The Regents of the University of California

COMMITTEE ON FINANCE
COMMITTEE ON COMPENSATION
November 18, 2010

The Committees on Finance and Compensation met jointly on the above date at UCSF–Mission Bay Community Center, San Francisco.

Members present: Representing the Committee on Finance: Regents Blum, Cheng, DeFreece, Island, Lozano, Makarechian, Schilling, and Varner; Ex officio members Gould and Yudof; Advisory members Mireles, Pelliccioni, and Simmons; Staff Advisors Herbert and Martinez
Representing the Committee on Compensation: Regents Hime, Johnson, Kieffer, Lozano, and Varner; Ex officio members Gould and Yudof; Advisory members Anderson and Pelliccioni

In attendance: Regents De La Peña, Lansing, Maldonado, Marcus, Pattiz, and Zettel, Regent-designate Hallett, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Provost Pitts, Executive Vice Presidents Brostrom and Taylor, Vice Presidents Beckwith, Duckett, Lenz, and Sakaki, Chancellors Block, Blumenthal, Desmond-Hellmann, Drake, Katehi, White, and Yang, and Recording Secretary McCarthy

The meeting convened at 10:50 a.m. with Committee on Compensation Chair Varner presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of September 16, 2010 were approved.

2. **UNIVERSITY OF CALIFORNIA POST-EMPLOYMENT BENEFITS RECOMMENDATIONS**

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

[Regents were provided with a packet of correspondence received regarding this item, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Committee on Compensation Chair Varner praised the efforts of those who had worked on the issue of post-employment benefits.

Provost Pitts recalled that a presentation on the University of California Retirement Plan (UCRP) and the retiree health program was made to the Board the prior September.

There would be a meeting in December to take action on the recommendations presented on this date.

Dr. Pitts stated that the University has a history of excellence, which rested upon the talent and dedication of its faculty and staff. The benefits provided by the University are an important factor in recruitment and retention. Dr. Pitts emphasized the necessity of continuing to provide benefits for UC’s future faculty and staff. In a time of rising costs and diminishing State support, UC must consider the sustainability of its post-employment benefits. Dr. Pitts noted that President Yudof’s recommendations were informed by the work of the Post-Employment Benefits Task Force (Task Force), following an intensive period of consultation with the entire UC community. He reported that the President’s recommendations have the support of the Chair and Vice Chair of the Academic Senate, UC’s Staff Advisors to the Regents, and the leadership of the Council of UC Staff Assemblies.

Executive Vice President Brostrom summarized the President’s recommendations, which, if implemented, would offer future faculty and staff a new, modified pension program, change the eligibility rules for retiree health care, gradually reduce the amount the University pays for retiree health premiums, and address the unfunded pension liability through a series of financial actions, including increasing the University’s contribution to UCRP.

Mr. Brostrom emphasized that the recommendations included no changes to the pension benefit formula for current faculty, staff, or retirees. Earned pension benefits were protected by law and could not be reduced or revoked. Current employees would be affected only by recommended increases to pension contributions and changes to retiree health provisions, if implemented. He recalled that at the September meeting, the Regents had approved increasing both University and employee contribution levels to UCRP for fiscal years 2011 and 2012.

Mr. Brostrom reported that the President was recommending a new tier, a modified pension program for future faculty and staff who join the University on or after July 1, 2013. The new tier would be a defined benefit (DB) plan, as was the current plan. He noted that the clinical enterprises have asked for an evaluation of a defined contribution (DC) plan for some of their employees. The new pension tier would raise the minimum retirement age from 50 to 55 years, and raise the age at which the maximum age factor for pension benefits is reached from 60 to 65 years. Mr. Brostrom explained that the new tier would provide for a maximum age factor of 2.5 percent at age 65, while the current plan provides 2.5 percent at age 60. The new tier would encourage retirement at later ages and reduce the normal cost for the University by about 20 percent, from 17.6 percent to 15.1 percent. The new tier would be self-sustaining, since contributions from the University and employees would cover the normal cost. The University would contribute 8.1 percent of covered payroll, with faculty and staff contributing seven percent.

Turning to the President's recommendations regarding the retiree health program, Mr. Brostrom noted that these recommendations would affect current faculty, staff, and retirees. The University would continue to provide a retiree health program, but it is the University's position that these rights are not vested; eligibility criteria and cost could be changed. The President recommended that UC's contribution to the retiree health program be reduced gradually to 70 percent of the total premium; currently UC contributes an average of 89 percent of health care premiums. The President also recommended a change in eligibility for retiree health benefits. As of July 2013, the new eligibility rules would apply to current faculty and staff. Some current faculty and staff would be "grandfathered" under the current rules, if, as of July 1, 2013, an employee's age plus service was at least 50 and the employee had at least five years of service credit. Mr. Brostrom estimated that approximately 45 percent of current employees would be grandfathered.

For employees hired in July 2013 and later, Mr. Brostrom reported that the President recommended graduated eligibility for UC contribution to retiree health premiums, based on an employee's age and years of service at retirement. These future employees would gain access to the retiree health program at age 55 with at least ten years of service credit, but with no University contribution. The University's maximum contribution would be 100 percent of premium for employees retiring at age 65 with at least 20 years of service. In both the new pension tier and the revised retiree health program, maximum benefits would not be obtained until age 65. This change would substantially reduce University costs for employees who retire before being eligible for Medicare.

Mr. Brostrom noted that, since the retiree health program was on a pay-as-you-go basis, the recommended changes would have an immediate impact on the program's unfunded liability. If implemented, the recommended changes would decrease the unfunded liability by approximately $2 billion. He cautioned that the effect of the federal health care reform program on the University as both a consumer and provider of health care was unknown at the current time. Mr. Brostrom also pointed out that the recommendations must be negotiated with 28 bargaining units, but anticipated that negotiations would be completed by the implementation date of July 2013. He stated that the University would meet all of its obligations under the Higher Education Employer-Employee Relations Act (HEERA).

Chief Financial Officer Taylor confirmed that the cost of UC's retirement programs had risen significantly over recent years and that it had become necessary to find a way to make the programs sustainable. If State support continued to fall short, funding post-employment benefits would compete directly with funding the University's academic programs. Current Regents' policy called for 100 percent funding of UCRP; the Task Force was charged with developing recommendations to meet that goal. UCRP's current overall funded ratio on an actuarial value of assets basis decreased from 95 percent as of July 1, 2009, to 87 percent as of July 1, 2010. On a market value of assets basis, UCRP's funded ratio was 73 percent. Mr. Taylor stated that pension liability had grown over time as a result of several factors: the University's decision 20 years ago to rely on surplus funds rather than require contributions, investment losses during the economic downturn of 2008-09, longer retiree life expectancy, and lack of pension funding from the State. During the 20-year "contribution holiday," 80 percent of active staff and faculty made no contribution to their DB program until the restart of contributions in April 2010. Mr. Taylor noted that UC would continue to work with the State to secure an agreement to have the State resume paying its share of contributions, as it does for California State University and the community colleges.

Mr. Taylor advised that the current recommendations would immediately improve UCRP's funding status and would lead to its full funding in 30 years. Mr. Taylor emphasized that the Task Force had examined every possible scenario under the current system and determined that the best possible outcome would leave an employer cost of 22 percent of payroll in 2023, even if the University contributed an additional $6.4 billion between the current time and 2019. Given that analysis, the Task Force looked for ways to address UCRP's unfunded liability. He noted that the essential first step had been taken of increasing employer and employee contributions for each of the next two years, rising to ten percent and five percent respectively. However, these increases would still leave contributions below the current normal cost of 17.6 percent, so the unfunded liability would continue to grow.

Mr. Taylor displayed a graph illustrating projected employer contributions to UCRP when current recommendations of a new pension tier, increased contributions to UCRP from existing employees, borrowing from the Short Term Investment Pool (STIP), and increased employer contributions to UCRP by an additional two percent per year beginning in 2013 until they reach 20 percent of annual payroll, were incorporated. He cautioned that the 20 percent cap on employer contributions was an artificial cap for long-range budgetary planning. Mr. Taylor advised that a 20 percent employer contribution would have an enormous impact on operating budgets of the campuses for the ensuing 20 years. He also cautioned that this analysis assumed a one percent increase in number of employees; should employee hiring remain flat, the projected rate of employer contribution could remain at the same level for an additional decade.

Mr. Taylor reported that the Task Force would continue to explore ways to fund UC's required contribution, including restructuring UC's debt and borrowing at lower interest rates from STIP. Mr. Taylor noted that it was the opinion of the Task Force that this method would be preferable to the previously explored method of issuing pension obligation bonds. To sum up the financial impact of UC's pension commitment, Mr. Taylor reported that, for every $100 of payroll, UC currently spent $28 on benefit costs, including an average of $13 for health and welfare programs, $8 for Social Security, Medicare, and other programs, and $7 for post-employment benefits. By 2017, the cost to UC would increase to $40 per $100 of payroll, with post-employment benefits alone costing over $18.

UCLA Chancellor Block summarized the real impact on campuses of required employer post-employment benefit contributions, which are expected to increase over the subsequent several years to approximately 20 percent of covered payroll. At that rate, he reported that UCLA's annual cost of benefits for State-funded salaries was estimated to be \$86 million; the cost for the medical center, auxiliaries, research, and other non-State payroll entities was estimated to be \$301 million annually, bringing the total cost for UCLA to \$390 million per year. Chancellor Block put these figures into context: \$86 million represented 20 percent of UCLA's current State funding, or the current salaries of 700 full professors, or a 33 percent increase in tuition. He commented that as the number of employees hired under the new tier grew, employer contributions would gradually decline, although the cost would still be substantial. He emphasized that under the current proposal it would take 30 years for the unfunded liability to be erased; Chancellor Block characterized the financial environment for the campuses during this transitional time as "exceptionally challenging." He elaborated that UCLA's State-supported budget component would be severely constrained by the increased retirement contributions, which would necessarily result in reduced faculty recruitment, staff support, and institutionally funded research and outreach. In grant-supported areas, UCLA would face personnel reductions as sponsored research-funded personnel costs rose by 20 percent, resulting in fewer technicians and staff scientists, as well as less support for graduate students and other individuals associated with the University's research mission. Additionally, medical centers' operating margins would decrease substantially or be eliminated, as resources were directed to retirement benefits. Chancellor Block expressed the opinion that it could be possible for UCLA and other campuses to mitigate some of the potential damage to the campuses of these increased costs by enhancing other revenue sources. However, he characterized the increased cost to his campus as "breathtaking" and noted that it would result in a very large change in operating revenues for many years.

Staff Advisor Martinez reviewed some aspects of the consultation process regarding post-employment benefits undertaken by the Office of the President. She noted that the Office of the President and the Department of Human Resources quickly responded to staff concerns that the proposed changes were difficult to understand. New materials were developed to clarify the proposed changes and their impact upon individual staff members; these materials were translated into several languages and widely distributed. At the President's request, the Staff Advisors met with staff groups including human resource officers on each campus, represented staff members, academic business officers, and clinical care nurses. The Staff Advisors received much feedback, which was communicated to senior leadership and to the President. Ms. Martinez reported that, overall, staff feedback had been consistent: staff understood that the University faced a difficult financial challenge and that the State had not supported UCRP to the program's detriment. She reported broad staff support for a DB plan and an understanding that funding post-employment benefits was a shared responsibility. She noted that staff remained concerned about the proposal to increase the minimum retirement age from 50 to 55 years, particularly for staff who perform physically demanding jobs.

Ms. Martinez indicated that the proposals before the Regents were the result of a consultative process and generally had broad staff support throughout the UC system. She noted staff concern that changes to UC's post-employment benefits might affect UC's ability to recruit and retain a vibrant future workforce. She also pointed out that the proposed changes would be a real reduction in benefits for future UC employees and that the increased contribution rates to UCRP would be a reduction in overall compensation for current employees, especially in light of the lack of recent salary increases. Ms. Martinez expressed the opinion that this broad consultative method was effective in facilitating discussion across the entire UC community and should be used again for any other issues with such extensive impact. She thanked President Yudof for listening to UC employees and incorporating their feedback into the current recommendations.

In response to a question from Committee Chair Varner, Mr. Brostrom confirmed that a 7.5 percent discount rate was used for actuarial assumptions; health benefits were discounted at 5.5 percent. Mr. Brostrom anticipated sufficient time to negotiate the proposed changes with all represented groups, so that changes for all employees could be implemented at the same time.

Faculty Representative Simmons emphasized that the proposed new tier would result in a fairly significant cut in overall compensation for faculty and staff. He affirmed that the consultation process used was an example of collaborative governance at its best. He thanked President Yudof and the vice presidents for their cooperation with faculty and staff. He noted that current costs were driven by the unfunded liability that had accumulated over time. He predicted a formal endorsement of President Yudof's recommendations.

In response to a question from Chairman Gould, Mr. Brostrom reported that medical centers have expressed interest in a DC or hybrid plan for some of their clinical faculty who tend to stay at the University for shorter periods than required to vest. This possibility would be examined in coming months. Turning to represented groups, Mr. Brostrom reported that there was concern about extending the retirement age for maximum benefits from 60 to 65, particularly for groups that perform manual labor. Proposals for variations in plan details could be reviewed, but Mr. Brostrom emphasized that the University would pay the same normal cost for every group.

Regent Blum asked about the legal authority to borrow from STIP to fund contributions to UCRP. Mr. Taylor responded that he would work with Chief Investment Officer Berggren and her staff on this matter. He predicted that any Regental policy issues would come before the Board in March. He noted that the preliminary view was that there were no legal impediments, but only policy issues.

Regent Makarechian asked why the Task Force recommended a DB plan rather than a DC plan for future hires. Mr. Brostrom noted that many comparator universities had DC plans. The Task Force received very strong feedback from faculty and staff that they valued a DB plan. In addition, a DB plan offered benefits to the University in recruitment and retention of faculty and staff. Mr. Brostrom explained that much of the value of a DB plan rose toward the end of an employee's career, thus providing a strong incentive for key employees to stay at UC. Also, a DB plan would encourage employees to retire at age 65, since the age factor would not increase beyond that age.

Regent Makarechian asked if the Task Force had considered the risk to the University of a DB plan, given that the University would be committed to payments regardless of market conditions. Mr. Brostrom agreed that, under a DB plan, the University was committing to making a benefit payment, whereas under a DC plan, market risk is borne by the plan participant. However, Mr. Brostrom noted that a DB plan had served the University well for 50 years. He emphasized that the major reason for the plan's current underfunding was the lack of contributions for the prior 20 years. Had contributions been made during that time, the plan would still be moderately overfunded.

The meeting adjourned at 11:30 a.m.

Attest:

Secretary and Chief of Staff