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Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

ACTION ITEM

For Meeting of January 17, 2008

TRANSFER OF ASSETS AND LIABILITIES FROM THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN TO THE LAWRENCE LIVERMORE NATIONAL SECURITY, LLC DEFINED BENEFIT PENSION PLAN AND AGREEMENT REGARDING THE ONGOING OBLIGATIONS OF THE DEPARTMENT OF ENERGY TO REIMBURSE THE UNIVERSITY FOR CONTRIBUTIONS TO THE UCRP

EXECUTIVE SUMMARY

Effective October 1, 2007, the management of the Lawrence Livermore National Laboratory ("LLNL") transferred from the University to the Lawrence Livermore National Security, LLC ("LLNS"). Approximately 4,000 former UC employees elected to transfer their benefits and service credit accrued under the University of California Retirement Plan (UCRP) to the LLNS Defined Benefit Pension Plan ("LLNS Plan"). Under the terms of management Contract No. W-7405-ENG-48 ("Contract") between the University of California and the Department of Energy / National Nuclear Security Administration ("DOE/NNSA") governing the transition to a successor contractor, the University is required to transfer the assets and liabilities associated with the UCRP benefits accrued by LLNL employees who have elected to participate in the LLNS Plan.

This item requests authorization to enter into two agreements that will implement the transfer of assets and liabilities from UCRP to the LLNS Plan on or about April 1, 2008 and confirm the DOE/NNSA's continuing commitment to fund any shortfalls attributable to the benefits of LLNL employees retained in UCRP, as well as to make any amendments to UCRP that are necessary to carry out the intent of the agreements.

The proposed agreement between the University and the DOE/NNSA governing the transfer of assets and liabilities from UCRP to the LLNS Plan substantially replicates the transfer agreement for the Los Alamos National Laboratory transaction with one exception. For the LLNS transaction, UCRP will retain $75,000,000 in excess of the amount of assets required to be retained under the Contract, which will represent the initial credit to a pre-funded reserve referred to as the "Contribution Reserve Amount." The Contribution Reserve Amount, adjusted as provided in the agreements with DOE/NNSA, will provide the DOE/NNSA with an identified funding source to apply against any future funding obligations to the LLNL Segment.

Previous Actions: **November 2007:** The Regents discuss the retirement plan elections made by transitioning LLNL employees and the status of discussions with the DOE/NNSA regarding the transfer of assets and liabilities from UCRP to the LLNS Plan.

September 2007: The Regents authorize the Associate Vice President, Human Resources and Benefits, to enter into discussions with the DOE/NNSA regarding the transfer of assets and liabilities from UCRP to the LLNS Plan and to amend UCRP to provide an alternative to the cash flow interim funding method authorized at the May 2007 meeting for supporting the timely payment of UCRP benefits to or on behalf of eligible members of the LLNS Plan who retire, die, or become disabled before the final transfer of assets and liabilities from UCRP to the LLNS Plan and their eligible alternate payees.

July 2007: The Regents authorize UCRP amendments to facilitate an effective transition of management to LLNS, including special provisions applicable to alternate payees entitled to benefits pursuant to domestic relations orders, rehired retirees, and employees with split appointments at LLNL and another University location.

May 2007: Pursuant to the DOE/NNSA awarding the management contract for LLNL to LLNS, The Regents authorize UCRP amendments to facilitate the closeout of the Contract and the transfer of UCRP assets to the LLNS Plan at a rate sufficient to meet the LLNS Plan's cash flow requirements.

Future Action: Following execution of agreements substantially as described in this item, assets and liabilities are expected to be transferred from UCRP to the LLNS Plan on or about April 1, 2008.

Relevant Policy: Plan document for UCRP and Contract.

Issues:

- Authorization to enter into an agreement to transfer assets and liabilities from UCRP to the LLNS Plan;
- Authorization to enter into an agreement that confirms DOE/NNSA's ongoing obligation to fund UCRP benefits associated with LLNL service if a shortfall occurs; and
- Authorization to amend UCRP to implement the transfer of UCRP assets on behalf of former UC employees at LLNL who have elected to participate in the LLNS Plan.

RECOMMENDATION

The President recommends that the Committee on Finance recommend to The Regents that, in accordance with the provisions of the Contract governing the transition to a successor contractor at LLNL as modified by the parties' agreement, the Associate Vice President, Human Resources and Benefits, be authorized to enter into the agreements listed below on behalf of the University as sponsor of UCRP and The Regents as trustees of UCRP, provided the agreements are substantially as described in this item; to execute any regulatory filings associated with the transfer of assets and liabilities; and to adopt and implement any amendments to UCRP that are necessary to carry out the provisions of the agreements:

1) The Agreement Concerning the Transfer of Assets and Liabilities ("Transfer Agreement"), which incorporates the terms agreed to by the University and the DOE/NNSA for the transfer of assets and liabilities from UCRP to the LLNS Plan, including the amount of assets to be transferred and the documentation required to be provided to UC prior to the transfer of any assets.

2) The agreement confirming the DOE/NNSA's ongoing funding obligation for UCRP benefits associated with LLNL service ("Funding Agreement"), which defines the method for calculating any future funding shortfalls, commits DOE/NNSA to a schedule of payments to restore full funding of the separately accounted for segment within UCRP to which the assets and liabilities associated with members' LLNL service are allocated ("LLNL Segment"), and addresses other administrative matters.

Neither of these agreements will become effective, and no assets will be transferred, unless the Office of the General Counsel determines each is in substantially the form as described in the Background section of this item and each has been properly executed.

In accordance with prior direction from The Regents, University administrators have consulted with the appropriate standing and special committees and task forces of the Academic Senate concerning the issues addressed in this item. As described more fully in the Background section of this item, at its meeting of December 19, 2007, the Academic Council endorsed the analysis and recommendation of the University Committee on Faculty Welfare-Task Force on Investment and Retirement ("TFIR") to support entering into agreements with the substantive terms discussed with TFIR, which are described in this item.

BACKGROUND

The University served as the prime contractor for the Berkeley Radiation Laboratory, the predecessor of LLNL, from 1943 to 1952, and then for LLNL through September 30, 2007. Under the prime contracts, DOE/NNSA reimbursed the University for contributions made by the University to UCRP to fund the benefits accrued by LLNL employees who participated in UCRP. The assets and liabilities associated with the UCRP benefits of University employees performing service at LLNL have been allocated to a segment within UCRP, the LLNL Segment, and accounted for separately by The Regents’ consulting actuary each year since the early 1990s at the request of DOE/NNSA.

Upon the expiration of the Contract on September 30, 2007 and consistent with their elections required under the LLNL Request for Proposal issued by the DOE/NNSA, active LLNL employees who transferred employment to LLNS began participating in either Total Compensation Package 1 (“TCP1”) or Total Compensation Package 2 (“TCP2”). Employees who elected to participate in TCP1 receive retirement coverage under the LLNS Plan, while those who elected TCP2 receive retirement coverage from the LLNS market-based defined contribution plan (“DC Plan”). The UCRP benefits and service credit of those who elected TCP1 must be transferred to the LLNS Plan under the terms of the Contract.[1] Vested UCRP members who elected TCP2 could either retire or become inactive UCRP members as of the transition date and remain eligible for a future UCRP benefit. No UCRP-associated assets or liabilities will be transferred for LLNL employees who elected to participate in TCP2.

Transfer Agreement

The proposed agreement between the University and the DOE/NNSA governing the transfer of assets and liabilities from UCRP to the LLNS Plan substantially replicates the transfer agreement for the Los Alamos National Laboratory transaction with one exception. For the LLNS transaction, UCRP will retain $75,000,000 as a Contribution Reserve Amount in excess of the amount of assets required to be retained under the Contract. The Contribution Reserve Amount, adjusted as provided in the Funding Agreement, will provide the DOE/NNSA with an identified funding source to apply against any future funding obligations to the LLNL Segment.

The formula outlined in the Contract (“Formula”) for determining the amount to be transferred to the LLNS Plan is defined as “A minus B” where “A” equals the market value of the assets allocated to the LLNL Segment prior to transfer and “B” equals the liabilities associated with the UCRP benefits of the active LLNL employees who elected to leave their benefits in UCRP and the group of former LLNL employees who had

[1] UCRP will retain the assets and liabilities for a supplemental benefit, referred to as the Capital Accumulation Payment (CAP), for all LLNL employees who elected to transfer their basic UCRP benefit to the LLNS Plan. All references in this item to the “UCRP benefit” of a LLNL employee refer only to the basic UCRP benefit.

already become disabled, retired, deceased or inactive UCRP members by October 1, 2007, or their eligible survivors or beneficiaries. Both groups are collectively referred to below as "Retained LLNL Payees." The Formula calculation results in a 100 percent funded status for the value of the benefits of Retained LLNL Payees on a market value of assets basis immediately following the transfer.

As of September 30, 2007, the total market value of UCRP assets allocated to the LLNL Segment was $5,600,667,264 ("A"), and the liabilities for the UCRP benefits of the Retained LLNL Payees as reported in the October 1, 2007 Special Interim Addendum Report for LLNL were $3,780,314,849 ("B"). Following the Formula results in a September 30, 2007 market value of assets to be transferred (with adjustments as set forth below) from UCRP to the LLNS Plan of $1,820,352,415 ("A minus B").

Under the terms of the proposed Transfer Agreement, in addition to the asset transfer amount described above, UCRP will retain an additional $75,000,000 in the LLNL Segment as the initial credit to a Contribution Reserve Amount. The Contribution Reserve Amount will be designated as a pre-funding reserve which may be used to offset any future DOE/NNSA funding obligations for the LLNL Segment. The Contribution Reserve Amount will be maintained as a nominal account that records the amount of assets within UCRP that can be applied against any future DOE/NNSA funding obligations for the LLNL Segment. It will be accounted for as part of the UCRP trust fund in the asset actuarial valuations and will be available to pay benefits under UCRP. The Contribution Reserve Amount, however, will not be counted in the assets that are taken into account in determining whether there is a shortfall in the LLNL Segment for a plan year that gives rise to a DOE/NNSA funding obligation. In other words, the DOE/NNSA's funding obligation for a year will be calculated as if the Contribution Reserve Amount did not exist. However, if on this basis there is a shortfall that creates a funding obligation for the year, the Contribution Reserve Amount may be applied against that obligation to the extent necessary to satisfy the obligation or until the Contribution Reserve Amount is exhausted. If no Contribution Reserve Amount is available, DOE/NNSA will be required to satisfy its obligation to reimburse UC for contributions to UCRP for the LLNL Segment through DOE/NNSA's normal budgetary process. The University will separately account for the Contribution Reserve Amount by increasing or decreasing such amount for earnings or losses at the market rate of return each year, increasing such amount for any subsequent contribution credits, and decreasing such amount by any amounts used to meet the DOE/NNSA funding obligation in any year. Application of this process will result in an initial transfer amount of $1,745,352,415 with adjustments as described below.

The proposed Transfer Agreement states that the amount of assets to be transferred will be adjusted for the total return earned by the UCRP portfolio from September 30, 2007, allocable expenses, buybacks for UCRP service credit, and any distributions from UCRP to LLNS employees who retired before the transfer of assets and liabilities to the LLNS Plan as authorized by The Regents in September 2007. The amount of assets to be transferred is considered to be the final transfer amount, with additional post-transfer adjustments, or true-ups, to reflect the final performance numbers of certain assets, other investment-related end-of-the-month accountings, any changes requested by the regulators and data corrections.

Assets will be transferred on an in-kind basis under a method agreed upon by UC and DOE/NNSA. The investments to be transferred will be documented in writing and attached as an exhibit to the Transfer Agreement. The agreement allows the flexibility to take into account restrictions on certain investments, such as private equities, real estate and emerging markets.

Prior to the transfer of any UCRP assets, DOE/NNSA will provide evidence that both the Transfer Agreement and the Funding Agreement have been executed or validly adopted and various other representations and assurances established by the University's legal counsel have been made.

The transfer of assets and liabilities from UCRP to the LLNS Plan will undergo regulatory review from the IRS to insure compliance with applicable federal tax laws and will be adjusted if necessary to conform to such requirements.

The transfer of assets and liabilities from UCRP to the LLNS Plan is proposed to take place on or about April 1, 2008. The LLNS Plan will then assume the liabilities transferred from UCRP effective as of October 1, 2007.

Funding Agreement

The Funding Agreement clarifies and implements the commitment by DOE/NNSA under the Contract to reimburse the University for any contributions made to UCRP to fund any existing or future funding shortfalls in UCRP attributable to the LLNL Segment. It also establishes the methodology of calculating whether a current shortfall exists.

The DOE/NNSA has agreed to a target funded ratio for the LLNL Segment within UCRP of 100 percent. Any year that the segment is underfunded (using UCRP actuarial assumptions), DOE/NNSA will be obligated to seven years of level payments in an amount projected to restore full funding by the end of the seven-year term. The Contribution Reserve Amount discussed above will be deducted from the LLNL Segment assets for purposes of determining the funded ratio of the LLNL Segment within UCRP in order to determine DOE/NNSA's funding obligation. On this basis, the DOE/NNSA will generally be required to follow a seven-year payment approach similar to that required for the corporate pension plans at its sites under recent changes in the pension funding rules that apply to private employer plans. Under the agreed-upon approach, the funding obligation of the DOE/NNSA will be the greater of the payment calculated under the seven-year amortization method or the amount needed to meet liquidity needs for the LLNL Segment. Liquidity needs are defined as three times the amount of benefit payments and expenses for the LLNL Segment for the prior plan year.

The Contribution Reserve Amount may be used to satisfy any funding obligation of

DOE/NNSA in any year in which a Contribution Reserve Amount remains available. If no Contribution Reserve Amount is available, the DOE/NNSA will be required to satisfy its funding obligation to reimburse UC for contributions to UCRP for the LLNL Segment through DOE/NNSA's normal budgetary process.

In return for clarifying its funding obligation and committing to a payment schedule if a shortfall in the LLNL Segment funding occurs, the University agrees that the LLNL Segment may remain within UCRP indefinitely, provided DOE/NNSA satisfies its payment obligations.

Because the liabilities of the DOE/NNSA are fixed under the Contract as of September 30, 2007, DOE/NNSA will have approval authority over any ad hoc inflation-based increases in benefits of Retained LLNL Payees even if the adjustments are proposed for all UCRP members and beneficiaries. DOE/NNSA will also have approval rights, which it cannot unreasonably withhold, for any proposed changes to UCRP that would:

- Affect only Retained LLNL Payees or any retained LLNL Payees together with any similar retained members and beneficiaries associated with the Los Alamos National Laboratory;
- Raise costs for the LLNL Segment beyond those of UCRP generally; or
- Use actuarial assumptions or an asset allocation for the LLNL Segment that is different from the assumptions and allocation used generally for UCRP.

The Regents retain all of the fiduciary authority to manage UCRP, but will continue, as in the past, to provide notice to DOE/NNSA of changes to UCRP. The Regents will oversee administration and management of UCRP and its trust fund without the need for prior approval from DOE/NNSA, and take all actions it deems necessary to track the costs and expenses properly allocable to the LLNL Segment. The University will continue to provide, at DOE/NNSA expense, an annual addendum report on the LLNL Segment and such other calculations as may be required to administer the Funding Agreement. A portion of the costs of UCRP administration will be allocated as an expense to the LLNL Segment.

When all benefits have been paid to the Retained LLNL Payees, DOE/NNSA will be entitled to receive any surplus in the LLNL Segment, subject to regulatory requirements on such a transaction, or will be required to pay any remaining deficit in the funding of the segment.

Actuarial Valuation

In order to determine the appropriate assets and liabilities of the LLNL Segment, a special actuarial valuation was performed by The Regents' consulting actuary, The Segal Company, based on October 1, 2007 data. The valuation was performed in consultation with internal and external counsel and as agreed to with DOE/NNSA in order to carry out the terms of the Contract. A complete copy of this October 1, 2007 Special Interim Addendum Report for LLNL is shown in Attachment 1.

Consultation

University administrators have consulted with the appropriate representatives of the Academic Senate, including the University Committee on Faculty Welfare ("UCFW"), the UCFW Task Force on Investment and Retirement ("TFIR"), the Academic Council Special Committee on Lab Issues ("ACSCOLI"), and the Academic Council regarding the issues described in this item. In addition, University administrators have consulted with various constituent groups on these issues. Attachment 2 contains the "UCFW-TFIR Analysis and Recommendation to Support the Draft 'Agreement on Terms for Transfer of Assets from UCRP to LLNS Plan and Continued Administration and Obligation Related to LLNL Portion of UCRP'" dated December 14, 2007, and the transmittal letter from the Chair of the Academic Senate indicating that this document was unanimously endorsed by the Academic Council at its December 19, 2007 meeting.

The University will take appropriate action concerning proposed changes that may trigger notice, consultation, and meeting and conferring obligations under the Higher Education Employer-Employee Relations Act, if any such action is required.

(Attachments: 1 2)