing locations plus the University's affiliate, the Hasting College of the Law. Any additional affiliates must be approved by The Regents.

- The fiduciary structure parallels that of UCRP. The Regents will serve as trustee and retain oversight responsibility for administrative and investment functions. The Associate Vice President, Human Resources and Benefits, is named as the "Trust Administrator," with primary responsibility for the administrative functions, including accounting and record keeping. The Office of the Treasurer will have primary responsibility for investing the assets of the trust, if any, according to policies established by The Regents.

- Contributions to the trust at the rate determined by the Trust Administrator are irrevocable. If a Participating Location requests to withdraw from the trust, the interest of the location in the trust accumulations, if any, must be transferred to a vehicle that will use the assets to provide health and/or welfare benefits unless the Participating Location's liabilities for all such benefits have been satisfied.

- The trust will pay vendors and administrative organizations for the programs included in the Annuitant Medical and Dental Plans. Each such benefit plan is defined to include a portion maintained for the cost-sharing employers with costs and expenses paid through the trust and a portion maintained for the non-participating locations the costs and expenses of which are paid outside the trust, based on actual cost.

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

8. **TEMPORARY MODIFICATION FOR CERTAIN EMPLOYEES OF THE LAWRENCE LIVERMORE NATIONAL LABORATORY TO THE POLICY ON REDUCED FEE ENROLLMENT FOR UNIVERSITY EMPLOYEES**

The President recommended approval of a temporary modification to the Policy on Reduced Fee Enrollment for University Employees. The temporary modification would allow those employees of the Lawrence Livermore National Laboratory (LLNL) who are enrolled as students in regular session courses at the University and were eligible under University policy and paid reduced fees (one-third of the Registration and Educational Fees), at such time as the University's management contract for LLNL expires on September 30, 2007 and the LLNL employees are no longer University employees, to continue to be eligible for the reduced fees provided under the Policy for the remainder of their academic quarter or semester in progress.

The temporary modification to policy would read:

> University employees of the Lawrence Livermore National Laboratory (LLNL) who are enrolled as students and who have received a reduction in University Registration and Educational Fees at the time the University's contract to manage the LLNL expires on September 30, 2007, shall remain eligible for the fee reduction from October 1, 2007 until the end of their academic quarter or semester in progress.

Pursuant to The Regents' Policy on Reduced Fee Enrollment for University Employees, all University employees, including employees of LLNL, currently are eligible for a two-thirds reduction in the University's Registration Fee and the Educational Fee when they enroll in regular session courses of up to nine units or three courses per session, whichever provides the greater benefit to the employee.

The University's contract to manage LLNL will expire on September 30, 2007. Whether or not the University subsequently participates in the management and operation of LLNL, as of October 1, 2007 employees at LLNL would no longer be employees of the University and thus will not be eligible for the reduced fees under University policy. In the interests of promoting stability in the LLNL workforce during the transition to a new contractor, as well as supporting the educational goals of these employees and assisting them in planning their educational expenses, it is recommended that The Regents permit these employees to complete their current coursework under the reduced fees rates for the duration of their academic quarter or semester in progress. Therefore, on October 1, 2007, when the LLNL employees would cease being University employees, they would not be required to reimburse the University for the reduced fees they received as UC employees for classes in which they are enrolled on that date. After their quarter or semester ends, the University's reduced fees policy would no longer apply to these employees and they would be required to pay full fees for subsequent classes in which they enroll.

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

9. **POSTPONEMENT OF ADOPTION OF RE89: POLICY RESTRICTING UNIVERSITY ACCEPTANCE OF FUNDING FROM THE TOBACCO INDUSTRY**

Chairman Blum recommended that consideration of RE89 be postponed until the July meeting.

It was recalled that at the January 2007 meeting, the Committee discussed a proposal to limit the acceptance by the University and its employees of research funding from companies associated with the tobacco industry. At the conclusion of the discussion, the Committee amended the recommendation of the proposal to postpone further consideration of the item until the May meeting. The proponent of the proposal, Regent Moores, is unavailable for the May meeting and has requested that the matter be postponed until July. Because the previous postponement in January was established by formal action, it has been concluded that an item for action at this meeting is necessary to honor Regent Moores' request.

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

10. **PRESENTATION BY THE ACADEMIC SENATE ON FUTURES REPORT ON THE UC BUDGET**

Academic Senate Chair and Faculty Representative John Oakley and Professor Christopher Newfield, chair of the University Committee on Planning and Budget, presented the key findings of the report prepared by Planning and Budget, "Current Budget Trends and the Future of the University of California," which was adopted by the UC Academic Council in December 2006.

It was recalled that the report was undertaken in response to faculty concerns that the long-term budgetary implications of short-term decisions made about the University's budget have not been analyzed in detail – specifically those contained in the Higher Education Compact. The report also evaluated State budget trends for implications and impact on the University's quality and mission.

Professor Newfield explained that, in the period proceeding 1980, California citizens invested in the vision of Nobel Prize-level quality of education being available to the top 10 percent of the State's population, with the idea that it would produce unprecedented levels of State development and affluence. However, costs of inflation, enrollment growth, and academic innovation have posed challenges to this vision. UC faculty have witnessed deteriorating teaching conditions and the departure of faculty peers to competitor schools. Analysis shows that UC has been struggling to keep up with the current costs of higher education over many years. In the last 20 years the State has cut public investment to the University of California by approximately 50 percent.

In this context, the Committee sought to answer two key questions: 1) the present and likely future of UC's core budget, and 2) how UC can compensate for structural budgetary shortfalls. Several scenarios of the future of UC's budget were compared. One option is to extend the current Compact, which would include increases in the General Fund of 4 percent to 5 percent per year, increases in student fees of 8 percent to 10 percent per year, and bringing professional school fees closer to market. Another option is to return to the 2001 pathway, which was the last time that UC was relatively financially healthy, and at the time the funding seemed economically and politically attainable. Another option is to return to the 1990 pathway, which was a recent benchmark of educational quality and the requisite funding to achieve that quality.

The Committee's primary conclusion was that the Compact permanently reduces the fraction of core funds provided by the State, so that even with large annual fee increases UC's core budget is permanently cut by approximately 25 percent. The Compact will not allow UC's State funding to recover to the 2001 pathway, but rather it locks in a decline. The gap between returning to the 2001 pathway and the current 2007-08 budget is $1.1 billion. A return to traditional UC quality, defined by the 1990 pathway, would require an additional $2 billion over the current budget.

Given this shortfall in State funding, the Committee looked at options to compensate. One option is faculty research, in which faculty augment UC's income through contracts and grants from the federal and State governments and from industry. However, these sources of income are unlikely to fill even a small amount of the shortfall. A second option is private fundraising, but the scale of the problem is too large to be resolved through endowment income. A third option is increasing student fees, which would have to be raised to $15,000 to $18,000 per year by 2010 in order to return to the 2001 pathway.

The Academic Senate believes that the University is at a crossroads, and the decisions made by The Regents over the next few years will determine if UC changes in dramatic ways. The conclusions of the report were that UC's quality depends upon returning to the 2001 pathway, that reaching that pathway through fee increases is deeply undesirable, and that preserving UC as a great public University requires a greater investment of public funds.

Faculty Representative Oakley asserted that a higher level of investment must be restored in order to invest in California's future through one of the great engines of the State economy.

Regent Marcus expressed his appreciation for the presentation, but questioned the practicality of asking the State for an additional $1 billion to $2 billion. He inquired as to what would be a practical solution to the problem. Mr. Newfield stated that the intent of the report is to send a clear signal to the State that augmented public funding is necessary to have a great public university. Regent Marcus suggested that, if the Legislature and the Governor do not have the political capital to increase State funding for UC, a referendum should be considered.

Regent Allen stated that further fee increases are a tax on young people and are damaging to the University's commitment to accessibility and affordability.

Regent Island commented that the fair conclusion to be drawn from the presentation is that student fee increases are not the path to take to ensure quality.

11. **AMENDMENT OF POLICY ON CONFLICTS DISCLOSURES BY MEMBERS OF THE INVESTMENT ADVISORY COMMITTEE**

Committee Chair Gould stated that, in discussions with the Chair of the Committee on Investments, Regent Wachter, it was felt that the issue of conflicts disclosure requires thoughtful review as to what appropriate disclosures should be required of those who give general counsel to the University but who are not involved in the direct choosing of investment managers. This item was withdrawn and will be resubmitted at a future meeting.

12. **REPORT ON NEW LITIGATION**

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

The meeting adjourned at 12:00 p.m.

Attest:

Secretary and Chief of Staff