The Regents of the University of California

**COMMITTEE ON FINANCE**
**COMMITTEE ON COMPENSATION**
December 13, 2010

The Committees on Finance and Compensation met by teleconference on the above date at the following locations: UCSF–Mission Bay Community Center, San Francisco; James E. West Alumni Center, Los Angeles Campus; 2220 Lodgepole Circle, Modesto

Members present: Representing the Committee on Finance: Regents Cheng, DeFreece, Island, Makarechian, Schilling, Varner, and Wachter; 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, Ruiz, Varner, and Wachter; Ex officio members Gould and Yudof; Advisory members Anderson and Pelliccioni

In attendance: Regents De La Peña, Pattiz, Reiss, 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 Duckett, Lenz, and Sakaki, Chancellors Birgeneau, Block, Blumenthal, Drake, Fox, Kang, Katehi, and White, and Recording Secretary McCarthy

The meeting convened at 3:45 p.m. with Committee on Compensation Chair Varner presiding.

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

The President recommended that the Committee on Finance recommend to the Regents that:

1. The President be delegated authority and discretion to fully fund the Annual Required Contribution (ARC) for the University of California Retirement Plan (UCRP) in the following two phases. From fiscal year 2011 through fiscal year 2018, the University would contribute to UCRP, to the extent practical, the “modified” ARC, which would include the normal cost plus interest only on the Unfunded Actuarial Accrued Liability (UAAL). Beyond fiscal year 2018, the University would contribute the full ARC payment, which would include the normal cost on the pension, interest on the UAAL, and an amount that represents the annual principal contribution of the 30-year amortization of the UAAL. The President may utilize borrowing from the Short Term Investment Pool (STIP), restructuring of University debt, and other internal or external sources to fund the gap between scheduled pension contributions from the University and employees, and the required funding amount, as described above.

The President recommended that the Committee on Compensation recommend to the Regents that:

2. UCRP be amended to provide a new tier of pension benefits applicable to employees hired on or after July 1, 2013, which would increase the early retirement age from 50 to 55, but retain many of the current features of UCRP in substantially the form as shown in Attachment 1. The new tier would not offer lump sum cashouts, inactive member Cost of Living Adjustments (COLAs), or subsidized survivor annuities for spouses and domestic partners. The proposed changes are shown in Attachment 2. For represented employees, all changes would be subject to collective bargaining.

3. The University's aggregate annual contribution to the Retiree Health Program be lowered, over time, to a floor of 70 percent.

4. The University implement a new eligibility formula for the Retiree Health Program for all employees hired on or after July 1, 2013, and non-grandfathered members described in Item 5 below, that is based on the graduated formula set forth in Attachment 3, using both a member's age and years of UCRP service credit upon retirement, subject to collective bargaining for represented members.

5. The current eligibility provisions for the Retiree Health Program be maintained for active UCRP members whose age[1] plus UCRP service credit are greater than or equal to 50 and who have at least five years of UCRP service credit as of June 30, 2013 ("grandfathered members"). Employees who are active UCRP members on June 30, 2013, but do not meet the grandfathered member criteria ("non-grandfathered members") shall be subject to the new eligibility provisions described in Item 4 above. In addition, if a non-grandfathered member retires between ages 50 and 55 with at least ten years of UCRP service credit, he or she would be eligible for "access only" coverage (no employer subsidy). A non-grandfathered employee could still attain the 100 percent UC contribution level at age 65 with 20 or more years of UCRP service credit.

6. The University implement an ad hoc COLA for UC-PERS Plus 5 Plan[2] annuitants to restore the purchasing power of their benefit to a level comparable to the benefit of their UCRP counterparts. In addition, the University implement an annual COLA provision generally based on the UCRP annual COLA formula, as long as the funded status of the UC-PERS Plus 5 Plan exceeds 100 percent.

7. The President be authorized to implement these approved recommendations regarding changes to UCRP, the UC-PERS Plus 5 Plan and the Retiree Health Program and supporting technical details.

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[1] Measured in full-year increments.

[2] Retired members of the University of California Voluntary Early Retirement Incentive Program (the UC-PERS Plus 5 Plan) were members of PERS while employed at UC. They elected concurrent retirement under PERS and the UC-PERS Plus 5 Plan effective October 1, 1991. These members receive lifetime supplemental retirement income and survivor benefits from the UC-PERS Plus 5 Plan.

[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 noted that the current item followed the discussions and briefings of the November meeting. The proposed changes to the UC Retirement Plan (UCRP) and retiree health program would meet the challenge of providing sufficiently generous benefits to recruit and retain high-quality faculty and staff, while addressing the fiscal sustainability of the programs at a time of rising costs and diminishing State support. The recommendations are the result of a lengthy review process by the President's Post-Employment Benefits Task Force (Task Force), including broad consultation with the entire University community, and have the support of the Academic Senate, the Staff Advisors to the Regents, and the leadership of the Council of UC Staff Assemblies (CUCSA). Committee Chair Varner noted that the Task Force received and reviewed many comments and suggestions, some of which are included in the final recommendations.

Provost Pitts recalled that the President's recommendations for changes to UCRP and the retiree health program were presented to the Regents for discussion in November. Dr. Pitts noted that the University has achieved excellence because of the talent and dedication of its faculty and staff, and benefits that the University provides are crucial in faculty and staff recruitment and retention. He noted that the University must address the fiscal sustainability of post-employment benefit programs at this time of rising costs and diminishing State support. Dr. Pitts stated that this item requests approval for recommendations based on the work of the Task Force; these recommendations are the same as those presented at the November meeting.

Executive Vice President Brostrom stated that the proposed UCRP new tier would have no effect on benefits of current retirees or employees; there is no change to the pension benefit formula for current employees. Earned pension benefits are protected by law and cannot be reduced or revoked. As approved by the Regents in September, both current employees and the University would face increased contributions to address the unfunded liability.

Mr. Brostrom stated that the age factor for maximum retirement benefits under the proposed new tier would increase from age 60 to 65; minimum retirement age would increase from 50 to 55. This change would reduce the plan's normal cost and the University's contribution by approximately 20 percent over the long term.

Mr. Brostrom addressed some criticisms of the proposed changes. In response to concerns that the new tier would be too generous, Mr. Brostrom pointed out that the plan's normal cost and the University's contribution would be reduced by 20 percent. In addition, Mr. Brostrom stated that the changes to UCRP must be viewed together with proposed changes to the retiree health program. By moving the age to retire with maximum benefits from 60 to 65, the plan would be more closely aligned with Medicare and would achieve significant savings in retiree health premiums. Regarding the suggestion that faculty be offered different retirement benefits from staff, Mr. Brostrom stated that long-serving staff are an extremely valuable asset to the

University and that UC supports its long tradition of staff having the same retirement benefits as faculty.

Mr. Brostrom noted that the Task Force considered a defined contribution plan, and would further examine this possibility for some of the clinical enterprises. Suggestions of a plan integrated with Social Security were rejected in favor of keeping the new tier more closely aligned with the current plan. Mr. Brostrom stated that concerns expressed regarding increasing the age for maximum retirement benefits to 65 for those workers who perform physically demanding jobs would be discussed during the collective bargaining process.

President Yudof stated that less expensive retirement plans were considered by the Task Force. He stated that he endorses the current proposal because he thinks it is the fairest to both faculty and staff, and has the broadest support. He recalled that some spokespeople for represented groups had expressed the opinion that the current proposal was the best proposal, while expressing concerns about particular elements. President Yudof expressed his opinion that proposing a less expensive plan would have hurt morale at the University. He noted that the current proposal has widespread coalition support as the least onerous of all possibilities.

President Yudof noted that raising the employee contribution more rapidly would have dealt with the unfunded liability more quickly. He stated that the Task Force felt that, in the current era of static raises, a gradual phase-in of increased employee contributions would be fairer to faculty and staff. He noted that borrowing from the Short-Term Investment Pool (STIP) would enable the University to approach funding the normal cost gradually. In closing, President Yudof summarized his view that this proposal is more than a simple fiscal proposal; it also represents an effort to achieve consensus around issues that are financially very difficult for employees.

Mr. Brostrom turned to proposed changes to the retiree health program. The University would continue to provide retiree health benefits, but would gradually reduce the amount of the employer contribution to 70 percent of the total premium. He noted that the University paid an average of 87 percent of premiums for retirees in the current year. The proposal would also change eligibility for retiree health benefits. Approximately 45 percent of current employees would be grandfathered under current rules, if, as of July 1, 2013, their age plus years of service are equal to or greater than 50 and they have at least five years of service credit.

UC Director of Pension and Retirement Programs Gary Schlimgen addressed the suggestion that employer contributions for retiree health premiums be banded according to income levels or years of service. He noted that Medicare retirees are currently rated separately from pre-Medicare retirees. The experience of the pre-Medicare retirees is blended with all active employees, which makes the premiums of the pre-Medicare retirees dramatically lower than if that group were rated by itself. He noted that this represents a subsidy for early retirees, those who retire before age 65. The cost of that implicit subsidy in the $14.9 billion retiree health liability is $2.2 billion, and $55 million for the upcoming fiscal year.

Mr. Schlimgen reported that the Task Force examined various possible bandings of time of service and salary combinations. He noted that current retirees have widely varying ranges of prior salary and years of service, and that surveyed retirees indicated that they were unwilling to share other personal financial information that would be needed in order to do a fair banding. After careful study, the Task Force concluded that it would not be feasible to do a historical banding, since it could have access to only partial information regarding a UC retiree's income. Mr. Schlimgen stated that each union would have the opportunity to address the proposed changes to the retiree health program during collective bargaining.

Mr. Brostrom reiterated that the proposed changes would be subject to collective bargaining. He stated that the University would take appropriate action concerning proposed changes that may trigger notice, consultation, and meet and confer obligations under the Higher Education Employer-Employee Relations Act (HEERA), if any such action is required. Mr. Brostrom noted that the University would consider options presented during collective bargaining, but that the University's contribution would not exceed 8.1 percent, the amount of the normal cost the University is providing under the new plan.

Chief Financial Officer Taylor presented information relating to funding the proposed changes. He noted that the Task Force was charged with meeting the Regent's policy of 100 percent long-term funding for UCRP. He reported that the funding level of UCRP, on an actuarial value of assets basis, had decreased from 95 percent on July 1, 2009, to 87 percent as of July 1, 2010. On a market value of assets basis, the funded ratio was 73 percent as of July 1, 2010. The unfunded liability had grown over time because no contributions were made for the past 20 years. Because of this "contribution holiday," over 80 percent of UC faculty and staff made no contribution to UCRP until contributions were restarted in April 2010.

Mr. Taylor displayed a graph indicating a $6.4 billion gap between funding policy contributions and the actual plan contributions including projected contribution increases. He pointed out that the UC contribution level could exceed 35 percent of covered payroll if sufficient changes are not made to contribution levels. Previously approved employer and employee contribution level increases for the subsequent two years, rising to an employer contribution of ten percent and employee contribution of five percent, are still below the normal cost of 17.6 percent.

Mr. Taylor displayed another graph incorporating a variety of Task Force recommendations, including creating a new pension tier, increasing contributions to UCRP, and borrowing from the STIP. This model incorporates an annual two percent increase in employer contributions to UCRP beginning in 2013, to a level of 20 percent of covered payroll, an artificial cap for budgetary planning. Mr. Taylor recalled Chancellor Block's presentation at the prior meeting on the effect on UCLA's operating budget of these employer contributions, which would be the equivalent of 700 State-funded full professors.

Mr. Taylor stated that the Task Force explored various methods of funding a portion of UC's employer contribution, including restructuring UC's debt and borrowing at low interest rates from the STIP. The Task Force concluded that these options were preferable to issuing pension obligation bonds to external markets at a much higher cost. The interest rate paid internally to UC's various STIP account holders would be substantially less and would reduce the annual liability on UC's balance sheet for the short term. In the long term, the Task Force estimated that the employer contribution could be reduced to 18.5 percent, an annual reduction of approximately $120 million. At the current time, the Task Force believes UCRP could comfortably borrow approximately $2 billion from the STIP and still prudently maintain sufficient liquidity to fund daily operations of the University, meet all bond covenants, have contingent funding available, and provide a cushion for any possible “black swan” events, those lying outside of the standard deviation, similar to the market downturn of 2008.

Faculty Representative Simmons stated that expert faculty had been involved in developing these recommendations, which had received the endorsement of the Academic Council. Mr. Simmons thanked President Yudof for listening to both faculty and staff. Mr. Simmons expressed his opinion that, while the increase in employer contributions would be difficult, the proposals would be sustainable and good for the long-term health of the University. He pointed out that increased employee contributions to UCRP and reduced employer contributions to retiree health premiums represent a pay cut for faculty and staff. The new tier plan would be a significant reduction in future compensation for the next generation of UC faculty and staff. These reductions occur at a time when faculty and staff compensation is generally less than competitive. Mr. Simmons concluded that this proposal represents a sacrifice for all parts of the University.

Regent Makarechian addressed concerns expressed by speakers during the public comment period who noted that the proposed later age for retirement with full benefits would be especially difficult for workers with physically demanding jobs. He asked if any other retirement plans have different retirement ages for such workers. Vice President Duckett responded that the University has retirement plans that account for the physically demanding nature of the work of police officers and firefighters and provide the ability to retire earlier. He predicted that the University would receive similar proposals during collective bargaining.

Regent Reiss asked for the annual dollar amount of the 2.4 percent interest that the University would pay to borrow funds from the STIP and of the 8.1 percent that UC would pay in employer contribution to UCRP. Mr. Taylor responded that the interest cost of the STIP borrowing would start at $25 million per year and would increase to approximately $150 million per year at the end of the 30-year period. He explained that these interest expenses have been built into the amount of the employer contribution, which would plateau at approximately 18.5 percent, including the interest cost. He noted that borrowing from the STIP would decrease the employer contribution from 20 percent of payroll to 18.5 percent, an annual savings of $120 million.

Mr. Brostrom stated that UC’s current covered payroll is about $8 billion, one-third of which comes from general funds, i.e., the State contribution, tuition and fees, and a small amount of other discretionary funds. He continued that 18.5 percent of current covered payroll would be approximately $1.5 billion, of which one-half billion would be from general funds, and the remainder from clinical enterprises, federal contracts and grants, and auxiliary enterprises.

Regent Reiss asked how much in aggregate monies per year the Regents would be approving in the current item. Mr. Brostrom responded that the 8.1 percent employer contribution in the proposed new tier would be $640 million in current dollars annually, with the State portion being $213 million. When the unfunded liability is included, the employer contribution grows to 18.5 percent for 15 to 18 years, depending on investment performance and the growth of the employee population.

Regent De La Peña asked if current employees' contribution to UCRP would also increase to seven percent. Mr. Taylor responded that employees hired on or after July 1, 2013, would contribute seven percent to UCRP; for current employees, the Regents have approved 3.5 percent beginning July 1, 2011, and five percent beginning July 1, 2012. Mr. Taylor explained that the Regents have taken no action on possible future increases for current employees beyond this five percent level. In response to a further question from Regent De La Peña, Mr. Taylor responded that the Task Force's financial modeling assumes that, beginning in July 2013, current employees would pay 6.5 percent, and eight percent in July 2014 and beyond, although the Board has not approved these rates. The contribution level for new employees hired after July 1 2013, was seven percent in the financial modeling. Regent De La Peña asked why the modeling of the contribution level of future employees would not rise to eight percent. Mr. Brostrom responded that future employees would have a 20 percent less generous retirement package than current employees. He stated that the modeling included the assumption that current employees should pay more, since they would receive higher benefits. Mr. Brostrom indicated that the University would pay a higher percentage of close to ten percent on normal cost for existing employees. Regent De La Peña also asked what level of return on investment the proposal assumes. Mr. Taylor responded that the assumed rate of return was unchanged at 7.5 percent.

In response to Regent Reiss' earlier question, Faculty Representative Anderson clarified that details of the proposal to borrow from the STIP, including debt service payments, would be presented to the Regents at a future meeting. He noted that the effect of borrowing from the STIP would be to lower the amount of money that must come from the operating budget, thus significantly easing the burden on the University's operating budget.

Regent Makarechian asked about borrowing from the STIP. Mr. Taylor explained that the STIP is the University's collection of reserves and operating funds. He stated that under the proposal the Regents would borrow from the STIP and make a permanent transfer to UCRP. The funding sources that pay the contribution toward UC's pension liability, such as various departments, hospitals, auxiliaries, or federal grants, would be assessed a debt service to repay STIP holders for the Regent's loan from the STIP. Mr. Taylor pointed out that there are 76,000 account holders in the STIP and that the loan to the Regents would be another STIP investment. In response to a question from Regent Makarechian, Mr. Taylor assured that there would be sufficient funds remaining in the STIP to meet the University's liquidity needs. Regent Makarechian asked if the proposed borrowing from the STIP would reduce the funds available to deal with emergencies. Mr. Taylor responded that, with its strong $9.1 billion balance as of June 30th, the STIP could afford to lend $2 billion and still have ample reserves. Mr. Taylor agreed with Regent Makarechian's assessment that money would be transferred from the STIP, where it would be earning very little, to UCRP where it would earn 7.5 percent.

Regent Zettel asked about potential risks of the proposal. Mr. Brostrom responded that the proposal's main underlying assumptions were consistent and steady increases in contributions, and investment returns of 7.5 percent. He expressed the opinion that this is a conservative estimate of return, noting that the California Public Employees' Retirement System (CalPERS) had used 8.5 percent and currently projects a return of 7.75 percent. The proposal also anticipates a growth in population: as the number of employees expands, the unfunded liability would be amortized over a greater base and the time to pay off the unfunded liability could be reduced. Should the employee base not expand, the time could be extended.

Mr. Schlimgen added that the Regents' actuary, the Segal Company, would perform a complete experience study in the subsequent year to compare actual performance with projected assumptions.

Regent Zettel also asked whether the unfunded liability would be eliminated or if it would just be kept from growing larger by this proposal for interim funding. Mr. Taylor responded that the Task Force anticipates that the interim funding strategy would enable the University to stabilize the current system while funding contributions are increased. In just a few years, the increased contributions would begin to reduce the unfunded liability. After 25 to 30 years, the plan would return to 100 percent funding.

Faculty Representative Anderson commented on the assumed rate of return of UCRP. He stated that the real rate of return is the difference between inflation and the assumed rate of return. Given the currently assumed inflation rate of 3.5 percent, the real rate of return would be four percent, which Mr. Anderson believed to be quite reasonable. He noted that the actuary's experience study may lower both the inflation rate and the assumed rate of return, since inflation could be lower than 3.5 percent.

Regent Kieffer noted that, should the real rate of return be lower than anticipated, the shortfall would be amortized over 30 years.

Regent Reiss acknowledged the difficulties of addressing the underfunded pension. She expressed empathy for future UC employees, noting that faculty and staff are the heart of the University. She noted that, given the current economic landscape, future public sector employees will no longer be able to anticipate receiving a defined benefit plan to which the employer makes a greater contribution than the employees. She stated that she considers the current proposal for future employees to be fair, since it is transparent.

Regent Zettel stated that she could not support the current recommendation, because she believed the proposed new tier to be too great a fiscal commitment for the University, given uncertain support from the State. She recommended looking at other options, such as defined contribution plans, possibly in exchange for higher salary levels.

Upon motion duly made and seconded, the Committee on Finance approved the President's Recommendation 1 above and voted to present it to the Board, Regents Cheng, DeFreece, Gould, Island, Makarechian, Schilling, Varner, Wachter; and Yudof (9) voting "aye."[3]

Upon motion duly made and seconded, the Committee on Compensation approved the President's Recommendations 2-7 above and voted to present them to the Board, Regents Gould, Hime, Johnson, Kieffer, Ruiz, Varner, Wachter, and Yudof (8) voting "aye."

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[3] Roll call vote required by the Bagley-Keene Open Meeting Act [Government Code §11123(b)(1)(D)] for all meetings held by teleconference.

The meeting adjourned at 4:25 p.m.

Attest:

Secretary and Chief of Staff