The Regents of the University of California

COMMITTEE ON FINANCE
March 19, 2008

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

Members present: Regents Blum, Brewer, Dynes, Garamendi, Gould, Hopkinson, Island, Kozberg, Varner, and Wachter; Advisory members Croughan and Scorza; Staff Advisors Brewer and Johansen

In attendance: Regents Allen, Bugay, De La Peña, Hotchkis, Lozano, Marcus, O'Connell, Pattiz, and Schilling; Regent-designates Cole and Shewmake; Faculty Representative Brown, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Chief Compliance and Audit Officer Vacca, Provost Hume, Executive Vice Presidents Darling and Lapp, Vice Presidents Beckwith, Broome, Dooley, Foley, Lenz, and Sakaki, Chancellors Birgeneau, Bishop, Block, Blumenthal, Fox, Kang, Vanderhoef, and Yang, Acting Chancellor Grey, and Recording Secretary Johns

The meeting convened at 11:40 a.m. with Committee Chair Gould presiding.

1. **READING OF NOTICE OF MEETING**

For the record, it was confirmed that notice was given in compliance with the Bylaws and Standing Orders for a Special Meeting of the Committee on Finance, concurrent with the meeting scheduled for this date and time, for the purpose of addressing an item on the Committee's agenda.

2. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meeting of January 17, 2008 were approved.

3. **UPDATE ON 2008-09 STATE BUDGET**

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Vice President Lenz began his presentation with an update of the State budget situation since the January meeting. In January, the Governor proposed a $141 billion State budget. Revenue estimates showed that the state faced a $3.3 billion shortfall during the present year, and a projected deficit of

$14.5 billion for fiscal year 2008-09. The Governor declared a fiscal emergency under Proposition 58 and proposed mid-year cuts to all State agencies. UC hospitals experienced some indirect reductions. The Governor's budget proposal for 2008-09 included across-the-board cuts of 10 percent. The Governor also called for a constitutional amendment, the Budget Stabilization Act, to halt bust-and-boom funding of State operations and to institute triggers that require spending reductions as soon as a deficit is projected. A key provision of the amendment is the creation of a Revenue Stabilization Fund, to set aside any additional revenue in excess of normal growth.

Under Proposition 58, the Legislature is required to meet in special session. The Legislature identified $4.3 billion in budget solutions for the current year which will create a $1 billion surplus by the end of this year. The mid-year reductions provided $7 billion in budget solutions for the 2008-09 fiscal year. These reductions will result in significant cuts to K-12 education, service cuts for the developmentally disabled, and funding cuts for the aged, blind, and disabled. The Legislature enacted the Governor's proposal for a 10 percent reduction in Medi-Cal rate providers, effectively a $14 million cut to UC hospitals and physicians.

In February, the California Legislative Analyst's Office (LAO) released its analysis of the Governor's budget proposal, indicating a structural deficit of $16 billion, $1.5 billion greater than the Governor's budget assumption. The LAO recommended an alternative approach that would reduce tax credits and tax expenditures to offset some of the proposed reductions. The LAO outlined a five-year plan to address the structural deficit. The plan recommends targeted budget reductions rather than across-the-board reductions. It proposes a realignment of the State-funded criminal justice system. Its approach would suspend Proposition 98, but reduce the magnitude of the proposed cut to K-14 education. Additional revenue from selective tax credits would be adopted, but without a general tax increase. The LAO plan avoids additional borrowing.

In regard to the University's budget, the LAO recommends enrollment growth of 1.8 percent, which represents $66 million to support the enrollment of 3,650 students. This is lower than the Regents' budget plan to increase enrollment by 5,000 students. It recommends a 10 percent increase in fees, setting aside 19 percent in return-to-aid, rather than 33 percent, as in the Regents' plan. The LAO proposes $49.5 million for non-discretionary price increases, and no employee cost-of-living adjustments.

The LAO recommends use of remaining State General Obligation Bonds to complete current higher education capital facilities projects, and proposes that any new project be funded from the proposed 2008 Capital Facilities Bond. It recommends an increase in two-year funding for UC capital projects of $5 million more than the Governor's budget and $55 million over the current legislative version. The LAO recommends that UC report to the Legislature on future non-State capital facilities projects.

Mr. Lenz then turned to the impact of the Governor's proposal on the University. As key points, he identified the Governor's failure to provide funding for two UC initiatives or to avoid a fee increase. The proposed ten percent across-the-board reduction for UC would total almost $332 million, creating a $417.4 million gap between the Regents' budget, approved in November, and the Governor's proposal.

Mr. Lenz referred to a chart displaying the compensation plan, program expansions, and new initiatives approved by the Regents at the November meeting, priorities for 2008-09 which would be funded in a normal year. He noted that the Regents may choose to fund, partially fund, or not fund these items.

Provost Hume stated that the University cannot and will not accept the Governor's proposed cuts. It will fight the proposal in Sacramento and take the fight to the people of California, working with the other segments of higher education. Mr. Hume informed the Committee that communications initiatives to educate the California public are currently under way. Elements of this public advocacy effort will be rolled out in the coming weeks. The University is working in close consultation with the California State University (CSU) and the California Community Colleges (CCC). The three higher education segments have a set of common messages in this State budget process. Mr. Hume highlighted two essential messages, agreed upon by the three segments, about the results of this significant disinvestment in higher education – the devastating loss of opportunity for individuals and families, and the damaging effect on the California economy.

Mr. Hume stated that he will work with Secretary and Chief of Staff Griffiths to ensure that the Regents are aware of what work is being done. He noted joint advocacy and communication activities. Four hundred alumni represented the University and spoke with legislators in Sacramento at UC Day. CSU representatives joined UC at that event. Likewise, UC will participate in the lobby day events of the other segments. Last week, the segments gathered a number of industry leaders for legislative hearings on higher education's contribution to those industries. Editorial board visits and other joint public outreach activities are planned. Mr. Hume acknowledged the work of Regent and Lieutenant Governor Garamendi to unite all the K-12 and public higher education segments to issue a collective statement of budgetary priorities on behalf of California's public education community.

Mr. Hume called attention to a web page about the State budget situation, linked from the UC home page. It summarizes UC's needs, provides tools for alumni and other advocates, and includes a section, updated weekly, telling the story of how the University contributes to the life of California. The basic message of this web page is about the enormous return on investments in higher education. The

University will convey this message in many ways, qualitatively and quantitatively.

The gravity of the situation has triggered a rapid and comprehensive consultation process within the University to identify budgetary priorities. Mr. Hume reported that he has weekly phone conferences with a task force of campus leaders. The administration has been consulting with Chancellors, Executive Vice Chancellors, Vice Chancellors for Budget and Planning, the Academic Senate, and the UC Student Association, and will continue to do so during the budget season. Mr. Hume noted that this work, along with the restructuring of the Office of the President (UCOP), will remain his highest priority over next three months.

Mr. Hume stated that his view of the University's priorities is shaped by the above-mentioned consultations and his own perspective as the University's chief academic officer. He stated that UC must adhere to its November 2007 commitment to increase student mental health services by at least $8 million in 2008-09. He recalled that the gap in services has been calculated at $40 million, which can be filled over a five-year period by systematic investments at a higher level. New funds are to be brought to this task, derived from a 10 percent increase to the Registration fee, which has been approved by student representatives.

Next Mr. Hume discussed the impact of the State budget process on enrollment growth. The University is being forced to make decisions on admissions when State support is not clear. He noted the record size of the applicant pool this year. In late February the University announced that it will offer admission to all eligible undergraduates for fall 2008, but has made it clear that it may not be able to continue to do so the following year, 2009-10, unless unfunded enrollments for 2008-09 are provided for in the State budget.

Mr. Hume then addressed faculty and staff compensation needs. Faculty salaries must be competitive with those at peer institutions, and the faculty scale system must be restored to health. Cost-of-living adjustments made for faculty must also be made for staff. Greater support for graduate students is also in the long-term interest of the state. Graduate students fuel the University's research engine, which drives the California economy, helps UC attract the best faculty, and exposes undergraduates to a research environment.

If the University is forced to make substantial cuts, it may need to reduce spending on its core academic support, including instructional equipment and technology, libraries, and facilities maintenance. UC may need to defer progress toward the restoration of instructional budgets. It may not be able to fund fully the price increases of non-salary items: equipment, library materials, and utilities. Campuses will defer purchases, identify further strategies for efficiencies, and find other means of obtaining these funds. Mr. Hume opined that making cuts in these areas will give the campuses maximum flexibility in advancing their academic priorities in a constrained fiscal environment; there will be less damage to UC's academic core strength with these cuts than if the University impeded progress on returning faculty salary scales to health, or if it reduced support for graduate students.

Mr. Hume stressed that it is impossible to isolate the impact of these cuts if they are made at the level proposed by the Governor. Among other considerations, faculty positions will remain unfilled and there will be damage to programs. He recalled the proposed new UC initiatives in public service and research – the educational imperative initiative and the research initiative – which were not supported by the Governor. If the Governor's proposal is approved, Mr. Hume stated that he will recommend that increased spending in these areas be postponed.

Mr. Hume continued with remarks on the University's efforts to manage existing resources better. Savings will be generated through the restructuring of the Office of the President, and campuses are developing plans to create intercampus administrative systems and other systemwide efficiencies. Mr. Hume estimated that, by working together, campuses can save about $40 million collectively this year. Those funds must stay on the campuses. The administration is examining better debt management, strategic sourcing, and a new strategy for investment earnings. However, Mr. Hume emphasized that the cuts proposed by the Governor are greater than the savings the University can achieve, no matter how aggressively it pursues them.

Mr. Hume stated that the University needs to consider raising student fees. He explained that he does not recommend this action, and urged the State to take a long view and to reverse the long-term decline in its investment in public education. Nevertheless, the Board may need to consider fee increases at the May meeting. Mr. Hume reported that the chancellors are unanimous in their view that fees should not increase by more than 10 percent. There has been discussion of a 7-to-10 percent increase in the Educational Fee.

Mr. Hume concluded his remarks by observing that the Governor's proposed cuts will force the University to turn away eligible students next year and to make reductions in student services. Students will experience larger class sizes, have a narrower range of courses available, and likely take longer to graduate, thus having to pay more for their college education. UC will not lower its standards, but it will become less efficient at educating and graduating students. UC research will be affected by a deteriorating student-faculty ratio, and by the University's inability to pay for the energy required to run laboratories, computers, and equipment. The University must do all it can to reduce or eliminate the proposed cuts and to work as efficiently as possible.

Committee Chair Gould emphasized that the Regents must be part of UC's advocacy campaign, and the need to articulate clearly what the effects of this reduction will be.

Regent Schilling asked about the planned spending of $102 million for unfunded enrollments, and the reason for it. Provost Hume clarified that this is to fund enrollment growth, based on the administration's conviction that the University must, as far as possible, follow students with funds. The University will advocate with the State to obtain these funds.

Regent Schilling asked if it is desirable to admit more students if those students will have a narrower offering of courses to choose from and take longer to graduate. Mr. Hume responded that this will happen if the University cannot obtain the funds, and that the University must fight for the funds.

Regent Hopkinson recalled the discussion at the last meeting of whether or not the University should admit all qualified students, and the suggestion of a special teleconference to discuss this important issue. She regretted that the decision was made without Regental involvement and concurrence.

Committee Chair Gould responded that there was discussion on the issue with a number of the Regents. It was understood that a special meeting was to take place if the University were contemplating a reduction in enrollment this year. He disagreed with Regent Hopkinson about the outcome of the previous discussion, and emphasized that the decision serves as a warning to the State about the implications for next year, but does not take away the opportunity of a UC education from successful applicants this year.

President Dynes stressed that, after this year, the University can go no further in delivering the education it is obliged to deliver if the State does not fund students as required. He expressed his personal feeling of obligation toward students who have prepared for UC eligibility throughout their high school years.

Regent Garamendi opined that, if the education segments work together, there is a reasonable chance to turn the situation around. The goal of the current advocacy program is to educate Californians about the extraordinary decision now being made about the future of the state. He defined this as a choice of either investing in public sector education or putting it on a starvation diet that will substantially weaken California in the future. While the LAO proposal is less harsh than the Governor's proposal, Regent Garamendi described it as a five- to ten-year starvation diet. The LAO proposal will not provide the resources UC needs. While it allows for some budget growth in the coming years, it begins at a lower, "starvation" base. Regent Garamendi noted current activities of the education coalition of UC, CSU, CCC, and K-12. He stated that this coalition has become broader, including the public safety and health care communities. Regent Garamendi stated that, later in spring and in early summer, there would be a discussion of increasing State revenues. He stated that the Governor has opened a door for this discussion.

Regent O'Connell emphasized the need for assistance from the business community. He observed that California has declined economically. Four or five years ago, California was the fifth largest economic engine in the world; now it is the eighth. California's spending per K-12 student was at about a mid-point among U.S. states; today California is 46th of the 50 states in this category. Regent O'Connell expressed his disagreement with a 10 percent across-the-board cut because of the underlying assumption that all programs are of equal value. He stressed the need to pass the budget sooner rather than later and discussed difficulties for K-12 program decisions caused by this delay. He suggested that the business community would play a key role in expediting passage of the budget. He cited the difficult two-thirds majority requirement in the State Legislature, and stated the need to focus on sympathetic Republicans, six in the Assembly and two in the Senate, and to communicate with business leaders about the implications of a lack of a well-educated, skilled workforce. He stressed that decisions now being made will hurt education in the future.

Regent Allen described the current cooperation across the education sectors as unprecedented. He noted that an action is planned for April 21. He reported that he attended UC Day in Sacramento and encouraged more Regents to do so. He referred to the student representatives' support for a 10 percent increase in the Registration Fee and emphasized that this is a historic occasion which reflects a collective acknowledgment of the need for mental health services. He also stressed that student representatives do not support a 10 percent increase in the Educational Fee, which is used to fund non-student service expenses. If the Educational Fee is increased, Regent Allen urged that it not be increased over 7 percent, which reflects the Governor's budget proposal.

Regent-designate Scorza concurred that students support no more than a 7 percent Educational Fee increase. Turning to Registration Fee policy, he reported that student leaders have discussed an increase in the range of 10 to 25 percent, at the discretion of the Chancellors, to fund mental health services fully. The Registration Fee is intended to be used for student services. Regent-designate Scorza reported that, in 2002, some Registration Fee funds were reallocated to non-student service programs. He also expressed students' confusion at the fact that, while they are agreeing to a higher Registration Fee for student services, campuses are being asked to cut support for student services. He asked that the use of student Registration Fee funds be examined to ensure that these funds are being allocated where intended. Provost Hume replied that the administration will examine this. He observed that the President rarely oversees the chancellors' discretionary funds.

President Dynes introduced Louise Hendrickson, a third-year graduate student in political science at UCR and president of the UC Student Association (UCSA), and Jesse Bernal, a UCSB graduate student and UCSA Committee Chair.

Ms. Hendrickson discussed the financial challenges faced by UC students, and the students' concern that the Governor's budget cuts may be passed on to students in the form of 30 percent fee increases. She noted that the Governor's proposal eliminates all competitive Cal Grant awards for 2008-09. Ms. Hendrickson stated that students are not able to plan for a four-year education because of unplanned and undefined fee increases; they do not know what their financial situation will be from year to year. She noted the potential loss of students to private universities. Ms. Hendrickson cited figures for what 7 percent and 10 percent fee increases would represent in dollars and working hours for undergraduate and graduate students, and stated that the total cost of attendance is higher at UC than at comparable institutions. She observed that UC student fee increases are not tied to inflation but are higher than the rate of inflation.

Mr. Bernal stated that the Regents should consider student input when balancing the UC budget. UCSA will not seek increases in graduate student support for 2008-09, but urges the Regents to support $8 million in additional funding for student mental health. UCSA supports earmarking Registration Fees for this increase. Mr. Bernal communicated UCSA's support for full funding of academic merit increases for faculty, but its recommendation for limits on faculty and staff compensation increases. UCSA recommends funding for non-salary cost increases. It supports the Office of the President's plan for enrollment growth in 2008-09 and recognizes UCOP's efforts to achieve administrative efficiencies. Mr. Bernal asked the University to seek savings at the campuses but to maintain core academic funds and student services. He urged the University to examine possible budget reductions at UCOP involving earmarked research funds and the removal of State burdens on UC, and to use these reductions to offset additional student fee increases. UCSA believes that a 10 percent Educational Fee increase is excessive and unnecessary and urges UCOP to examine all possible reductions to avoid any unreasonable Educational Fee increase.

Ms. Hendrickson asked the University's support for legislation regarding tuition, undocumented students, and financial aid. She asked the Regents to adopt Regent Garamendi's resolution stabilizing student fees and invited them to join in a statewide action on April 21.

Regent Kozberg observed that the current discussion differs from those in the past. She cited the dire situation facing the University, and opined that the University may have to think differently than it has in the past about joining a broad coalition with business, labor, education, and transportation to advance common interests.

Committee Chair Gould described the present moment as a breaking point requiring a combined effort to develop a plan. He expressed appreciation for the students' perspective in the discussion of how to move public opinion and understanding.

3. RESOLUTION STABILIZING STUDENT FEE INCREASES

Regent Garamendi recommended that the following be resolved:

A. The University of California will stabilize student fees by capping fees for the 2008-09 school year at 2007-08 levels, and by limiting student fee increases for school years beyond 2008-09 to the rate of inflation as measured by the California Consumer Price index. These limitations do not apply to professional school fees approved at the September 2007 Regents meeting; and

B. The Regents and University representatives will keep the Legislature and the Governor apprised of the state budget resources required to fund the University adequately; and

C. Where appropriate, the University will seek savings from administrative efficiencies to reduce the cost to the State of adequately funding the University; and

D. The above limitations and requirements constitute the current policy of the University, but are subject to change at any time if, in the judgment of the Board of Regents, economic circumstances and the best interests of the University require. This statement of current policy is not a contract or an offer of a contract.

E. The Regents adopt the Resolution (Attachment 1).

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Regent Garamendi stated that the issue had been well framed by the students: the 90 percent increase in student fees over the last four or five years; the burden placed on students; and the mistaken notion that UC is the least expensive public education institution. He stated the need to address the revenue shortfall issue in the structural deficit. The Legislative Analyst's Office (LAO) proposal suggests closing loopholes, and Regent Garamendi believed that it is profoundly wrong in closing the revenue gap by taxing children and students, who would account for about $2 billion in revenue under this proposal. This would occur through a decrease in the Child Tax Credit and increases in taxes on students. Other sources of revenue should be and are being considered. Regent Garamendi described proposed student fee increases as a tax. He deemed the significant increases in student fees over the last five years a serious departure from a historical pattern in California. Most entrepreneurial success in California began in the public education system. He speculated about the hypothetical position of California in the world today if it had not had a free higher education system forty years ago, and asked where California will be in the coming decades if it no longer has a free higher education system. Regent Garamendi attributed the erosion of the California economy to the lack of investment in public education. He explained his resolution as a statement that the burden of educating Californians is one shared by all, not the specific responsibility of students.

Regent Kozberg expressed agreement with Regent Garamendi's statements, but felt that, as a fiduciary, one cannot put a cap on any funding option.

Regent Garamendi withdrew his motion, suggesting that the matter be discussed further at the next meeting. Committee Chair Gould approved of this suggestion.

4. ESTABLISHMENT OF A TOTAL RETURN INVESTMENT POOL (TRIP)

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Executive Vice President Lapp explained that this item is a proposal designed to generate additional discretionary revenues for UC in the face of a State budget shortfall. Vice President Broome described it as an alternative investment pool, the Total Return Investment Pool (TRIP), to allow campuses flexibility to invest some of their funds in a longer-term pool with the objective of achieving a higher earnings rate. She observed that the currently existing Short-Term Investment Pool (STIP) serves the liquidity needs of UC. It is now over $7 billion, and about 90 percent of these monies are owned by the campuses, in thousands of campus funds. Those monies being considered for longer-term investment are not State funds, fees, or General Funds, but funds from endowments, capital programs, medical center reserves, and practice plans. These funds are used for programs which are longer-term in nature. The funds are accumulating income, and the objective is to maximize the income on them.

The TRIP will be designed by the Treasurer's Office. Ms. Broome explained that the STIP has no equity component. The TRIP will have an equity component between 20 and 30 percent and therefore a higher-risk profile. The risk will be borne by the campuses, and the campuses will decide how much to invest in the TRIP. This item will be brought back to the Committee on Finance as a request to authorize the President to establish the TRIP fund and to establish the target payout rate. The Committee on Investments will be asked to approve investment policies and guidelines for this new pool.

Regent Hopkinson requested an estimate of the total dollar amount of the pool. Ms. Broome responded that the pool would begin at $1.2 billion and reach $2 billion over time.

Regent Hopkinson observed that, according to current policy, the Regents establish the payout rate for the endowment fund, while this proposal authorizes the President to establish the target payout rate. She found this inconsistent. If the Regents decide to delegate this authority, Regent Hopkinson opined that the criteria for delegation need to be stated more clearly. She observed a conflict between the stated objective that "each individual campus and UCOP would have the sole authority to determine how to allocate any respective gains" and the President's authority to establish the target payout rate. Ms. Broome responded that it is possible to make the proposal for the payout rate consistent with the payout rate policy for the endowment fund. She clarified that the campuses decide how to allocate gains as well as losses. Regent Hopkinson indicated that she was satisfied with this response and had no objections.

Committee Chair Gould opined that this will be an important tool for the campuses. He acknowledged the complexity of the equity market and that an education process would be involved in the campuses' investment in this new pool.

5. RETIREE HEALTH BENEFIT VALUATION METHODS AND ASSUMPTIONS FOR POST-EMPLOYMENT HEALTH BENEFITS

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Committee Chair Gould described this item in relation to the statewide work of Regent Emeritus Parsky on how to fund liabilities and public exposure for post-employment benefits. He observed that the Academic Senate and UC staff are very much aware of this issue. The Regents should pay attention to this issue because it is a substantial cost driver, which will constitute a significant part of the UC budget in the coming years.

Associate Vice President–Human Resources and Benefits Judy Boyette explained that the present discussion concerns proposed methods and assumptions for valuing retiree health benefit costs for fiscal year 2007-08 financial reporting. This is a new requirement under Governmental Accounting Standards Board (GASB) 45. These methods and assumptions will be recommended for action by the Regents at the May meeting. The fiscal year 2007-08 retiree health benefit actuarial valuation will also be presented for action in May, because it will be necessary for preparing this year's financial statements.

In May 2007 the Regents took action to establish a retiree health trust, to facilitate the administrative functions related to implementation of this GASB financial reporting requirement. The current discussion is preparation for the Regents to demonstrate their effective oversight and prudent management of this issue. The administration will continue to communicate with the Regents about the overall retiree health program, including any possible pre-funding decisions.

The Governor's Public Employee Post-Employment Benefits Commission recently published a report with testimony from many parties, including testimony by Ms. Boyette on behalf of UC. Among the recommendations provided by the report was that boards overseeing retirement trust funds should evaluate the underlying assumptions, including discount rates, investment returns, health care inflation, and whether plans are open or closed systems. Another recommendation was that each public employer identify its liabilities in these areas and make them public. The current discussion and the material to be presented in May for action are intended to be consistent with the Governor's Commission recommendations and to provide a basis for the valuation of UC's post-employment liability for retiree health.

Over the past two years, the administration has discussed retiree health benefit issues with and received input from faculty and other constituent groups, as well as conducting periodic discussions with the Regents. These discussions will continue and be part of collective bargaining agreements, as required. Ms. Boyette pointed out that these accounting changes take effect this fiscal year. UC is required to include in its financial statements the value of future retiree health benefit costs. Currently there is no requirement for pre-funding.

Ms. Boyette introduced Tim O'Beirne, of Deloitte Consulting, the University's health actuary. Mr. O'Beirne began his remarks with an overview of the actuarial valuation process and terminology. He noted that he would focus on actuarial methods and assumptions. The primary measures to be included in the financial reporting will be unfunded liability and the annual required contribution. The principal audience for this reporting will be the credit reporting agencies and UC's creditors. The methods and assumptions to be addressed are the amortization method, the discount rate, and the assumed increase in total health care costs. Mr. O'Beirne observed that the benefit cost assumptions are unique to retiree health valuation and different from pension valuation; the demographic assumptions are identical to those used in the UC Retirement Plan.

Mr. O'Beirne then discussed the amortization method, in which the employer has some flexibility. The University is proposing an amortization period of 30 years, a flat dollar approach, and a closed rather than an open period. Mr. O'Beirne noted that the percentage-of-pay approach is used by many public sector entities, but described the flat dollar approach as more prudent and conservative.

The discount rate is the method used to estimate future benefit costs in today's dollars and affects total liability. GASB allows little flexibility in choosing the discount rate, and requires that it be based on long-term expectations and an employer’s general assets, in the absence of pre-funding. The University proposes a discount rate of 5.5 percent, using a building-block approach in actuarial and accounting standards and is based on the risk in the Short-Term Investment Pool (STIP). With pre-funding, the University could use a higher discount rate; this is a matter for future discussion.

Benefit cost assumptions are unique to the retiree health situation. Initial expectations are around current levels, and declining over time. The underlying assumption is that medical costs are around 16 percent of gross domestic product (GDP) and will grow to 20 percent over nine years. Unfunded liability is estimated at $12 billion. Annual expense is estimated at almost $1.4 billion, compared to the current pay-as-you-go cost of about $200 million. Credit rating agencies are the primary audience for this reporting and will be looking for activity in the future. Mr. O’Beirne then discussed a chart displaying the projected increase in UC retiree health benefit costs over the next ten years, from around $200 million in 2008 to over $500 million in 2018.

Committee Chair Gould pointed out the current cost of $200 million and the anticipated cost of $336 million in five years, which is an increase of $136 million on a pay-as-you-go basis. He emphasized that this represents merely covering the annual cost, with no change in benefit or value to the University. The University may even lose ground overall through its exposure. He asked the Committee to reflect on what a significant cost driver this is for the University.

Regent De La Peña asked which inflation rate was used in these estimates. Mr. O’Beirne responded that the discount rate is based on an inflation assumption of 3 percent, and some historical risk premium for the assets invested in. For medical health benefits, the inflation assumption is 10 percent initially, grading down to 5 percent annually in the longer term.

Regent Garamendi expressed serious concern about the increased annual expense for GASB financial reporting compared to the pay-as-you-go cost. If the University follows GASB requirements and pre-funds $1.3 billion annually, this will represent an expenditure of $1.1 billion more than the present level. Regent Garamendi asked if the University is required to comply with GASB. Mr. O’Beirne replied that GASB does not require pre-funding; it requires recognition of this expense on UC’s accounting statements. Credit rating agencies and creditors are the principal audience for this financial reporting. In the last few years since implementation of this new requirement, agencies and creditors have expressed awareness that this is not a new liability or expense, but they expect public sector employers to recognize, describe, and manage it.

Regent Garamendi asked if this would have an effect on the interest cost of UC borrowing. Mr. O’Beirne replied that this would be the most direct effect.

Regent Garamendi asked for an estimate of how significant that might be. Mr. O'Beirne answered that the credit rating agencies have deferred this question for future determination and will not make a decision this year.

Regent Garamendi suggested that this would have an effect on the University's credit rating. Ms. Boyette responded that the credit rating agencies will examine what actions the University takes to manage costs. There will be further discussions with the Regents on this matter. Even if benefits are maintained at the same level, there are possible measures to control costs.

Committee Chair Gould noted that discussion of this item will continue at the May meeting.

6. **AMENDMENT TO AUTHORIZATION FOR APPROVAL OF APPROPRIATIONS FROM LOS ALAMOS NATIONAL SECURITY, LLC FEE INCOME TO BE EXPENDED IN FY 2007-2008**

The President recommended that the appropriations from Los Alamos National Security, LLC fee income to be expended in FY 2007-2008, which were approved by the Regents in September 2007, be amended as follows (**additions shown by underscoring, deletions shown by strikeout):**

A. The President be authorized to expend, for the following purposes and in the following amounts, from the University's net share of Los Alamos National Security (LANS), LLC income earned from contract inception through September 30, 2007:

(1) Supplemental compensation and other payments previously approved by the Regents for certain LANS LLC employees, incurred through September 30, 2007 – $ 1.2 million.

(2) An appropriation to the Office of the President budget for federally unreimbursed costs of University oversight of its interest in LANS LLC and Lawrence Livermore National Laboratory (LLNS) LLC, paid or accrued through June 30, 2008, including but not limited to an allocable share of the costs of the Regents, the Secretary and Chief of Staff to the Regents, Human Resources, Finance, Strategic Communications, Governmental Affairs, the General Counsel, the University appointed Governors on the LLCs, and the Vice President for Laboratory Management – $2.6 million.

(3) An appropriation to a new LLC post-contract contingency fund – $700,000.

B. The balance of fee income to be appropriated to scientific research in the following priority order:

(1) California Institutes for Science and Innovation – $2.5 million

(2) UC Campus-Los Alamos Research and Education Initiatives – $3.050 million

(3) Los Alamos-New Mexico Universities Research Initiatives – $1.5 million

(4) Science and Technology Policy Initiatives – $1.0 million

(5) UC System-Wide Institute for Geophysics and Planetary Physics – $500,000

(6) UC Institute on Global Conflict and Cooperation – $500,000

(7) Collaborative Research Program – $1.0 million

(8) UC Professorship – $1.0 million

(9) UC National Laboratory Doctoral Student Fellowship Program – $1.0 million

(10) National Science Foundation Centers – $203,000

(11) UC Berkeley for Asia-Pacific Forum – $25,000

(12) Edward Teller Centennial Symposium – $15,000

(13) ~~(10)~~ Net fee income received in excess of the above appropriation would be used to supplement funding for S&T Policy Initiatives, Collaborative Research Program and the UC National Laboratory Doctoral Student Fellowship Program.

C. The intent of the University is to maximize the use of fee income for science while maintaining appropriate oversight, and the Regents will review such allocation.

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Executive Vice President Lapp explained that this item seeks to amend a previous item approved in September 2007 regarding expenditures approved for the Los Alamos National Security (LANS), LLC fee. The University would like to add three more initiatives: the National Science Foundation Centers, the UCB Asia-Pacific Forum, and the Edward Teller Centennial Symposium. In response to

Committee Chair Gould's questions, Ms. Lapp confirmed that allocation amounts are consistent with values set on utilization of fees by the Regents.

Regent Hopkinson requested clarification about the UC Professorship, funded at $1 million. Associate Vice President John Birely explained that the UC Professorship, approved last September, would be jointly funded by a UC campus and one of the laboratories, similar to current practice at the Los Alamos Neutron Science Center. It would provide partial funding for the professor's salary and research, and for graduate student researchers. In response to Regent Hopkinson's question, Mr. Birely explained that the UC Professorship might provide for one or two professors, depending on the magnitude of the research carried out.

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

5. **REPORT ON NEW LITIGATION**

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

General Counsel Robinson referred to the written materials provided. He stated that there was nothing noteworthy on which additional comment was needed.

6. **DEPARTMENT OF ENERGY REQUEST TO INCREASE THE CONTRIBUTION RESERVE AMOUNT RELATED TO THE AGREEMENT REGARDING THE TRANSFER OF ASSETS AND LIABILITIES FROM THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN TO THE LAWRENCE LIVERMORE NATIONAL SECURITY, LLC DEFINED BENEFIT PENSION PLAN**

The President recommended that, in accordance with the request of the Department of Energy (DOE)/National Nuclear Security Administration (NNSA), the Associate Vice President, Human Resources and Benefits, be authorized to enter into an agreement to modify the Current Transfer Agreement to retain an additional amount up to $100 million in the Contribution Reserve Amount in the UC Retirement Plan (UCRP) provided the modification is substantially as described in the Background to this item; all assurances and representations made in the Current Transfer Agreement have been appropriately modified to reflect the larger Contribution Reserve Amount to be retained in UCRP and the reduced amount of assets to be transferred to the Lawrence Livermore National Security (LLNS) Plan; and the agreement has been properly executed.

The increase will be in addition to the $75 million Contribution Reserve Amount reflected in the Current Transfer Agreement, thus totaling up to $175 million.

The President also recommends that the Associate Vice President, Human Resources and Benefits be authorized to execute any regulatory filings associated with the transfer of assets and liabilities and to adopt and implement any amendments to UCRP that are necessary to carry out the provisions of the Modified Transfer Agreement.

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

Associate Vice President–Human Resources and Benefits Judy Boyette informed the Committee that the Department of Energy /National Nuclear Security Administration (NNSA) contacted her the previous week with an urgent request that the University agree to a modification of the transfer agreement regarding transfer of assets and liabilities from the UC Retirement Plan to the Lawrence Livermore National Security Defined Benefit Pension Plan. This transfer agreement was authorized by the Regents in January and executed in February. In the modification to the agreement, the UCRP would retain additional assets of up to $100 million, raising the total Contribution Reserve Amount to $175 million. These assets provide the DOE/NNSA with an identified funding source which they may apply against any future funding obligations to the segment that the University has retained in UCRP. Ms. Boyette explained that this is a one-time modification to the transfer agreement; all other aspects of the agreement approved by the Regents in January will remain in effect. The transfer of assets is expected to occur on or around April 1.

Committee Chair Gould observed that adding to the Contribution Reserve Amount protects the University's retirement system.

Regent Hopkinson asked why the University should voluntarily add $100 million to the reserve when it already has a signed agreement. Ms. Boyette stated that this action will be beneficial to the University. DOE is required to request that Congress appropriate funds for these contributions. If the funds are already in the UCRP, in the Contribution Reserve Amount, monies can be applied without waiting for the Congressional process.

Regent Hopkinson stated that she did not understand why it is not the obligation of the federal government to provide these funds, if they wish to increase the Contribution Reserve Amount. Ms. Boyette responded that these are DOE funds which would otherwise be transferred to another plan. Committee Chair Gould stated that the transfer is based on a reassessment of UC's obligation to UCRP participants. This obligation may be greater than previously estimated, and it is to the University's advantage to have these monies located in the Contribution Reserve Amount.

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

The meeting adjourned at 1:10 p.m.

Attest:

Secretary and Chief of Staff

ATTACHMENT 1

RESOLUTION STABILIZING STUDENT FEES

WHEREAS, California's system of public higher education is a vital part of our collective future; and

WHEREAS, California's students should not bear the financial burden of the state's past underinvestment in public higher education; and

WHEREAS, Undergraduate fees at the University of California have increased by 79% since 2001 while graduate student fees have increased by more than 84%, causing students to struggle to continue their education and forcing many to work longer hours or to go deeper into debt to finance their degrees; and

WHEREAS, The level of student debt carried by California students has increased by 60% over the last decade *(EdFund, Trends in Student Aid, 2006)*; and

WHEREAS, Low-income and underrepresented students tend to incur the heaviest debt burdens (*California Postsecondary Education Commission, Keeping College Affordable in California, 2006*); and

WHEREAS, Higher tuition rates have the potential to close the door of opportunity, especially for low-income and underrepresented students. Financial barriers deterred as many as 1.6 million U.S. students from attending a four-year university during the 1990s, and will likely prevent another 2.4 million students from earning their bachelor's degree this decade (*Advisory Committee on Student Financial Assistance draft report, Mortgaging Our Future: How Financial Barriers to College Undercut America's Global Competitiveness, 2006*); and

WHEREAS, In addition to the personal benefits that students gain from educational attainment, each state dollar invested in public higher education is returned to the state three times over in the form of higher tax revenues and decreased demand for social services; (*Survey Research Center, UC Berkeley, 2005)*; and

WHEREAS, California's need for a highly educated workforce will become ever more acute in the coming years, as newly created jobs increasingly demand training in health, technology, and professional services;

NOW, THEREFORE, BE IT RESOLVED THAT:

1. The University of California will stabilize student fees by capping fees for the 2008-09 school year at 2007-08 levels, and by limiting student fee increases for school years beyond 2008-09 to the rate of inflation as measured by the California Consumer Price index. These limitations do not apply to professional school fees approved at the September 2007 Regents meeting; and

2. The Regents and University representatives will keep the Legislature and the Governor apprised of the state budget resources required to adequately fund the University; and

3. Where appropriate, the University will seek savings from administrative efficiencies to reduce the cost to the state of adequately funding the University; and

4. The above limitations and requirements constitute the current policy of the University, but are subject to change at any time if, in the judgment of the Board of Regents, economic circumstances and the best interests of the University require. This statement of current policy is not a contract or an offer of a contract.