The Regents of the University of California

COMMITTEE ON FINANCE
COMMITTEE ON COMPENSATION
September 16, 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 and Simmons; Staff Advisors Herbert and Martinez
Representing the Committee on Compensation: Regents Hime, Johnson, Kieffer, Lozano, Ruiz, and Varner; Ex officio members Gould and Yudof; Advisory member Anderson

In attendance: Regents De La Peña, Lansing, Maldonado, Marcus, O'Connell, Pattiz, Reiss, and Zettel, Regents-designate Hallett and Pelliccioni, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Provost Pitts, Executive Vice Presidents Brostrom and Taylor, Senior Vice President Stobo, Vice Presidents Duckett, Lenz, and Sakaki, Chancellors Birgeneau, Block, Blumenthal, Desmond-Hellmann, Drake, Fox, Kang, Katehi, White, and Yang, and Recording Secretary McCarthy

The meeting convened at 10:30 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 July 14, 2010 were approved.

2. **UNIVERSITY OF CALIFORNIA POST-EMPLOYMENT BENEFITS – AN OVERVIEW**

[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 briefly introduced the item. He noted that this discussion was only the first step in a long process. He stated that the Regents are only starting to collect information on this matter and nothing has been decided yet. He recounted that President Yudof convened the Task Force on Post-Employment Benefits, charged with examining the University of California Retirement Plan (UCRP or Plan), particularly to ensure its proper funding going forward. Committee Chair Varner stated that this would be the first report of the Task Force and that the Committees would subsequently hear comments from employees, faculty, and others. Those comments would be considered as President Yudof developed his recommendations to present in November. Action would then be taken by the Regents in December. Committee Chair Varner reiterated that the discussion of this date was only the first in a series of discussions of a very complex and difficult task which would require input from all sources in order to be completed successfully. He expressed appreciation for the patience of all involved in this difficult process.

Provost Pitts thanked all Task Force members who worked many hours for more than 15 months. He noted that the presentation of this date was intended to be educational for the Regents, given the very complex issues involved. Dr. Pitts stated that this process would continue through at least December, with discussions at the campuses, at all sites around the University, with the unions, with faculty and staff groups, and with the Regents. He noted that UC leadership, with the help of the Academic Senate and Council of UC Staff Assemblies, would meet with interested groups of faculty, staff, and administrators at the campus sites.

Gary Schlimgen, Director of Pension and Retirement Programs, presented an overview of current post-employment benefits provided to faculty, staff, and retirees. He noted that material for this item was extensive and included details of the pension plan and the completely separate retiree health program, comparator information, and an outline of communication efforts connected with the recent review of UC's post-employment benefit programs.

Mr. Schlimgen characterized UC's retirement plan as central to its ability to recruit and retain top talent, which has enabled UC to accomplish its mission and remain great for decades. The Plan has enabled faculty and staff to retire, after spending a career at UC, with a secure income sufficient for a comfortable retirement when combined with tax-deferred savings and Social Security. These post-employment benefit programs, one element of a multi-dimensional, comprehensive, market-competitive pay and benefits package, give UC an edge, but the programs require sufficient funding by all parties in order to be sustainable for the long term. Mr. Schlimgen stated that the information in his presentation would provide a context for future discussions leading to proposed action for consideration by the Board.

Mr. Schlimgen explained that UCRP membership currently consists of approximately 52,000 retirees and survivors, 31,000 vested former employees, and 116,000 active members who are career faculty and staff. While UC's larger, active workforce includes an additional 77,000 part-time or casual employees, Mr. Schlimgen stated that this presentation focused on the 116,000 active career employees, since they are earning a retirement benefit and retiree health eligibility. In sum, UCRP supports about 200,000 members.

Mr. Schlimgen enumerated the UCRP benefits. During members' active employment, UCRP provides disability protection, survivor benefits, and death benefits. After completion of the five-year vesting period, members receive either lifetime retirement income with annual cost-of-living allowances or a lump sum equivalent. Upon a retiree's death, UCRP pays a portion of that benefit as a survivor continuance for the life of the eligible survivor. Therefore, Mr. Schlimgen noted, a defined benefit plan such as UCRP can be a 70 to 80-year commitment.

Mr. Schlimgen described some specific examples of monthly retirement benefits provided by UCRP. Benefits are defined by a formula: an age factor, multiplied by the service credit, multiplied by the highest 36 months of compensation (Highest Average Plan Compensation or HAPC). The current benefit formula at age 60 is 2.5 percent times years of service, times the highest 36 months of salary. The age factor declines sharply for younger retirement ages to 1.1 percent at age 50. Hence, a 30-year employee who retires at age 60 would receive 75 percent of his or her pre-retirement income for life. The final salary applies to all service. So an employee who worked past age 60 would not qualify for a higher age factor, but could qualify for a higher HAPC and more years of service.

Mr. Schlimgen stated that UCRP's pension actuary, the Segal Company, presents an annual actuarial valuation to the Regents each November. The actuarial valuation considers member data, financial data, and plan provisions to arrive at the Plan's funded status, its liabilities and assets.

Regarding the cost to fund retirement benefits, Mr. Schlimgen explained that the normal cost is the portion of the long term cost allocated to a year of service and applies only to active members. Each year, the Plan absorbs an additional liability of the added year of service credit earned by active members. Currently, UC has about $8 billion in payroll and the normal cost is 17.6 percent of covered payroll. Thus, the Plan absorbs an additional liability of $1.4 billion each year as a result of the additional year of service credit earned by active members. Ideally, between the entry age and the retirement age of a UCRP member, the Plan would accrue assets to cover the liabilities that the Plan assumes each year. In fact, assets vary, because funding sources, such as contracts, grants, and patient care, vary. Mr. Schlimgen stressed that it is crucial to acquire assets each year to cover liabilities.

Mr. Schlimgen addressed UCRP's investment rates of return over time. UC suspended contributions in 1990, when the Plan was 137 percent funded; that contribution holiday lasted much longer than anticipated. The Plan earned returns of more than 20 percent during four consecutive years and had a 19 percent gain just a few years ago. On the other hand, the Plan lost 19.2 percent two years ago. Mr. Schlimgen stressed that the assumed rate of return is 7.5 percent, so the 19.2 percent loss was 27 percent below the assumption. The Plan earned 12.7 percent the last year, above the assumed rate of 7.5 percent.

Using assumptions provided by the University, the actuary smoothes out the volatility in the investment return and, on a smoothed basis, the Plan was 149 percent funded in 2001. Since contributions were suspended, the funded status has eroded as the normal cost has been added to the Plan. Mr. Schlimgen indicated that the actuary would report in November that the Plan's current funded status is 85 percent on an actuarial basis. On a market value basis, the Plan is funded at 71 percent, virtually unchanged from last year, because of the normal cost, payments to retirees, and the Plan's underfunding.

Mr. Schlimgen recounted that the current UCRP funding policy, approved in September 2008, established a long-term funding target and determined the total policy contribution level. The contribution level calculations start with the normal cost of about 17 percent of pay and add one-fifteenth of the unfunded liability. Thus, the current funding policy would require 20.4 percent of payroll. A proposal which would be considered by the Committee next recommends changing the amortization period to 30 years.

Mr. Schlimgen further explained that the Regents separately determine the total contributions, and the split between employer contributions and member contributions, based on the availability of funds and the impact on total compensation. In February 2009, the Regents approved the initial restarted contributions through June 30, 2011. The University rate is four percent from all payroll funding sources. The member rate is generally two percent, less an offset, up to the Social Security wage base, and four percent of earnings above the Social Security wage base. These rates are the same as the contribution rates in 1990, when the Regents suspended contributions. The total approved contributions to date are six percent. The subsequent item would request approval of contribution rates for the upcoming two fiscal years based on Task Force recommendations.

Mr. Schlimgen presented a graph detailing the projected and funding policy contributions. The graph showed the normal cost of 17.6 percent of covered payroll, with the Regents' funding policy being the normal cost plus one-fifteenth of the unfunded liability. Mr. Schlimgen pointed out that a total of 20 percent of covered payroll should be going into the Plan today. He added that, if the projected funding level were contributed each year, that payment would exceed 35 percent of pay and would stay above 30 percent of pay based on the normal cost and the current unfunded liability. A slow ramp-up, increasing the current approved contributions by two percent for the employer and by one percent for the member with a cap at five percent, would result in an additional gap of $14 billion between the projected balance and the funding policy. As a result, the funding policy level contributions would become 50 percent of pay, and thus would create an additional shortfall.

Mr. Schlimgen discussed unfunded liability, assuming an average annual 7.5 percent investment return. If funding were at the full funding policy contribution rate, the unfunded liability would increase in the near term because the Plan would still be accumulating prior unrecognized losses, but would decrease to only $4 billion by 2022. However, if current contribution rates continue, the unfunded liability would increase dramatically, to $26 billion by 2022. If the funding policy contribution rates were made, the funded ratio on a smoothed basis would dip down initially, but then would rise and stay above 80 percent. On the other hand, if the slow ramp-up contributions were made, the funded ratio would decrease quickly to 60 percent and would remain there, absent any program changes or contribution increases. Mr. Schlimgen cautioned that, were the funded ratio to go that low, the Plan might never be able to recover from a serious market correction like the most recent one.

Mr. Schlimgen discussed how UCRP compares with the California Public Employees' Retirement System (CalPERS) which covers California State University faculty and staff. CalPERS has a funding policy similar to that of UCRP; however, CalPERS is actually funded at the policy level. CalPERS has a similar normal cost to that of UCRP. The CalPERS employer rate is 19.9 percent; the rate for most employees is five percent. Mr. Schlimgen reported that there have been discussions about increasing the CalPERS employee rate. Despite its level of contributions, as of the prior June, the CalPERS funded ratio was 59 percent on a market rate basis, below that of UCRP. While UCRP has a maximum benefit of 2.5 percent at age 60, the CalPERS maximum is 2.5 percent at age 63. CalPERS benefits are generally based on the highest 12 months of compensation, although recent hires' benefits are based on 36 months.

Members of the California State Teachers' Retirement System (STRS), which covers faculty at California community colleges, are not covered by Social Security. Under STRS, the employer contribution rate is 8.25 percent, the employee rate is eight percent, and the State contributes 4.5 percent. With an approximately 60 percent funded ratio on a market value basis, STIRS is not as well-funded as UCRP. STRS maximum benefit factor is 2.4 percent at age 63, or at age 61.5 with 30 years or more of service.

Mr. Schlimgen reported on plans at UC's comparison institutions. Among the Comparator 8 faculty plans, three institutions offer a choice of a defined benefit (DB) plan or a defined contribution (DC) plan. Four institutions have DC plans; one offers a cash balance plan. There is also variety among the staff plans. Among the Comparator 26, most have defined contribution plans. Mr. Schlimgen noted that UC's defined benefit plan gives the University an advantage.

Mr. Schlimgen proceeded to discuss the entirely separate UC retiree health plan, which is not part of the pension plan and is not pre-funded. UC offers medical benefits, both for those eligible for Medicare and those not eligible, a dental plan, and access to a vision plan. Mr. Schlimgen pointed out that UC believes that retiree health benefits, not being vested or accrued, have a different legal status from pension benefits. Changes have been made to retiree health benefits in the past and changes could be made again.

Approximately 53,000 retirees currently receive retiree health benefits from UC. Roughly 37,000 are in Medicare, with Medicare primary and the UC retiree health plan secondary, and about 16,000 are early retirees not yet eligible for Medicare. The UC contribution for the retiree health plan varies from about $300 per month for Kaiser coverage for a single person to $1,400 per month for Blue Cross coverage for a family.

Mr. Schlimgen pointed out that retiree health benefits are on a pay-as-you-go basis. The Retiree Health Trust assesses a fee of $3.31 per every $100 of covered payroll; these funds are used to pay UC premiums for retiree medical and dental coverage.

Mr. Schlimgen reported that the current annual cost of the UC portion of retiree health medical and dental premiums is $255 million. The Retiree Health Trust was established in 2007, but has not been funded yet. Under the Governmental Accounting Standards Board's (GASB) regulations, which now apply to the public sector, UC had to include the liability on its audited financial statement. Mr. Schlimgen pointed out that, given medical inflation and the increasing number of retirees, the pay-as-you-go cost of the retiree health plan could reach almost $450 million by 2014. The balance sheet obligation, which has to be reported under GASB regulations, grows every year.

Mr. Schlimgen showed a graph of an overview of smoothed unfunded liability for UCRP combined with that of the retiree health plan. Assuming no program changes and a slow ramp-up of increases to the pension plan, Mr. Schlimgen pointed out that, by 2014, UC's unfunded liability would be $38.6 billion, which is one of the main reasons President Yudof formed the current Task Force.

Mr. Schlimgen noted that there are implications for collective bargaining; any post-employment benefit changes must be bargained with 16 systemwide and 12 local bargaining units. Represented employees would accumulate credit and participate on previous plan terms until a resolution is negotiated, which is anticipated to be a long process. Mr. Schlimgen emphasized that the University is committed to meeting all of its Higher Education Employer-Employee Relations Act (HEERA) obligations around any proposed changes.

Regent Kieffer asked for more complete information about post-employment benefits for both staff and faculty at comparable institutions. He said that the public may not be aware of the challenges UC and other institutions across the country are facing. Regent Kieffer urged the aggressive dissemination of information, which, he commented, is different from merely saying that people can find the information in reports available online. Information should be presented in a different form, one that is more easily understandable by the press, by members of the UC family, and by the public. Committee Chair Varner noted that such material is available and should be distributed.

Regent Kieffer reiterated that such information about comparable institutions would be helpful to give the public a perspective from which to view the choices confronting UC, since comparable institutions are facing the same choices. Dr. Pitts pointed out that there is much detail in the report on the website.

Faculty Representative Anderson noted that UCRP had a very good annual investment return of 12.7 percent, well above the assumed rate of return. Nonetheless, the funded ratio by market value of assets remained at 71 percent. Mr. Anderson asked Paul Angelo, the Regents' actuary from the Segal Company, why, despite this favorable 12.7 percent investment return, the funded ratio remained constant. Mr. Angelo responded that the funded ratio remained the same because the Plan accrued another year of normal cost of approximately $1.4 billion, plus interest on the unfunded liability. Even though the 12.7 percent return surpassed the 7.5 percent assumed rate of return, the fund is still phasing in losses from prior years and operates with inadequate contributions. Mr. Anderson said that he was referring to market value, not actuarial value. Mr. Angelo responded that, using market value, even though the return surpassed the assumed rate of return by several percentage points, that gain was cancelled out by inadequate contributions and another year of normal cost. Mr. Anderson noted that a significant factor was that UCRP did not earn the 12.7 percent return on the approximately $10 billion that the Plan is short. Mr. Angelo responded that the Plan also accrues interest on its unfunded liability.

Mr. Anderson asked Mr. Angelo about the total remuneration studies that have been done which assume a rate of salary growth of 3.25 or 4 percent. Salary growth of 5.5 percent was assumed in the actuarial study. Mr. Anderson asked whether, if the actuarial valuation were to use 3.75 or 4 percent as the assumed rate of salary growth, this would produce a significant reduction in the normal cost of the Plan. Mr. Anderson noted that he was not suggesting that the actuarial valuation use the lower rate of salary growth. Mr. Angelo responded that the most significant reduction would be in the accrued liability, that the normal cost would be reduced. Mr. Angelo cautioned that the actuarial study is a longer-term projection than shorter-term projections such as remuneration comparisons. Mr. Anderson responded that using this different rate would certainly decrease the liability. He asked that Mr. Angelo rethink whether using the different rate would have an effect on normal cost and report back to the Committees. Mr. Angelo replied that it would have an effect on normal cost.

Regent DeFreece asked whether, if salary growth were to increase to 5.5 percent, this would be attributable to the expansion of the base of employees or to salary increases for staff, especially non-represented staff. He expressed concern that the non-represented staff are frozen in place. He would advocate increases for non-represented staff. As their salaries increase, so would the pension liabilities. Mr. Angelo responded that, for the actuarial valuation, the long-term assumption regarding salary increase included three components: price inflation, real wage growth, and a merit and promotion component. He added that, in the current economic climate, real salary increases tended to be lower than the long-term average.

Mr. Schlimgen added that the November valuation report would highlight the rate of salary increase, since the report would include an experience study looking at year-to-year salary of all the members. He stated that, even though one might not think there has been a significant salary increase, there actually was an aggregate year-to-year increase in salary, when represented employees' increases, faculty merit increases, promotions, and stipends were included.

Committee Chair Varner commented that the Committee on Compensation was aware that there have not been salary increases. He stated that the Regents feel obligated to consider the issue of salary increases and would ask the chancellors to examine salary increases as part of this process.

Staff Advisor Martinez thanked Mr. Schlimgen for his presentation and asked him about the communication plan. She echoed Regent Kieffer's concerns about disseminating information. While information is available on UC's website, she noted that she has received comments from staff about the difficulty of absorbing and understanding the information. She asked about future communication plans.

In response, Mr. Schlimgen enumerated prior communication efforts, including an attachment to this item summarizing the historical and ongoing communication efforts. Mr. Schlimgen acknowledged that, although the Task Force has done a great deal of work, much remains to be done, since the subject is so complex. Members of the Task Force held two series of location forums, 64 in total. Each session was attended by hundreds of people and the forums reached a total of 12,000 people. Meetings were held with internal groups, faculty groups, and the union coalition. "The Future of UC Retirement Benefits" website has historical information, recorded versions of the fall and spring forums, and other background material. President Yudof has asked Executive Vice President Brostrom, Provost Pitts, and Chief Financial Officer and Executive Vice President Taylor to lead the consultation and communication effort over the next two months, as the Task Force receives more input on potential changes to the program.

Dr. Pitts observed that, while a great deal of information is available, individual employees and faculty members are concerned about how the proposed changes would affect them personally. This type of individual question is best handled face-to-face at discussions scheduled for the next couple of months.

Ms. Martinez reiterated that Staff Advisors are getting a lot of feedback from staff, since the defined benefit plan is an important compensation issue.

Committee Chair Varner noted that the Regents are mindful that retirement benefits are a very important component of the University's compensation packages. He remarked that the Regents have received significant input on this issue from various sources and wanted to be sure to have a process for collecting the input and disseminating it as the University shapes the final plans for consideration.

Chairman Gould said that he appreciated the information from the Task Force and noted the need to continue to refine the message to make it as clear as possible to the entire UC family. He stated that, given the implications of the information presented by the Task Force, it was clear that the Regents must act.

President Yudof agreed. While there are political and fairness concerns, there is a compelling math problem that would not go away. UCRP must be put on the right trajectory and contributions increased over time, so that UCRP can meet its obligations. He noted that there is flexibility in the three proposed plans, each with different associated costs. He stated that, while the three existing plan proposals may not ultimately be the correct ones for the University, the Regents cannot let the current situation continue without jeopardizing the long-term security of current and future UC employees.

Regent Makarechian expressed concern that the $1.9 billion in unfunded liabilities in 2009 had been projected to rise to $9.1 billion by 2011, but are now $14 billion. He commented that there would be an additional cost under new GASB rules, since the unfunded liability would have to be taken on the balance sheet, rather than as a footnote. This liability could affect UC's credit rating, thus increasing future financing costs.

Regent Makarechian stated that another additional cost is the loss of significant funds from the federal government. He noted that monies come from three areas: from the employees, from the UC portion coming from the State, and from reimbursements from the federal government. He noted that a large number of UC employees' salaries are funded by the federal government, but, without increased contributions, UC would not be adequately reimbursed by the federal government. Regent Makarechian asked how much UC has lost in reimbursements from the federal government and what effect these lost reimbursements would have on the future of UCRP if contributions were not increased.

Dr. Pitts responded that the UC payroll is funded from three approximately equal sources: State general funds, medical centers, and a third source which includes federal grants, auxiliaries, dormitories, and various other enterprises of the University with payrolls attached. Federal grants, while critical to the University, represent only about ten percent of payroll. He emphasized the importance of these government funds which are now being underpaid, just as UC is currently underpaying its normal cost. Dr. Pitts stated that government funds certainly would contribute to the solution, but only up to 10 or 11 percent of payroll.

Chief Financial Officer and Executive Vice President Taylor noted that if UC were paying the full 20 percent that the actuary says it should pay this year, that contribution would yield an additional $1.4 billion. Of that $1.4 billion, approximately $140 million would come from the federal government, with the rest coming from various University sources, medical centers, and auxiliaries. The proposed GASB changes, which were discussed at the meeting of the Committee on Compliance and Audit a few weeks prior to this meeting, are the topic of a hearing which will be held in San Francisco next month. Mr. Taylor said that, should the GASB pursue the proposed changes, UCRP's balance sheet would be affected in a way that could look very troubling. Mr. Taylor met in the previous month with ratings analysts in New York who were still evaluating the effects of the proposed GASB changes. UC is clearly not the only major public institution with this challenge, as most public institutions are facing the same problem, and many are in worse shape. Mr. Taylor noted that the proposed GASB changes would not be a positive credit factor.

Executive Vice President Brostrom noted that in the previous week, under Mr. Taylor's leadership, UC had its ratings reaffirmed as AA for limited project revenue bonds. One of the factors cited by the ratings agency was the work of the Post-Employment Benefits Task Force in addressing this funding issue.

Regent Pattiz associated himself with the comments of President Yudof and Chairman Gould that the Regents should move forward quickly. He noted that the press has blamed the current situation on the Regents' inactivity and delay. Regent Pattiz stated that he speaks for many when he said that UC is fortunate to have President Yudof at the table. Regent Pattiz criticized the personalized approach of some remarks made during the public comment period earlier that day. Regent Pattiz thanked President Yudof for his leadership.

Committee Chair Varner reiterated that the Committees are only discussing the issues at this stage of the process; nothing has been decided yet.

Regent Blum echoed the remarks of Regent Pattiz. Regent Blum recalled that he has tried to move this issue for many years and appreciated President Yudof's leadership in addressing the problem. Regent Blum stated that, ten years from this time, no one would want to look back and think inaction caused further problems. He stated that President Yudof has thought through this difficult issue sensibly.

3. **UNIVERSITY OF CALIFORNIA RETIREMENT PLAN: UNIVERSITY AND MEMBER CONTRIBUTION RATES FOR PLAN YEARS BEGINNING JULY 1, 2011 AND JULY 1, 2012, AND AMENDMENT OF REGENTS POLICY 5601: UNIVERSITY OF CALIFORNIA RETIREMENT PLAN FUNDING POLICY**

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

A. University contribution rates for University of California Retirement Plan (UCRP) Plan Years beginning July 1, 2011 and July 1, 2012 be as shown below:

Member Class	**Number of Active Members July 1, 2010**	**University Contribution Rates on Covered Compensation**		
		Plan Year 2010-2011 (current rates)	Plan Year beginning July 1, 2011	Plan Year beginning July 1, 2012
Coordinated with Social Security	112,700	*4%*	7%	10%
Noncoordinated	1,796	*4%*	7%	10%
Safety	418	*4%*	7%	10%
Tier Two	14	*2%*	3.5%	5%

B. Member contribution rates for Plan Years beginning July 1, 2011 and July 1, 2012 be as shown below, subject to collective bargaining for represented members:

Member Class	**Number of Active Members July 1, 2010**	**Member Contribution Rates on Covered Compensation***		
		Plan Year 2010-2011 (current rates)	Plan Year beginning July 1, 2011	Plan Year beginning July 1, 2012
Coordinated with Social Security	112,700	*2% up to Social Security wage base, then 4%*	3.5%	5%
Noncoordinated	1,796	*3%*	3.5%	5%
Safety	418	*3%*	4.5%	6%
Tier Two	14	*none*	none	none

*All contribution amounts are reduced by $19 per month.

C. The University contributions and the member contributions for the Lawrence Berkeley National Laboratory (LBNL) segment of UCRP be made on the same basis as determined for the non-laboratory segment of UCRP (i.e., campuses, medical centers and Hastings College of the Law), subject to the terms of the University's contract with the Department of Energy and subject to collective bargaining for represented members at LBNL.

D. Authority be delegated to the Plan Administrator to amend the UCRP Plan documents as necessary to implement these changes.

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

E. Regents Policy 5601: UCRP Funding Policy be amended as shown in Attachment 1 to increase the period for amortizing any past or future gains/losses from 15 to 30 years, effective July 1, 2010 and to clarify that funding policy contributions are determined by applying a mathematical formula (rather than recommended), while the actual contribution amounts reflect additional factors.

[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.]

President Yudof noted that this item represents the first step in a multi-step process concerning two related, but separate, issues. One issue is to address contribution levels to the UC Retirement Plan (UCRP) to ensure funding for current employees with vested rights who are entitled to their payments, given that the State, employees, and the

University have not contributed funds for the past 20 years. The second, related issue is consideration of an additional tier and its characteristics, given the future cost of retirement benefits and the impact of that cost on operating budgets. The University now faces a looming liability, not knowing what future rates of return would be. President Yudof stated that, while the pace of acceleration of contributions may be debatable, he had no doubt that it is critical to act.

Gary Schlimgen, Director of Pension and Retirement Programs, presented two recommendations to the President from the Task Force on Post-Employment Benefits. The first recommendation, under the jurisdiction of the Committee on Compensation, is the adoption of University and member contribution rates for the subsequent two plan years. The second recommendation, falling under the jurisdiction of the Committee on Finance, is an amendment to the Regents' UCRP funding policy to increase the amortization for any gains or losses from 15 years to 30 years.

Mr. Schlimgen explained that the 30-year amortization recommendation of the Task Force would better align the funding policy with realistically attainable contribution levels, to reduce future policy-level volatility. The near-term effect of the change in the amortization period would be a reduction in the amount the University must report as a pension expense on its financial statements.

Mr. Schlimgen stated that UCRP cannot invest its way out of its current funding status, even though the 20-year return for UCRP has been about 8.9 percent, surpassing its assumed earnings rate. Mr. Schlimgen emphasized that contributions are key to the adequate funding of the Plan and payment to UC's retirees. The initial proposed actions based on the Task Force recommendations are to increase the University and member rates of contribution more rapidly than originally projected in order to capture more contributions from all fund sources, thus reducing the growth of UC's unfunded liability. Currently, the University contributes four percent for all members. Mr. Schlimgen reported that the Task Force recommended that the University contribution rate be increased to seven percent of pay effective July 2011, and to ten percent of pay effective July 2012. The proposed member contribution rates would increase to three-and-a-half percent in July 2011 and to five percent in July 2012. The $19 offset would be retained for member contributions.

Mr. Schlimgen showed a slide illustrating normal cost. The normal cost of 17.6 percent of covered payroll is currently about $1.4 billion. Current approved funding through contributions totals six percent, four percent from the University and two percent from members, resulting in an amount well below both normal cost and the Regents' funding policy. The current proposal would increase the employer contribution to seven percent in 2011 and then to ten percent in 2012, and increase the member contribution to three-and-a-half percent in 2011 and to five percent in 2012. Mr. Schlimgen said this rate of increase is as fast as possible, given the current situation. Even at this higher proposed rate of contribution, Mr. Schlimgen noted that the University and member contributions would then total 15 percent, still below the normal cost of 17.6 percent, and would still not begin to pay off the unfunded liability. Mr. Schlimgen stated that methods to attack the unfunded liability would be discussed at the November meeting.

Paul Angelo, Regents' actuary from the Segal Company, recounted that a funding policy had been set in 2008; that policy is described in detail in the current item and in the earlier item from 2008. Mr. Angelo stated that at issue is how fast the unfunded liability will be paid, or the amortization component of the funding policy. The 2008 funding policy was based on a fairly rigorous 15-year amortization period, consistent with the general fiscal prudence of the University. The amortization rate is being revisited at this time because of the recent market turmoil and the restarting of contributions. Mr. Angelo said the University has used a leveled dollar method of amortization and the Task Force was not recommending a change in that method. He noted that the California Public Employees' Retirement System (CalPERS) uses a 30-year amortization. The Task Force recommended a longer amortization period for UC. Mr. Angelo showed a graph demonstrating annual payments using various amortization periods. Changing to a 30-year term would have the benefits of reducing future volatility, since gains and losses are spread out over a longer period, and of making the funding policy level more attainable as an actual contribution amount. Mr. Angelo showed two graphs illustrating the change in projected shortfall related to the proposed change to a 30-year amortization. By lowering the funding policy amount, UC would be able to see the end of the unfunded liability. He stated that, in a technical way, by having a more attainable funding policy, UC would reduce the amount of shortfall in the early years and greatly reduce the cost of that shortfall in later years. However, there is a tradeoff in that, instead of paying over a 15-year period, UC would be paying over a 30-year period; it would be like refinancing a mortgage over 30 years.

Mr. Schlimgen summarized that the two recommendations under consideration are proposed changes in University and member contribution rates and in the amortization schedule.

Regent Kieffer asked if funds for the higher contributions in 2011 and 2012 would be coming from the State in some fashion as a result of Regents' requests.

President Yudof said that UC has worked very hard with the State Senate and Assembly leadership and complimented the work done in that regard by Vice President Lenz and Associate Vice President Juarez. President Yudof stated that there is increasing recognition that it is unfair that the State does not contribute at all to UC employees. He noted it is a gross inequity that the State makes an employer contribution for high school teachers, but makes no contribution to the University. President Yudof expressed hope that, despite the State's current dire financial straits, in the next few years the State would begin to pay its share. If not, then UC would have a real problem, as the increased percentage of personnel budget would impact UC's operating budgets. President Yudof expressed concern that the squeeze on operating budgets could result in layoffs, non-replacement of employees, or inability to assemble an adequately sized corps of classroom teachers. President Yudof said that a ten percent contribution to UCRP does not really solve the problem. He noted that there are also issues of equity and affordability of increased employee contributions for those employees who receive low compensation or who have not had recent salary increases. President Yudof said that he did not know how the contribution would be funded at this time.

Faculty Representative Anderson asked Mr. Schlimgen if the recommendations which would be considered in November with regard to the new tier would decrease the current unfunded liability. Mr. Anderson clarified that, since the liability is based entirely on past service and the tier would apply only to prospective service, the new tier would have no effect on the current unfunded liability. Mr. Schlimgen replied that the current discussion did not involve the new tier or how it would affect the historical liability. He stated that, at the President's direction, the more substantial recommendations from the Task Force, including the new tier, would be discussed at the November Regents' meeting. Mr. Anderson stated that he believed that the new tier would have no effect on the historical liability.

Faculty Representative Simmons commented that the Academic Senate has joined with Regent Blum for many years in advocating restarting contributions. He said that, painful as it is, the Academic Senate supports the increase in contributions called for in this recommendation. He reiterated President Yudof's remarks that this increase in contribution rates is a pay cut for the entire faculty and staff, represented and unrepresented. He stated that the University must somehow find a way to provide competitive compensation for all of its workers. Mr. Simmons noted that the University is a great institution because of the loyalty of its staff and their interests must be protected. He expressed agreement with President Yudof that the employer contribution would have a substantial impact on the operating budget of the University, including all of UC's programs and the operating margins of the health centers. Nonetheless, this move forward is unavoidable; failure to act would have an even greater negative impact on the long-term future of the University. Mr. Anderson joined in Regent Pattiz's prior comments congratulating President Yudof and the administration for taking steps to move forward on this long, difficult process.

Regent Zettel thanked President Yudof and the Task Force for their hard work on this very difficult issue. Regent Zettel asked when the Task Force would be coming back to the Regents to report whether its projections have been accurate and effective in reducing the unfunded liability, taking into account whether the State has contributed any funds. Mr. Angelo replied that, while he would not address the question of State funding, the actuaries would review all the figures from UCRP every year and report on liabilities and costs to the Regents each November.

Executive Vice President Brostrom commented that there is language in the State Budget Conference Committee report, pursuant to which UC will meet with the Department of Finance and the Legislative Analyst's Office to try to work out a funding proposal. A meeting on this issue was to occur the following week in Sacramento.

Committee Chair Varner commented that he thought such discussions with the State would be very important as the Regents move forward on this issue.

Regent Cheng expressed concern regarding the impact on student services. He stated that he supports the necessary restarting of contributions to UCRP and commended President Yudof and the Task Force for their leadership. Regent Cheng expressed concern that pressure on non-unionized staff’s take-home pay would eventually result in a burden on the quality of students’ experience. He encouraged students to become involved in this conversation and urged the inclusion of students in the communication plans regarding UCRP.

Chairman Gould stated that it is clear to him that the Regents are compelled to act on both the change in amortization period and the increase in contributions. He commented that UC’s positioning with the Legislature in Sacramento around the issue of State support for UC’s retirement contributions is of the highest priority, especially in view of the upcoming elections. The entire UC community should work to help secure the commitment of the new governor and Legislature.

Regent Blum responded to Regent Zettel’s earlier question by saying that it is unknown if the new level of contributions would solve the problem of unfunded liability, given the unknown rate of return. He recalled that contributions were considered unnecessary in 2007, because returns were 15 percent per year. Regent Blum said the plan to save $500 million in expenses by running the system more efficiently should be accelerated so that the saved money could help pay for the unfunded liability.

Regent Makarechian asked about the figure of 17.6 percent of pay and inquired as to the total pay for the campuses. Mr. Schlimgen responded that the current covered payroll is about $8 billion, so that 17.6 percent of $8 billion is about $1.4 billion. Regent Makarechian asked what portion of that amount is being paid by the State or the federal government. Mr. Schlimgen responded that the State’s portion is one-third of the total normal cost. President Yudof added that the State is not currently making a contribution to UCRP. Mr. Schlimgen said that, while the State is continuing to cover CalPERS, California State University, and community college employees, the State is not yet funding UCRP. Mr. Schlimgen added that UCRP is covering $26 million this fiscal year, because the State is not making its share of the contribution. For the Plan Year beginning July 1, 2011, the employer contribution at seven percent would be $580 million; the State’s share of that $580 million would be $192 million. Regent Makarechian noted that UCRP is currently losing that reimbursement amount from the State. Regent Makarechian asked what the federal government’s portion would have been for this fiscal year. Mr. Schlimgen responded that the federal government’s portion would be ten percent of $860 million for the Plan Year beginning July 1, 2012. The State’s share of the 2012 employer contribution would be $284 million. Regent Makarechian commented that UCRP is losing those amounts plus the 7.5 percent interest on that money had UCRP received it.

Regent Makarechian asked how bonuses are calculated in relation to contributions to UCRP. Mr. Schlimgen responded that bonuses are not covered by the retirement plan.

Finance Committee Chair Lozano stated that the Committee on Finance had reviewed the proposal to extend the amortization period from 15 to 30 years and is in agreement. She further stated that this action needed to be taken in order for the Task Force to present the actuarial valuation at the next meeting. Compensation Committee Chair Varner indicated that the Committee on Compensation had likewise reviewed the contribution proposal and agreed with the need to take action.

Upon motion duly made and seconded, the Committees approved the President's recommendations and voted to present them to the Board.

The meeting adjourned at 11:35 a.m.

Attest:

Secretary and Chief of Staff

Additions shown by underscoring; deletions shown by strikethrough

Regents Policy 5601: UCRP Funding Policy

Approved September 18, 2008

1) The funding policy is effective with the July 1, 2008 actuarial valuation and determines ~~recommended~~ total <u>funding policy</u> contributions starting with the Plan Year beginning July 1, 2009.

2) Each year the ~~recommended~~ <u>funding policy</u> contributions will be ~~effective~~ <u>calculated</u> for the Plan Year starting one year after the date of the actuarial valuation.

3) Each year the Regents will determine both the actual total contributions and the split between Member Contributions and University Contributions based on the ~~recommended~~ total <u>funding policy</u> contributions and various other factors, including the availability of funds, the impact of employee contributions on the competitiveness of UC's total remuneration package, and collective bargaining. In no event shall the University Contributions be lower than the Member Contributions.

4) The funding policy will determine ~~recommended~~ total <u>funding policy</u> contribution rates based on an actuarial valuation of the non-laboratory segment of University of California Retirement Plan (UCRP) (e.g., campuses, medical centers and Hastings College of the Law). The Lawrence Berkeley National Laboratory will contribute on the same basis as determined for the non-laboratory segment of UCRP, subject to the terms of the University's contract with the Department of Energy. The Lawrence Livermore National Laboratory and Los Alamos National Laboratory Retained Segments in UCRP will be subject to the funding policies outlined in the University's contracts with the Department of Energy. Throughout this policy the term "UCRP" shall refer to the non-laboratory segment of UCRP.

5) The ~~recommended~~ total <u>funding policy</u> contributions to UCRP will consist of the Normal Cost plus an amortization charge for any Unfunded Actuarial Accrued Liability (UAAL) or minus an amortization credit for any surplus.

6) The Regents' Consulting Actuary will conduct an annual actuarial valuation of UCRP. The Normal Cost and the Actuarial Accrued Liability (AAL) in each actuarial valuation will be determined under the Entry Age Normal Actuarial Cost Method, using actuarial assumptions adopted by the Regents.

7) The asset smoothing method used to determine the Actuarial Value of Assets will be based on the Market Value of Assets adjusted for "unrecognized returns" in each of the then last five years. Unrecognized return is the difference between actual and expected returns on a market value basis and is recognized over a five-year period.

8) As of the effective date of this policy, any initial surplus as of that date will be amortized as a level dollar amount over a period of three years, as was specified by the Regents in the adoption of this policy.

   a. Any changes in surplus after the effective date due to actuarial gains and losses (including contribution gains and losses) will be amortized as a level dollar amount over 15 years.

   b. Any change in surplus due to a change in actuarial assumptions, cost method or asset smoothing method will be amortized as a level dollar amount over 15 years.

   c. Any change in surplus due to a Plan amendment will be amortized as a level dollar amount over 15 years.

   d. In the first year after the effective date when UCRP has a UAAL (as opposed to a continuation of the current surplus condition) all amortization bases will be considered fully amortized and contributions will be determined under the remaining provisions of this policy.

9) For any future year when UCRP has a UAAL (as opposed to a continuation of the current surplus condition), the calculation of the UAAL will be maintained by source (as listed below) and each new portion of or change in UAAL will be amortized as a level dollar amount over a fixed amortization period.

   a. Any initial UAAL (after a period of surplus) or change in UAAL due to actuarial gains and losses (including contribution gains and losses) will be amortized over ~~15~~ 30 years.

   b. Any change in UAAL due to a change in actuarial assumptions, cost method or asset smoothing method will be amortized over 15 years.

   c. Any change in UAAL due to a Plan amendment will be amortized over 15 years, unless the nature of the Plan amendment suggests a shorter period.

10) For any future year in which UCRP has a surplus (other than a continuation of the current surplus condition), such surplus will be amortized as a level dollar amount over 30 years, and all prior UAAL amortization bases will be considered fully amortized.

11) Effective July 1, 2010, all UAAL amortization bases as of July 1, 2010 will be combined and the combined base will be amortized as a level dollar amount over 30 years.

~~11)~~12) This funding policy supersedes any previous funding policies.