The Regents of the University of California

COMMITTEE ON FINANCE
November 14-15, 2012

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

Members present: Regents Blum, Gould, Island, Mendelson, Newsom, Stein, Varner, and Wachter; Ex officio members Brown, Lansing, and Yudof; Advisory members Flores and Powell; Staff Advisors Barton and Smith

In attendance: Regents De La Peña, Kieffer, Makarechian, Pattiz, Reiss, Rubenstein, Ruiz, Schilling, and Zettel, Regent-designate Feingold, Faculty Representative Jacob, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Chief Compliance and Audit Officer Vacca, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Beckwith, Duckett, Lenz, and Mara, Chancellors Birgeneau, Block, Blumenthal, Desmond-Hellmann, Drake, Katehi, Khosla, Leland, White, and Yang, and Recording Secretary Johns

The meeting convened at 9:15 a.m. with Committee Chair Varner presiding.

President Yudof introduced UC Student Association (UCSA) president Raquel Morales and thanked UCSA for its successful efforts to register student voters and for assisting in the passage of Proposition 30.

Ms. Morales introduced herself as an undergraduate at UC San Diego. She reported that UCSA registered 51,846 students to vote, breaking all previous records. While Proposition 30 does not address the State's continuing disinvestment in higher education, it makes it possible to avoid a mid-year fee increase. Students and their families expect that revenue from Proposition 30 will be used to ensure the affordability, accessibility, and quality of higher education in California and Ms. Morales stated that they would be dismayed if there were further fee increases. She urged the University to avoid such increases, and expressed concern about possible increases in professional degree supplemental tuition. She also communicated students' concern about increasing nonresident enrollment at UC.

Committee Chair Varner noted that a recent opinion piece in the *San Francisco Chronicle* had presented criticisms of some UC financing strategies. He asked Chief Financial Officer Taylor to address this.

Mr. Taylor stated that there were many factual inaccuracies in the article and in a report issued by the same individuals. The University has performed due diligence and determined that the interest rate swap agreements in question saved the University $40 million over the cost of traditional fixed rate bonds. A statement to the effect that the University was losing $257 million was factually inaccurate. The authors of the article and report did not engage in any dialogue with the University or contact the University with questions about its debt program before publishing this opinion. Had they done so, the University would gladly have explained its position. The University has been careful in the management of its debt program. In the past four years, the most difficult financial times in the history of the University, UC's credit ratings have remained stable. This would not be the case if the University had taken imprudent risks.

Regent Kieffer asked what the principal errors in this analysis were. Mr. Taylor responded that when the University entered into interest rate swaps in 2003 and 2007, it compared these swap rates to fixed rate bonds and variable rates. Variable rate bonds present risk. Interest rates have decreased, and in this case, the University would have saved money with variable rather than fixed rate bonds. But by 2047, it is likely that rates will increase, and under those circumstances, the University will be protected from rising interest rates.

Governor Brown noted that the report claimed that the University's debt increased from $6.9 billion to over $14 billion in about four-and-a-half years. Mr. Taylor recalled that 40 percent of the bonds issued by the University are for housing, to build dormitories to house students. This reduces commuting and traffic, improves the quality of students' educational experience, and is paid as part of students' dormitory fees. The University has added 70,000 students in the past 15 years; it has taken time for UC to build facilities to catch up with that growth.

Governor Brown asked if this debt is different from or more secure than other kinds of debt, and about the doubling of UC debt. Mr. Taylor responded that UC debt has doubled because the State has not been financing UC capital facilities. UC has taken on many responsibilities that in normal circumstances would be financed by State bonds.

Governor Brown observed that university and college housing is financed privately in other states. Mr. Taylor responded that this model has been applied at UC Davis and UC Irvine.

Governor Brown asked about the increasing burden as UC increases its debt load and its annual payments and how this burden would affect educational quality, faculty recruitment, and pension liabilities that are not adequately funded. Mr. Taylor responded that the University does not pay any debt with student tuition revenues.

In response to another question by Governor Brown, Mr. Taylor stated that besides student housing, another major source of UC debt is the cost of seismic retrofitting. Combined, these two categories account for almost 70 percent of the University's debt. He noted that 81 percent of UC facilities, such as parking and housing, are self-supporting.

Governor Brown noted that the City of Oakland entered into interest rate swaps that did not have a favorable outcome. Mr. Taylor responded that there were many examples of such outcomes in the market. He stated that the University's policy on interest rate swaps, adopted by Regents' action in July 2011, *Authorization to Approve Interest Rate Swap Guidelines*, is as robust as any policy at any institution of higher education in the U.S., with as many checks and balances. This policy will ensure that the University does not act in a reckless manner with its debt or hedging instruments.

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

Upon motion duly made and seconded, the minutes of the meeting of July 18, 2012 were approved.

2. **STATUS OF 2012-13 BUDGET AND APPROVAL OF UNIVERSITY OF CALIFORNIA 2013-14 BUDGETS FOR CURRENT OPERATIONS AND FOR STATE CAPITAL IMPROVEMENTS**

The President recommended that:

A. The Committee on Finance recommend that the budget plan included in the document, *2013-14 Budget for Current Operations,* be approved.

B. The Committee on Finance concur with the recommendation of the Committee on Grounds and Buildings that the 2013-14 Budget for State Capital Improvements be approved.

[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.]

Executive Vice President Brostrom began the discussion by expressing appreciation for the Governor's leadership and the voters' support in passing Proposition 30, and thanked students for their success in registering student voters. This historic vote gave the University an opportunity for fiscal stability for years to come. The defeat of Proposition 30 would have resulted in an immediate $375 million reduction in State funding to the University, a reduction of over 15 percent in UC core funding. The passage of Proposition 30 provided fiscal relief and the ability to engage in long-term planning. Nevertheless, it was not a panacea for UC's financial challenges. Mr. Brostrom recalled the University's need to pursue alternative revenue sources and administrative efficiencies.

Proposition 30 provided a revenue base that would allow development of a sustainable multi-year funding plan for UC in collaboration with the Governor and Legislature. As a result of its passage, UC's budget would not be cut further, and State revenue from the 2012-13 tuition increase deferral would be built into the 2013-14 budget. While Proposition 30 did not provide funding specifically for UC, it did provide resources for the State to reinvest in higher education, and it held the promise of funding stability through a multi-year agreement with the State.

Mr. Brostrom observed that there were two essential reasons for the rate of growth of UC costs. The first is that UC has absorbed nearly $900 million in State funding reductions over the past four years, nearly 30 percent of the State funding for UC. Tuition increases have addressed about one-third of this reduction. The level of State funding for UC was now at the same level as it was in 1997-98, when UC had 75,000 fewer students, one less campus, and fewer degrees and programs. On a per-student basis, UC core funding, including both State funding and tuition, was currently 25 percent less than it was in 1990. The University has absorbed some of these reductions through administrative efficiencies, but for the most part, these reductions have undermined the quality of UC's core academic programs, through freezes on faculty hiring, stagnating faculty salaries, insufficient support for graduate students, and increased student-faculty ratios. The University hopes to take advantage of the stability of the next few years to address and reinvest in quality.

The second reason for the growth of UC costs was the need to fund the UC Retirement System. In the current year, the University would contribute over $800 million to the retirement system. This was an expense that did not exist three years earlier, before the resumption of contributions. In the following year, the contribution would exceed $1 billion. For this reason alone, UC costs were growing faster than the rate of inflation. Mr. Brostrom observed that the funding level for UC's pension program had in fact decreased, even though the employer contribution had increased.

These two essential causes of UC cost growth required the University to seek a solid and sustainable funding agreement with the State, while making a commitment to an equally aggressive pursuit of administrative efficiencies and alternative revenues.

Chief Financial Officer Taylor then discussed the Working Smarter initiative, now in its third year. He reported that the initiative has achieved a good momentum and he anticipated that by July 2013, the initiative's third anniversary, it would have achieved over $400 million in fiscal impact, and that it would exceed its goal of $500 million in five years. The University would be able to show its stakeholders that it uses its funding as wisely as possible. The Working Smarter initiative has programs under way in many areas of the University and is partnering with the California State University (CSU) to reduce costs for contracts and procurement.

In response to a question by Governor Brown, Mr. Taylor explained that the Working Smarter initiative has 34 programs in its portfolio. The programs in the areas of risk management and enterprise administration are likely to generate the greatest savings. Mr. Brostrom added that all UC campuses are examining restructuring and other ways to save money and increase revenue. The Working Smarter initiative is a systemwide effort focused on areas where the size of the UC system as a whole can generate greater savings. In addition, coordination with CSU would result in an unmatched buying power.

Governor Brown asked how this initiative was contributing to the productivity of the UC enterprise. In order to be more efficient and responsive to existing fiscal constraints, the University should have an understanding of how its enterprise functions, how instruction is delivered, or how much time is spent on different tasks, and the costs of all these activities. Mr. Brostrom responded that most decisions about these enterprise functions are made on the campuses. The Working Smarter initiative is concerned with systemwide applications. One example was the development of a new payroll process for the University, UCPath, a common system for all UC employees at all locations. Following UCPath, the University hopes to develop other common administrative systems for other tasks; these new systems would reduce administrative expenses and free up more funds for teaching and research. Mr. Taylor anticipated that the UCPath system would generate $80 million in savings annually.

President Yudof asked about the progress of the Working Smarter initiative toward its $500 million goal. Mr. Taylor responded that the initiative had saved more than $300 million, and anticipated that it would save $400 million by July 2013, its third anniversary.

Mr. Taylor explained that one goal of the Working Smarter initiative was to ensure that a successful program on one campus could be applied on other campuses. One example of this was the P-Card program for procurement; the University would soon move to a common e-procurement platform for all the campuses. UC San Diego had begun this successful program several years earlier, and other campuses were being encouraged to adopt it in order to save money which could be directed to core operations. Similarly, successful techniques in liquidity management, strategic sourcing, and fundraising are shared among the campuses.

In response to questions by President Yudof, Mr. Taylor explained that strategic sourcing is the leveraging of UC's size to secure better contracts for its purchases. In the current year the University would save approximately $85 million through strategically sourced contracts. The goal for this program is to save $200 million.

President Yudof observed that savings from the program would be savings from State funds, patient revenues, research, and other funds. Mr. Taylor estimated that savings from State funds in fiscal year 2013-14 would be about $20 million. He then briefly defined the liquidity management program, an effort to rationalize the amount of liquidity in the Short Term Investment Pool (STIP). New cash forecasting tools allow the University to predict its cash needs more exactly and to earn more through investments. In the past year, the University had earned an additional $60 million through this liquidity management program.

Mr. Brostrom noted that the University's 2013-14 budget plan would include balance sheet strategies, business and finance strategies, and enrollment, tuition, and financial aid strategies. Mr. Taylor outlined some balance sheet strategies. In liquidity management, the University is carrying out an analysis for the campuses fund by fund, to ensure that transfers from STIP to the Total Return Investment Pool (TRIP) are appropriate. Liquidity management might provide another $20 million to $40 million annually in unrestricted funds. Mr. Brostrom added that since its inception, TRIP has outperformed STIP by over four percent; in the future, it might be expected to outperform STIP by two percent to 2.5 percent. Every $1 billion moved into TRIP would provide $20 million to $25 million in unrestricted revenues to the campuses.

Mr. Taylor then mentioned the University’s renewed efforts to secure approval for the restructuring of State lease revenue bond debt. There were currently about $2.4 billion of State Public Works Board lease revenue securities outstanding, issued by the State on behalf of UC’s academic and research facilities. These bonds count against UC ratings ratios. The University would continue to make the case to the State that through restructuring, over the next ten years, UC could save $80 million annually and free up revenue. If interest rates rise, the financial benefits of this approach would not be as strong.

Mr. Brostrom noted that the University had experienced success in reducing costs in health and welfare benefits by $90 million in the past few years. Health and welfare benefits represent approximately $1.6 billion of UC’s expenses. The University had managed to reduce costs without unduly affecting the benefits of its employees, by introducing a new network, implementing a family member verification program, and working with the federal government on an early retirement reinsurance program. In the coming year, UC would rebid all its health insurance offerings. Given the University’s purchasing power, Mr. Brostrom anticipated that UC would receive aggressive bids. In addition, UC would introduce a new self-insured program.

Other strategies were to increase nonresident enrollment and to make changes to the University’s financial aid model. Mr. Brostrom observed that middle-income students are the most vulnerable category of students, inasmuch as they do not qualify for Cal Grants or Pell Grants. The University is seeking to develop alternative revenue sources in order to extend financial aid to middle-income students. Currently no tuition is charged to students from families with annual income below $80,000, or about 45 percent of UC undergraduates. UC would like to extend this financial aid to students with family income between $80,000 and $120,000, and to waive 50 percent of tuition for them. This category of students pays the highest percentage of family income for a UC education. The University does not wish to rely on return-to-aid for this need, but is looking for other revenue sources.

In response to a question by Committee Chair Varner, Mr. Brostrom responded that about 29 percent of tuition revenue is returned to financial aid, or about $660 million in the current year. In essence the University taxes students to provide financial aid for other students.

Senior Vice President Stobo then discussed consolidation of medical center infrastructure and clinical services and the new self-insured health plan. The financial success of the UC medical centers is closely linked to the programmatic success of UC’s health professional schools, especially its medical schools. Over the previous five years, patient revenue at UC medical centers had increased 1.5 times in the aggregate. During the same period, the medical centers’ financial support for research, educational, and clinical programs at the medical schools increased twofold. The previous year, this support amounted to more than $500 million. The national health care reforms to be experienced in the coming years would present a challenge to UC’s medical centers, particularly in the area of costs. Sharing infrastructure would help reduce costs. Infrastructure costs include laboratory tests, currently duplicated at each medical center, which could be carried out at one medical center. Some medical centers rely on third-party laboratories for certain sophisticated tests; this service could be provided within UC. Dr. Stobo stated that UC should also consider rationalization of clinical services or consolidation, so that specific services would be provided at one or another medical center, rather than duplication of services at all five medical centers. The implementation of these strategies would be facilitated by the fact that UC's medical centers had been functioning as a system in many areas over the past several years.

Dr. Stobo explained that the self-insured health plan would be a health plan for UC employees. The University would like to begin offering this plan during the open enrollment period in fall 2013 and believes that the plan could produce savings in delivery of health care costs. UC also feels that it is important for its medical centers and physician groups to provide high-quality, affordable care to its employees. An important part of the plan would be a strong wellness and prevention program. This would be a unique feature among the various plan offerings now available. The plan would rely predominantly on UC providers, physicians, and facilities, and would include incentives for healthy behaviors.

Chairman Lansing stressed that the self-insured health plan would save money, promote prevention, and provide better insurance. Mr. Brostrom added that the costs paid would remain in the UC system. Mr. Taylor noted that UC already self-insures for almost every other type of risk, and that there is an existing infrastructure to manage this program.

Chairman Lansing asked about the implementation schedule for the plan. Dr. Stobo responded that the plan would be offered to employees in fall 2013 and would begin effective January 1, 2014.

Regent De La Peña suggested that this plan could be commercialized and offered to other groups in addition to UC employees.

Regent Island referred to the proposed consolidation of clinical services and asked how teaching opportunities would be affected by this consolidation. Dr. Stobo responded that each medical center would have to offer a plethora of essential services for the safety and convenience of the public. The services to be consolidated would be high-end tertiary or quaternary services such as liver transplants. In Northern California, liver transplants are not performed at both the UCSF and Davis medical centers, but only at UCSF. Dr. Stobo emphasized that there are other sophisticated, costly procedures that are currently performed throughout the system that could be consolidated. Patients would be willing to travel 30 to 40 miles to receive these procedures, and they are not a critical part of the core educational program.

Regent Island asked if resident training for a procedure such as liver transplants would be localized at the medical center that performs that procedure. Dr. Stobo responded in the affirmative. Residents and fellows wishing to specialize in a particular procedure could spend their educational time at the relevant medical center. Chancellor Desmond-

Hellmann added that it was not uncommon for UC medical students to go to other medical center locations or community hospitals to gain additional experience and training.

President Yudof emphasized that the self-insured health plan would be one option among many and that no employee would be forced to join. He requested an estimate of savings the plan might generate. Dr. Stobo responded that the plan would be voluntary and would be offered along with other, commercial plans that employees could choose. He expressed the hope that employees would select the plan, and that the incentive to do so would be based on the plan's wellness and prevention elements. In addition, the plan would be competitively priced. Dr. Stobo estimated that the University could save $30 million to $50 million in pharmacy costs annually under the plan. Referring to Regent De La Peña's earlier comment, Mr. Brostrom noted that UC had introduced a self-insured health plan for its students two years earlier. Prior to that new plan, there had been different programs on each campus. The new plan had reduced costs by about $8 million and allowed for expanded offerings.

Dr. Stobo observed that most employers as large as UC have a self-insured health plan.

Chairman Lansing stated that this was an opportunity to improve health insurance as well as reduce costs. The proposal to consolidate clinical services in the Northern and Southern California regions is also aimed at providing better services with greater efficiency. Committee Chair Varner concurred that reducing costs was not the overriding consideration.

Chancellor Drake drew attention to the fact that UC hospitals are routinely industry leaders in their regions. This plan would allow UC employees receive the highest-quality care at an affordable price.

Mr. Brostrom then continued the presentation by mentioning another strategy, the reform of the UC Retirement Plan (UCRP) and annuitant health benefits. He recalled that there would be a new tier in the UCRP beginning in July 2013 for employees hired after that date. This new tier would reduce UC's normal cost by 20 percent. It would not affect the unfunded liability of the UCRP, but overall costs would decrease over ten to 15 years. The new tier would have an immediate effect on UC annuitant health benefit costs.

The retirement age, when maximum benefits are accrued, would be moved from age 60 to age 65. UC retirees are eligible for Medicare at 65. The period between ages 60 and 65 was most costly in UC's annuitant health program. Once this change in the retirement age is fully implemented annuitant health costs might be reduced by as much as 50 percent.

Mr. Brostrom noted that there would be a report on another long-term strategy, technology transfer, later in the meeting.

Mr. Taylor briefly mentioned a proposal for a parking asset transfer to the UCRP. A task force would review this proposal, which requires considerable due diligence. Regent Newsom urged the task force to examine carefully the arguments for and against such a transfer, and the experience not only of other universities, but of municipalities. Mr. Taylor concurred that there were examples of parking securitization deals that had gone awry, and that it would be a priority for the University not to repeat those mistakes.

Mr. Brostrom then mentioned another strategy, cohort-based tuition, under which a student entering UC would be informed of the rate of increase for tuition or the total cost of education during his or her time at UC. In the past, the University could not guarantee this because of the unpredictability of State funding. With the passage of Proposition 30, the University might wish to pursue this. Committee Chair Varner expressed support for this strategy.

Provost Dorr then discussed online education at UC. She reported that every campus has one or another online education effort. These efforts are often found in graduate or University Extension programs, and this technology is used to deliver some elements of undergraduate courses. Every campus is using multiple approaches. The new phenomenon of massive open online courses (MOOCs) offers a good opportunity for independent learners and for the University to become better known and appreciated. Ms. Dorr noted that while MOOCs are an exciting development, they are not closely tied to the achievement of academic goals. She recalled that one goal of UC's online education initiative was to develop online courses that could be taken for credit by students on every campus. Agreements among the campuses would be necessary to achieve this. Another goal was that UC's online courses would be open to non-matriculated students. The online education initiative is taking place in an environment that is constantly changing. UC faculty are now working to develop courses that will be recognized as equivalent by all campuses. Ms. Dorr expressed confidence that the success of this effort would benefit students and faculty on all campuses.

Chairman Lansing observed that certain courses lend themselves to online delivery, others not. She stressed that the development of online education at UC is a high priority for the Regents. The University should do nothing that would hurt academic quality, but it must move forward with this effort expeditiously in order not to be left behind by developments in the world of education.

Chairman Lansing requested information about the possibility or feasibility of having the University assign more hours of teaching for some UC instructors.

Ms. Dorr responded that it would be possible to give a presentation to the Regents on online education at the January or March meeting.

President Yudof observed that there had been much debate about the financing of online education. He requested an analysis of the amount of the University's investment in online education, an assessment of whether the investment was sufficient, whether it should be increased, or whether the financing arrangement should be altered. He asked Ms. Dorr to explore these questions with the Academic Senate.

Regent Newsom emphasized the importance of commitment and resolve. He echoed Chairman Lansing’s sense of urgency about this matter, which should not be a passing interest for the University.

Regent Kieffer praised the administration’s cost-saving projects, noting that their implementation was not a simple matter. With regard to online education, he stated his view that in the next few years the University would have to address the fact that universities are changing; UC must be aware of how they are changing, taking into consideration information from all over the nation and the world. The University must consider course content, educational outcomes, and effective teaching models. The first step was to secure financial support, and the second and more difficult step would be to bring about the necessary changes in UC teaching and research. Regent Kieffer stressed that this was a broad question involving not only online education, but the University’s overall ability to teach and carry out research in the best way possible.

Regent Pattiz stressed that changes in the information and media world were occurring rapidly. He stated that the Regents must invite leaders of the digital and online world, who would be eager to engage with the University, to speak at a meeting. The University must be in a leadership position in this area; it could do so by identifying the appropriate resources and people. Online education must be a priority for the University, with important implications for the future direction of UC.

Regent Reiss stated that the development of online education was necessary to maintain the excellence of UC. She asked that a presentation on online education at a future meeting include information on progress made by the University in effectively providing courses students need to complete their degrees on time. She asked whether UC’s online education program is responding to this need, and if not, what obstacles stand in the way of this goal, the timely completion of degrees.

Regent Stein expressed students’ hesitancy about online education. While digital media are at work in many areas, this does not mean they would be effective in the classroom. He cautioned that before linking its reputation to online education, the University must be absolutely certain that the quality of online instruction is equal to the quality of the classroom experience. Regent Stein requested that students have an opportunity to discuss the matter with Ms. Dorr before the presentation to the Regents. He also requested data regarding student satisfaction with online learning experiences.

Chairman Lansing emphasized that nothing would be done that would hurt the quality of the University. There was an urgent need to implement a stronger, more robust pilot program.

Governor Brown expressed appreciation for the durability of the University and its traditions, but noted that institutions as venerable as the U.S. Post Office and newspaper empires were being upended by changes in digital communications. University-level education online was already a reality. The text of the Ratio Studiorum, the foundational document of Jesuit educational theory first issued in 1599, is available online in English translation. The University would experience pressure to change if other entities could provide the same learning online. The University's proposed budget projected a nine percent increase in State funding; in order to avoid a student fee increase, Governor Brown estimated that the State would have to provide an approximately 12 percent annual increase in General Fund support. General Fund revenues could not meet this goal, and the State has many other claimants. He noted that quality and excellence are often invoked in discussions about the University, but observed that these are highly abstract terms and stated his belief that there might be more inexpensive but equally satisfactory alternatives to classroom teaching. Governor Brown proposed that the Board invite foremost representatives of the new technologies, individuals from Udacity or other relevant organizations, to make a presentation at the following meeting, with a response from UC professors. He emphasized the need to act quickly. The presentation should elucidate the relevant issues and possibilities and frankly discuss the harsh realities of the marketplace and technology.

Committee Chair Varner and Chairman Lansing stated that this would be arranged. Regent Pattiz offered assistance in providing access to individuals who might be involved in this presentation.

Regent Island recalled that the there had been discussions about online education about four years earlier. He expressed disappointment at the slow progress of this effort, in particular that the faculty had not pursued online education with greater alacrity. No concrete concept had yet been presented to the Board; this concept should be presented by the faculty. He stressed that the Regents should neither set curricula nor impose the concept of online education on the University. He asked that Ms. Dorr move this matter forward more quickly.

Regent Blum emphasized the difference between dictating curriculum and indicating strategy. The role of the Board is very much to indicate strategy. He expressed support for the Governor's proposal. The necessary expertise could be found nearby in Silicon Valley but also within UC. He expressed agreement with Regent Island that the process had been too slow, and noted that some instructors on the campuses feel threatened by online education. These misgivings must be overcome.

Regent Pattiz stated that it was not surprising that there would be resistance to online education within the University, but UC had now reached a point where it must consider these technologies.

Chancellor Birgeneau stressed that online education was already under way on the campuses. The most advanced consortium in the development of MOOCs, edX, was led by the Massachusetts Institute of Technology, Harvard University, and UC Berkeley. He stated that in discussions with him, students indicated that they are very much aware that education will undergo significant changes in the coming ten years. Students at UC

Berkeley are involved in platform research and are demanding that the University change how it teaches. UC Berkeley offers online master's degrees. UCB offers an online course on the use of quantum mechanics in computing; 25,000 students were registered in this course in the current semester.

Governor Brown countered that the world of digital technology has not inserted itself into the heart of the University's academic program. Developments in Silicon Valley could leave the University far behind.

Governor Brown asked how many courses at UC Berkeley can be taken entirely online. Chancellor Birgeneau responded that the Berkeley campus' strategy is to offer courses with both an in-class and online component.

Governor Brown asked if UC Berkeley offered any course for credit for which 40 percent of the work could be done online. Chancellor Birgeneau responded that this was the case for some computer science courses, including introductory courses.

Governor Brown underscored the need to seek cost savings. Chancellor Birgeneau reiterated that UC is playing a leadership role in the development of online education through creative efforts by its faculty and through its partnership in consortia with other universities.

Governor Brown stressed that it would be instructive to hear the points of view of individuals from outside the University. Their ideas could then be evaluated for how appropriate they might be within the University framework.

Committee Chair Varner asked that the presentation include detailed information on current online education activities on each campus, as well as plans for next steps. Chairman Lansing added that this information should concern courses offered for credit.

Ms. Dorr concurred with all the speakers about the potential contribution of digital media to an excellent UC education. She stated that the presentation would include information on campus efforts now under way.

Regent Kieffer asked that the presentation also report on any obstacles, administrative or otherwise, that stand in the way of these efforts. He noted that the Regents were interested not only in online education, but in the changing delivery model for education, and what actions the University must take to adapt to the new environment.

Senior Vice President Dooley then provided a brief update on UC fundraising initiatives. He recalled that a number of task forces had been formed about a year previously to pursue alternative revenue sources and to improve UC's advocacy and communications efforts. Mr. Dooley stated that UC had made progress in all three areas. The University has created a business partnership program, reaching out to iconic California companies and requesting that they support student financial aid with a three- to five-year commitment for scholarships for middle-income students. This effort has generated significant interest. He anticipated that this program would be publicly launched in the first quarter of the next calendar year.

For the fiscal year ending June 30, 2012, the University raised nearly as much in funding as during the previous year. It was the third highest year on record, with just below $1.6 billion raised. Virtually the entire amount was raised by campuses and campus foundations.

President Yudof emphasized that UC has raised significant funds, although all but a small percentage of this amount is restricted funding that cannot be applied to the general operating expenses of the University. Donors expect UC's core funding to come from the State and tuition. The University is making efforts to increase the amount of unrestricted funding. Mr. Dooley explained that the business partnership program was one such effort to raise unrestricted funds. Another effort, not yet completed, would be an online fundraising platform linked to Facebook.

Chairman Lansing expressed optimism about this platform and stated that it would engage students. Mr. Dooley added that revenues generated by this effort would be available for student support in 2013-14.

In response to a question by Committee Chair Varner, Mr. Dooley stated that before the University can restructure its return-to-aid, it must generate alternative revenue sources.

Vice President Lenz then discussed the 2013-14 UC budget plan. He expressed the University's gratitude for the passage of Proposition 30, which addresses a foremost goal of the University, fiscal stability and the ability of campuses to plan their budgets. The 2013-14 budget plan includes recommendations for enrollment growth, compensation, benefits, funding for non-salary costs, and reinvestment in the quality of UC. Revenue assumptions include State General Funds, professional degree supplemental tuition, UC general funds, and alternative revenues. The plan proposes increases in expenditures for enrollment costs, professional school programs, the UC Riverside School of Medicine, and mandatory costs such as retirement contributions, employee and annuitant health benefits, academic merit increases, and compensation. The plan also addresses existing funding deficiencies for non-salary costs and deferred maintenance. A critical feature of the plan is a multi-year effort to restore quality by enhancing undergraduate instructional support, increasing funding for graduate student support, reducing the student-faculty ratio, supporting start-up costs for new faculty, and reducing the salary gaps for faculty and staff. The total proposed $584.3 million increase in expenditures also includes the repayment of STIP borrowing in 2012-13 and financial aid for professional degree students.

The plan assumes that the State will honor the provision of the 2012-13 budget to provide $125.4 million as a tuition buyout. UC hopes that the State will increase the University's base budget by six percent and provide additional funding for the UCR School of Medicine. The plan assumes increased revenue from professional degree supplemental tuition of $20.8 million; $7.5 million of this amount would be used for financial aid. The plan assumes $23 million in nonresident supplemental tuition, based on an increase of approximately 1,000 nonresident students. The plan also assumes a modest increase in indirect cost recovery for contracts and grants from recently negotiated increases in federal rates by several campuses. The University anticipates constraints on federal research funding in the following year.

The plan also looks to alternative revenues. If approved by the State, a debt restructuring proposal could provide $80 million; asset management from STIP to TRIP could provide $20 million; systemwide contract savings could amount to $20 million.

Mr. Lenz concluded by briefly outlining the 2013-14 Budget for State Capital Improvements that would fund 39 major capital projects. This budget includes about $432 million for 12 new facilities and almost $134 million for 17 renovation and infrastructure improvement projects. There is also one project for equipment in a new building already under construction, and nine seismic and life safety projects.

President Yudof observed that the budget plan reflected the University's desired direction. The University must realize savings and await the results of the legislative process. He stressed that the budget in its final actual form would not likely resemble the plan as presented that day, because there were many contingencies. It was unlikely that the State would fund $788 million in capital improvements as the University was requesting. President Yudof expressed particular concern about the need for a classroom building on the Merced campus.

Regent Stein concurred that there was an urgent need to invest in the growth of UC Merced. He referred to assumptions in the budget plan of about $150 million in new State funding from a base budget adjustment and $80 million from debt restructuring, and asked what elements would be removed if the University did not secure this funding. He also asked about the status of the University's multi-year agreement with the Governor and Legislature. Mr. Lenz responded that if this funding were not received, the University might not increase student enrollment or provide salary increases for employees, and campuses might be asked to absorb deferred maintenance costs and non-salary price increases. There is flexibility in the budget plan and expenditure assumptions would be adjusted if necessary. Mr. Dooley stated that the University had worked extensively with the California Department of Finance to develop a framework for a multi-year funding agreement. The Department of Finance has indicated that it wishes to continue discussions. Mr. Dooley recalled that the agreement includes specific goals that the University must meet in order for the agreement to be fully implemented. He expressed confidence that the basic framework of the agreement was still viable, revenues permitting.

In response to questions by Regent Island, Mr. Lenz explained that the assumption of an increase of $23 million in nonresident supplemental tuition was for all campuses, and based on assumed growth of 1,000 additional nonresident students. The existing level of nonresident supplemental tuition, $407 million, was already in the University's base budget assumptions; the $23 million represented additional growth.

In response to a question by Regent Newsom, Mr. Lenz clarified that the assumption of an additional $126.5 million in State General Funds listed on a slide in the presentation was separate from and in addition to the $150.2 million base budget adjustment assumption.

Regent Newsom expressed concern about the assumption that the State would provide an additional $276.7 million in General Fund support, as well as the assumption of $80 million in debt restructuring. Mr. Lenz responded that this would depend on the Legislature. He clarified that the $80 million would be savings generated by debt restructuring, not additional funding. If the debt restructuring did not take place, the University would either need offsetting revenue or have to make reductions in expenditures.

Regent Newsom stated his view that it was unlikely that UC would receive $276.7 million in additional support from the Legislature, and that the default in that case would be a tuition increase. He asked if the budget plan assumes a tuition increase, or if the University would develop an alternative. Mr. Lenz responded that the Regents have the option of reducing the expenditure plan. The budget plan presented that day represented the Regents' priorities if revenue is available. The Governor and Legislature may indicate that they have other priorities. There would be a long process of negotiations with the State in the next six months.

Regent Newsom expressed concern about the magnitude of a possible fee increase. Mr. Brostrom stated that in the past, the University has addressed this kind of situation not by increasing tuition, but by sacrificing quality. The largest expenditure increase in this budget plan was the $155 million reinvestment in quality. He stressed that a diminution in quality has occurred. The student-faculty ratio has increased dramatically, as one example.

Regent Newsom anticipated that the University would argue strongly against further diminution of quality in upcoming discussions, and reiterated his concern that the default would be a fee increase. Mr. Lenz stated that the University's default solution has been to not reinvest in the quality of the institution. There has been no State funding for enrollment growth, deferred maintenance, and many other budget items for some time. The University has simply managed without this support or found other mechanisms. A tuition increase has not been the default solution.

Regent Newsom asked what the equivalent of a $126 million tuition buyout would be for students. Mr. Brostrom responded that it would represent a six percent increase in tuition for students, with a net of five percent going to the campuses; the University would seek other resources to cover financial aid.

Governor Brown stated that the quality of the University is treated as an abstract concept. This concept has to be analyzed to determine what its constituent elements are, and the University should explore alternative pathways to achieve the same educational outcomes. He underscored the fact that complex institutions like UC move slowly. If there were no tuition increases for the next five years, the State would have to increase its General Fund commitment to UC by 12 percent annually. Governor Brown stated that this was unlikely to happen. In fact the University was proposing tuition increases unless there were some third alternative. Although it might appear that there is no third way, as expressed in the Latin phrase "tertium non datur," Governor Brown expressed his view that there were other ways to reshape the University with a deeper understanding of its quality and excellence, though this would not be a simple matter. A paradigm change is required. General Fund revenues must be put in the service of restructuring, of reasonable, creative change. All constituents, including faculty, must be involved in the discussion. Governor Brown stressed that State support for other deserving California programs had also been reduced, and that the State faces significant debt. He stated his view that the State could secure funding for UC, but it had to be sustainable over the long term. An annual 12 percent funding increase is not sustainable. The path ahead would be very difficult, but the Governor expressed his desire to assist the University. Tuition increases could not be avoided by anything other than heroic efforts to make changes that could be made if there were sufficient political will to make them.

Chairman Lansing observed that the Regents had been intensely examining alternate revenue sources over the past several years to avoid tuition increases. The Regents and the Governor share the same goal, and the Regents are eager to work with the Governor to achieve it. She thanked the Governor for developing and supporting Proposition 30 and for making education a high priority in words and deeds.

Regent Newsom asked when the University would have to schedule a tuition increase, if one were needed to address a budget shortfall. He suggested that this might take place before the May Revision of the Governor's budget proposal, subject to any augmentations toward the end of the budget process. Mr. Brostrom responded that the University would be engaged in discussions with the Governor and his staff in the coming weeks and would have some idea of the Governor's January budget proposal. The University can reduce expenditures in its budget plan, as it has in the past. It could remove the reinvestments in UC quality, or again not provide a regular compensation increase for non-represented staff. The University would consider all options in the light of the State budget. He emphasized that if the University were to consider any tuition increase, it would also seek to provide more financial aid to middle-income students.

President Yudof stated that any tuition increase would occur after consultation with students, with an end date in May. The University is requesting what it genuinely believes it needs. Proposition 30 has allowed UC to avoid almost $400 million in further reductions, but the University is still addressing $800 million in reductions.

Regent Newsom expressed concern that the University would find itself in the same situation at the end of the budget cycle, facing serious and difficult decisions. Mr. Dooley responded that the assumptions in the budget plan were based on the results of discussions with the California Department of Finance, including assumptions about increases in funding and debt restructuring. The tuition buyout assumption was more recent. Mr. Dooley stated that it was unlikely that all three of these items would fail to be realized. Regent Newsom stressed that even if two of these three items were realized there might still be a six percent tuition increase.

In response to a question by Regent Reiss, Mr. Lenz explained that all the revenue assumptions in the budget plan were flexible and subject to change. Committee Chair Varner and Chairman Lansing clarified that the Regents were approving a budget plan, a framework that would be used in moving forward.

Regent Newsom stated that he could not support this item. Governor Brown expressed understanding that the budget plan was something like a wish list for the University, with its long-term future in mind.

Upon motion duly made and seconded, the Committee approved the President’s recommendation and voted to present it to the Board, Regent Newsom voting “no” and Governor Brown abstaining.

3. **APPROVAL OF PROFESSIONAL DEGREE SUPPLEMENTAL TUITION LEVELS FOR 2013-14**

This item was withdrawn. Committee Chair Varner explained that Governor Brown had requested additional time to gain a better understanding of the policies and methodology involved in the setting of professional degree supplemental tuition levels. Office of the President staff would provide the Governor with relevant information.

The Committee recessed at 11:50 a.m.

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The Committee reconvened on November 15, 2012 at 10:25 a.m. with Committee Chair Varner presiding.

Members present: Regents Blum, Gould, Island, Mendelson, Stein, and Varner; Ex officio members Lansing and Yudof; Advisory members Flores and Powell; Staff Advisors Barton and Smith

In attendance: Regents De La Peña, Kieffer, Makarechian, Pattiz, Reiss, Rubenstein, Ruiz, Schilling, Torlakson, and Zettel, Regent-designate Feingold, Faculty Representative Jacob, Secretary and Chief of Staff Kelman, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Provost Dorr, Executive Vice President Brostrom, Chief Financial Officer Taylor, Senior Vice Presidents Dooley and Stobo, Vice Presidents Beckwith, Duckett, Lenz, and Mara, Chancellors Block, Blumenthal, Drake, Katehi, White, and Yang, and Recording Secretary Johns

4. **PARTICIPATION IN A SEPARATE 501(C)(3) ENTITY, TRANSFER OF THE CENTER FOR EXECUTIVE EDUCATION AT THE HAAS SCHOOL OF BUSINESS TO THE ENTITY, AND EXTENSION OF LOAN TO ENTITY, BERKELEY CAMPUS**

The President recommended:

A. Approval of the University's participation in a separate non-profit entity (Entity) that shall own and operate the Haas School of Business (Haas) Center for Executive Education (CEE), subject to the following terms and conditions:

(1) The Entity shall be organized exclusively for charitable, scientific, and educational purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986 (the Tax Code), or corresponding section of any future federal tax code, and shall apply for, and maintain, tax exempt status under Section 501(c)(3) of the Tax Code. Should the Entity be dissolved, all assets shall revert to the University.

(2) The Entity shall be governed by a seven-person Board of Directors (Board) including the Dean of Haas, the University of California Berkeley (Berkeley) Vice Chancellor of Administration and Finance (or a designee), and a member of the Haas or Berkeley Ladder Faculty as well as four independent Directors. The Chairman of the Board will be the Dean of Haas. The Directors shall receive no payments from the Entity other than reimbursement for travel expenses.

(3) The Entity's organizational documents shall require a supermajority (at least five out of seven) of the Board to approve any of the following actions by the Entity:

a. Any change in the affiliation agreement between the Entity and the University

b. Any change in the distribution of the net earnings of the Entity

c. Any change in the composition of the Board

d. Any amendment to the bylaws or articles of incorporation of the Entity

e. Dissolution of the Entity

B. Approval of the transfer of the CEE program to the Entity, including assets (and corresponding liabilities) such as client contracts, accounts receivable, revenue accounts, client relationships, knowhow, and good will, subject to the following conditions:

(1) The Entity shall enter into an affiliation agreement with the University, detailing the respective rights, duties, obligations, and economic terms of the parties in connection with the affiliation, including the Entity's use of the University's name and intellectual property. The affiliation agreement shall require the Entity to pay, on an annual basis, (i) the prevailing administrative full costing fee, which is currently set at seven percent of gross revenue, to Berkeley, and (ii) all of the Entity's net earnings to Haas. The affiliation agreement shall also provide that, in continuation of CEE's current practice, educational content will be reviewed and approved by a member of the Haas Ladder Faculty to ensure that the University and Berkeley's brand and reputation are protected. The University and the Board of the Entity shall receive an overview report on educational content at least annually. Amendments to the affiliation agreement shall require the consent of the University and the Entity.

(2) The termination of the affiliation agreement shall result in the automatic dissolution of the Entity.

(3) The University shall have the right to conduct a periodic review of the Entity's programs to ensure that the Entity is operating at a level consistent with the University's standards of excellence.

(4) The Entity may act as a service organization to other University campuses, schools, and units interested in leveraging the Entity's executive education infrastructure and capabilities on a fee-for-service basis or through the application of a sharing model when conducting joint programs.

C. Approval of an interest-free loan from Haas to the Entity for up to $500,000, with repayment required within six months after the transfer of the CEE program to the Entity.

D. That the President be authorized, after consultation with the General Counsel, to approve and to execute (i) any documents reasonably required to accomplish the above; and (ii) any modifications, addenda, or amendments (collectively, "amendments") thereto, provided that such amendments do not materially increase the obligations of the University or materially decrease the payments to the University from the Entity; provided, however, that the authority to approve and to execute the affiliation agreement and any amendments thereto may not be delegated by the President.

[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.]

Executive Vice President Brostrom explained that this item proposed to transfer the successful Center for Executive Education (CEE) program at the Haas School of Business at UC Berkeley to a separate non-profit 501(c)(3) entity. The CEE provides non-degree corporate training and is a significant source of revenue to the Haas School. The proposal is designed to enhance, preserve, and expand the program. If successful, the expansion would generate additional revenue that would be devoted to supporting and improving core programs at the Haas School. This proposal was exemplary in using non-core activities and revenues to support UC's core mission. At the same time, CEE not only generates revenue; it annually trains over 2,000 executives. Under this proposal, the number of executive trainees would grow substantially. High-quality programs like CEE enhance the reputation of the Haas School and the University in the U.S. and internationally.

Provost Dorr observed that the CEE program is a non-degree program that does not award regular course credit. For this reason, the proposed action is not officially an Academic Senate matter. Nevertheless, the Berkeley campus felt that the Academic Senate should examine the proposal. Two key bodies of the UC Berkeley division of the Academic Senate were consulted, the Committee on Academic Planning and Resource Allocation and the Divisional Council. Both bodies expressed support for the proposal, while recognizing that it was outside their official purview. The proposal includes certain provisions that were important to the faculty reviewers: ladder-rank UC faculty would continue to review and approve CEE programs and offerings, and they would periodically be able to review CEE's overall academic quality. The Systemwide Academic Council was also informed about the proposal.

Chancellor Birgeneau expressed enthusiasm for the proposal and for separating non-degree from degree programs. CEE would bring leaders from a broad spectrum of businesses to the campus. With the flexibility of a 501(c)(3) entity, the program would generate significant income for the Haas School and the campus.

Richard Lyons, Dean of the Haas School, explained that the proposal represented the restructuring of a non-core operation to serve the core mission of the School, its degree programs, research, and public service. All instruction in CEE is not for credit or degrees. The board structure for the new entity would include three UC Berkeley members: the Vice Chancellor – Administration and Finance, the Haas School Dean, and a Haas School faculty member. There would be four non-UC employees on the board, likely selected from the Haas School Board or the UC Berkeley Foundation Board of Trustees.

Mr. Lyons outlined the rationale for the new entity. Gross revenues for the Haas School are approximately $100 million, including public funding. In the previous year, CEE accounted for $17 million of that amount. The Haas School believes that the new arrangement would increase its ability to grow this business. Mr. Lyons anticipated that CEE would become globalized, with centers in Asia and Europe. These CEE centers would need directors. Based on information about competitors, Mr. Lyons projected that the necessary compensation levels for these center directors would be above current UC thresholds. The Haas School is currently searching for a senior executive for CEE. A more flexible compensation structure including performance-based pay would allow the hiring of a stronger executive CEE leader and more effective marketing. CEE has been constrained in its ability to grow because it has not been able to provide performance-based compensation, unlike public and private competitors.

Mr. Lyons noted that governance and control issues had received careful consideration. CEE would provide not only financial, but also reputational benefits to the Haas School. Over 2,000 executives participate in the CEE program annually. While the duration of their study at CEE is shorter than that of students in the Haas School, this experience makes them more likely to hire graduates from or send students to the Haas School and UC. He reported that a recently hired faculty member expressed specific interest in opportunities to teach non-degree executive education courses; thus CEE contributes to the Haas School's ability to recruit outstanding faculty.

Mr. Lyons projected that CEE would achieve a 17 percent annual growth rate over the coming seven years, with revenue rising to approximately $50 million. He estimated that growth of CEE without the new 501(c)(3) structure would be one-half to two-thirds of this amount. He pointed out that faculty receive no credit against their workload for teaching executive education courses. CEE would not create conflict of interest for faculty and would not impair teaching in degree programs. The Haas School has exercised great caution to avoid conflict of interest generally in the design of this enterprise. The current faculty oversight of course content would continue into the future. Every current employee in CEE would be offered a role in the new enterprise. The split of cash flows from CEE would remain as they were currently. No cash flows would be directed toward private sector entities.

Mr. Lyons concluded by emphasizing that there was not a significant financial risk in the proposal. CEE is an ongoing concern that has been growing rapidly, even in difficult financial times. This is a robust fee-for-service business.

Regent Blum noted that executive education programs are becoming increasingly popular. The Wharton School of the University of Pennsylvania, a prestigious school competing with UC, now has a campus in San Francisco. He expressed strong support for the proposal.

Regent Gould praised the entrepreneurial nature of the proposal. He asked if CEE would pay a set percentage back to the campus. He noted that there would be certain necessary costs to establish the new entity, but that as it grew in scale, costs would become fixed. He asked if the Haas School had examined different possible sharing relationships as the program grows. Mr. Lyons responded that different sharing relationships were considered, especially those at public and private business schools that have pursued the development of 501(c)(3) entities. At a number of schools, zero percent of revenues is returned to the campuses. CEE would return seven percent of its revenue to the Berkeley campus.

Regent Island asked about the need to separate from UC Berkeley rather than remaining within the Haas School. Mr. Lyons responded with three points. First, CEE would have an employee responsible for business development and fulfilling enrollment targets. This has been shown to be most effective with an incentive-based contract. Second, CEE clients are accustomed to the corporate world and contracts that are understood and signed quickly. Currently, Haas School contracts require nine signatures and cannot include certain services that corporate clients expect. The current arrangement for contracts diminishes agility. Third, the chief executive for CEE recently left, mostly due to operational frustrations, and because her salary was approaching a threshold at which Regental approval would be required. Mr. Lyons anticipated that within five years there might be three or four CEE employees at compensation thresholds and receiving performance-based compensation elements that take many steps to approve within the existing operating system.

Regent Island asked if the existing UC bureaucracy did not allow the necessary flexibility to make CEE competitive. Mr. Lyons responded that he would apply the term "bureaucracy" to specific areas where CEE required greater flexibility: a performance-based pay relationship with employees; the ability to move base salaries more easily, including above current thresholds; the ability to run contracts in a more agile manner; and the ability to provide services CEE currently had difficulty providing.

Mr. Lyons assured Regent Island that the establishment of the entity outside the Haas School was not an attempt to avoid oversight by the Board.

In response to a question by Regent Makarechian, Mr. Lyons explained that the seven percent return to the campus comes from gross revenues. In 2011-12, the total revenue for CEE was $16.8 million; seven percent of this was the amount of the campus assessment.

Regent Makarechian noted that CEE would be a non-profit entity and asked where profits would be directed. Mr. Lyons responded that profits would be used to support the Haas School's core operations: degree and research programs and public service efforts.

Regent Kieffer asked if there is a point at which creating profits and moving them to the University might compromise UC's tax exempt status. General Counsel Robinson stated his view that the creation of a separate business entity should address tax concerns.

Regent Kieffer asked if there were any other examples of separate 501(c)(3) entities that provide services within the University. Mr. Lyons responded that a 501(c)(3) entity, the Berkeley Endowment Management Company, was established to provide asset management services for the UC Berkeley Foundation. This entity, which had not existed five years earlier, was created specifically to provide a service for the University that could not be provided as effectively under the University's operating system. Mr. Brostrom added that endowment management at both the Berkeley and Los Angeles campuses is performed by separate 501(c)(3) entities. In other areas, the University makes use of private contracting. For example, a performance-based contract with an outside entity provided an increase of $2 million in football ticket sales at UC Berkeley.

In response to a question by Regent Kieffer, Ms. Dorr confirmed that University Extension programs are not operated as an outside, separate entity.

Regent Kieffer asked if there might be other opportunities for 501(c)(3) entities at UC to meet needs beyond the traditional mission of the University. Chancellor Birgeneau responded that so far there had not been any other such proposals.

In response to a question by Regent Stein, Mr. Lyons confirmed that CEE students are not conventional students; they are not full-time students taking out loans to pay for this education. They are more commonly mid-career professionals or executives whose tuition is paid by their companies.

Regent Stein stated his understanding that CEE is funded entirely by program revenue and that a shortfall would never be addressed with campus funds. Mr. Lyons responded in the affirmative, observing that there has never been a shortfall under the current arrangement. In the future, the Haas School will have to ensure that there is a reserve within CEE to address a shortfall.

In response to another question by Regent Stein, Mr. Lyons confirmed that there are no campus or core funds committed to CEE. CEE funding is completely separate.

Regent Mendelson observed that the California Alumni Association is a 501(c)(3) entity that can take actions the University cannot, such as support for scholarship programs for underrepresented minorities. He expressed strong support for the proposal, noting that Harvard University derives tremendous value, prestige, and stature from its executive education program.

Mr. Lyons noted that other units at UC Berkeley, such as the School of Public Policy and the School of Law, sometimes run programs through the CEE, for a small service charge. CEE is an infrastructure asset.

Regent Rubenstein referred to the proposed board structure for CEE and asked how the four non-UC employee board members would be selected. He suggested that another ex officio member, an alumnus or alumna, be added. Mr. Lyons responded that the selection of those four board members would be addressed in the affiliation agreement. The four members would most likely be drawn from the Haas School and UC Berkeley Foundation boards, most of whom are alumni. The initial intention is to appoint four alumni to the CEE governing board.

In response to another question by Regent Rubenstein, Mr. Lyons confirmed that as board members retired, the CEE governing board would select new board members. The affiliation agreement stipulates that any change in the composition of the board requires five out of seven votes. The board will have a nominating committee and follow a process similar to most governing boards.

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

5. **UNIVERSITY OF CALIFORNIA FINANCIAL REPORTS, FISCAL YEAR 2012**

The President recommended adoption of the 2011-12 Annual Financial Reports for the University of California, the University of California Retirement System, and the five University of California Medical Centers.

[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.]

Associate Vice President and Systemwide Controller Peggy Arrivas highlighted the fact that the University continues to remain financially strong, with stable debt ratings. Trends observed in the latest financial results were consistent with trends of prior years. The changes from the previous to the current year were expected.

There was a decrease in net assets in 2012 of $1.9 billion, compared to an increase of $414 million in 2011, a change of $2.3 billion. A breakdown of the $2.3 billion change indicated that the largest two contributing factors were overall investment results and reductions in State appropriations. For the first time in the University's history, its unrestricted net assets were negative. Revenues as well as expenses increased compared to the previous year. Campus foundations raised nearly $600 million in gifts; almost the entire amount was given to the campuses. The University contributed $3 billion to the UC Retirement System and paid $3 billion in benefits to retirees. Ms. Arrivas noted that the format of the financial reports for the retirement plans had been consolidated and updated into a single document that was consistent and easier to read.

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

6. **REPORT ON IMPLEMENTATION OF THE UNIVERSITY-WIDE PROCUREMENT TRANSFORMATION 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.]

Chief Financial Officer Taylor observed that many agreements had been signed to date to leverage systemwide spending to achieve savings, but that progress overall had been limited due to a lack of systemwide technologies, a cumbersome public bidding process, few consequences for UC employees who purchase off contract, and diminishing returns from renegotiations of existing contracts.

Chief of Staff and Director Maria Anguiano outlined the University's four goals for procurement transformation: to align UC around best practice strategies, to improve the use of technology and analytics, to redesign the process to rapidly source commodities, and to offer sourcing services in areas that have traditionally been outside the scope of the procurement program, such as benefits and construction.

The University is currently recruiting a chief procurement officer to lead the entire procurement program. UC's purchasing history over the past two years is being analyzed. The University has contracted with SciQuest for a supplier and contract management tool that will provide UC procurement professionals with an overview of systemwide, regional, and local vendors. The first phase in the implementation of this sourcing technology would commence by the end of the current month. Ms. Anguiano mentioned projects envisioned for the next year to two years: to set commitment levels for purchasing as well as consequences for purchasing off contract, to make purchasing as easy as possible for staff and faculty, to standardize processes systemwide, and to develop staff expertise.

Mr. Taylor anticipated that the University's procurement program would save $40 million in the following year and achieve $200 million in savings by fiscal year 2016-17. The return on investment in the program might exceed 900 percent.

Regent Torlakson praised the program.

7. **ANNUAL ACTUARIAL VALUATIONS FOR THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN AND ITS SEGMENTS AND FOR THE 1991 UNIVERSITY OF CALIFORNIA-PUBLIC EMPLOYEES' RETIREMENT SYSTEM VOLUNTARY EARLY RETIREMENT INCENTIVE PROGRAM**

[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.]

Vice President Duckett reported that as of July 1, 2012, the funded status of the UC Retirement Plan (UCRP) had decreased from 82 percent to 79 percent. This was primarily due to investment loss on the actuarially smoothed value of assets. On a market value basis, the funded ratio had decreased from 81 percent to 77 percent. The valuation results include a supplemental transfer to UCRP that was achieved through external financing. The actuarial accrued liability of UCRP had grown to $54.6 billion. The market value of assets is $41.8 billion. The policy contribution rate is set at 28.6 percent of covered payroll, which includes the normal cost and the amortization of the unfunded actuarial accrued liability.

For fiscal year 2013, UCRP contribution rates would be ten percent for the employer and five percent for the employee. On July 1, 2013, the employer contribution rate would increase to 12 percent and the employee rate to 6.5 percent. As of that date, the employer rate would cover the UCRP normal cost. Mr. Duckett recalled that the employee contribution rate was subject to collective bargaining.

President Yudof noted that a number of unions had carried out an actuarial analysis that suggested that the UCRP should assume a higher rate of return. He stressed that there is no certainty regarding market performance over the next ten to 30 years. He stated that, as part of the collective bargaining process, Mr. Duckett was pledged to meet with actuaries or other experts representing UC unions, to read their materials, to consider their views, and to respond. Mr. Duckett concurred with this statement.

President Yudof stated that the unions' view on the UCRP would be considered by the appropriate body, the UC administration, through the collective bargaining process. Mr. Duckett emphasized that this would be done.

Regent Gould stated that presumed rates of return were being challenged not only at UC but at other institutions in the U.S. He stressed that the Regents, as fiduciaries, need to pay careful attention to the assumed 7.5 percent rate of return and to be mindful of national standards.

Executive Vice President Brostrom recalled that in the current year, the University was contributing only 15 percent of payroll to the UCRP, while the normal cost was 17.8 percent. It would be premature to make actuarial assumptions about the unfunded liability given that the University was not covering necessary costs. Mr. Duckett observed that other large public pension plans were currently lowering rather than raising their return assumptions.

8. **ANNUAL ACTUARIAL VALUATION OF THE UNIVERSITY OF CALIFORNIA RETIREE HEALTH BENEFIT PROGRAM**

[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.]

Vice President Duckett reported that, compared to the prior year, the unfunded actuarial accrued liability of the UC retiree health benefit program has remained level, at about $14.5 billion. This is accounted for by the fact that gross medical premiums for retirees, especially Medicare retirees, have been less than expected due to certain provisions of the Patient Protection and Affordable Care Act, and because of intensive negotiations by UC benefits staff aimed at cost control. Based on the lower than expected gross premiums, the University's financial accounting had authorized a reduction in the assessment rate effective January 1, 2013. The assessment rate was currently 3.72 percent and would be lowered to 1.8 percent. This would generate approximately $40 million in savings during the remainder of the fiscal year.

Regent Ruiz referred to the proposed self-insured health plan discussed earlier by Senior Vice President Stobo. He asked if the University was seeking to include retirees in this or a similar plan. Mr. Duckett responded that this plan was primarily being considered for active employees. The University would implement other measures involving new health care exchanges in spring 2013 to reduce costs. UC had also examined ways in which Medicare-eligible retirees in some outlying areas of California and out of state could receive more benefits by joining an existing health care exchange. He stated that the new self-insured plan would include a component for retirees.

Regent Ruiz asked about the implementation timeline. Mr. Duckett responded that it would be concurrent with the entire self-insured plan, to be ready for 2014. Executive Vice President Brostrom added that by moving the retirement age from 60 to 65, more UC retirees would be receiving Medicare, and this would represent a significant cost saving for the University. These retirees would not be eligible for the self-insured program at that point.

9. **REPORT OF THE WORKING GROUP ON TECHNOLOGY TRANSFER**

[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.]

Regent Makarechian explained that the Working Group on Technology Transfer was formed by Chairman Lansing to identify ways to maximize revenue potential for UC inventions. The Working Group found that UC is consistently among the top five royalty income-generating universities in the U.S. Comparison with peer institutions indicated that there is significant potential for increased revenue, although Regent Makarechian recalled that there is a period of seven to ten years before revenue can be realized from a discovery or invention. Revenues from technology transfer could not be a substitute for adequate State funding and could not address UC's current difficulties, but should be part of the University's long-term strategies.

The Working Group set out to identify the best practices of the institutions most successful in technology transfer. Among public universities, it considered the University of Michigan, Ohio State University, University of Florida, and the Wisconsin Alumni Research Foundation. It interviewed technology transfer directors of Stanford University, the Massachusetts Institute of Technology, and Columbia University. At UC, the Working Group spoke with technology transfer directors at the Berkeley, San Francisco, and San Diego campuses, with Chancellors Desmond-Hellmann, Drake, and Katehi, and with faculty members and researchers.

Regent Makarechian noted that the private and public institutions that were most successful in technology transfer were those where this function was addressed at the highest levels. If the University were a for-profit corporation, the chief executive, financial, and investment officers would evaluate all inventions and choose which to invest in. He described the University's current approach as a lottery; the University purchases as many tickets as possible and hopes that one will win. This process must change and should be brought to the attention of the highest levels of the University. Therefore, the Working Group recommended that a committee be formed to recommend policies, to seek outside advisors, and to examine investment opportunities. There were many entrepreneurs and investors who would be willing to enter into joint ventures with the University; Regent Makarechian stressed that there was substantial outside funding for such ventures. He urged that the new committee be initiated as soon as possible, given that financial returns from inventions developed at the University take seven to ten years.

Vice President Beckwith expressed agreement with Regent Makarechian's observation that the technology transfer process is highly uncertain in any one case. It is impossible to predict winning inventions; most are in the biomedical and pharmaceutical areas.

Regent Blum expressed support for this proposal. Currently the University was taking an ad hoc approach to ventures. He drew attention to the many relationships between Silicon Valley companies and Stanford University. A research university like UC should have a serious focus in this area.

Chairman Lansing stressed that this was the beginning of a long-term effort. The new committee would seek to establish public-private partnerships, to seek outside investors to join in a fund with the University, with the University retaining a certain percentage of any successful invention.

Regent Makarechian stated that this was one of the ideas put forward by the Working Group. It also recommended seeking donations from alumni and others to promote the development of UC inventions.

Chairman Lansing stated that donors to the University would welcome a winning invention by UC. This was an important example of the kind of alternate revenue source that the University was currently pursuing. She expressed enthusiasm for the proposal.

Regent De La Peña expressed support for the formation of a new committee to address the development of technology transfer at UC.

President Yudof noted that it was sensible to seek outside funding in this area. He advised the Office of Technology Transfer to maintain a close relationship with the new committee. Regents would be able to assist with development of relationships with interested entities and individuals. This effort also required careful cooperation with the campuses, with income returned to the campuses.

Regent Blum urged the University to be mindful of patent and licensing rights issues, which can be complex. Regent Makarechian responded that institutions with a successful record in technology transfer prepare business case studies for each disclosure. Among other issues, these studies consider the question of profit sharing. Based on these studies, the institution then decides which disclosures to invest in. Mr. Beckwith added that the first recommendation in the Working Group report was to invest in technology transfer. Compared to peer institutions, UC invests about half as much in protecting patents and generating licenses, as a percentage of research funding. If the University invested more in patent protection, it might achieve a higher rate of revenue-generating inventions. The current investment in patent protection is restricted and this limits the number of inventions in which UC can invest.

Regent Kieffer suggested that there might be an obstacle to this endeavor in the institutional culture of the University. Some faculty may not wish to move past an initial discovery to clinical trials or other more practical applications. Regent Makarechian acknowledged that this was sometimes the case, but noted that the new committee could address situations like this by arranging joint ventures in which clinical trials would be performed by pharmaceutical companies or other institutions.

Regent Reiss referred to the report's recommendation for local advisory boards at each campus, including venture capitalists and other experts. She asked why there would not be a systemwide board. Regent Makarechian responded that the new committee overseeing the systemwide effort would receive important information from the local advisory boards about local industries. The new committee would recommend policies and advise on budgeting, allocation of funds, and policy matters. However, the program was being carried out on the campus level. The local advisory boards would receive input from local businesses.

Regent Reiss asked if the distribution of royalty income is standardized systemwide and about how UC's royalty shares compare to those of peer institutions. Regent Makarechian responded that the purpose of the new committee would be to analyze these policies in depth.

The meeting adjourned at 11:45 a.m.

Attest:

Secretary and Chief of Staff