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Office of the President

TO MEMBERS OF THE COMMITTEE ON FINANCE:

ACTION ITEM

For Meeting of July 16, 2014

AUTHORIZATION TO FUND UNIVERSITY OF CALIFORNIA RETIREMENT PLAN MODIFIED ANNUAL REQUIRED CONTRIBUTION WITH CONTRIBUTION FROM SHORT TERM INVESTMENT POOL

EXECUTIVE SUMMARY

This item requests authorization for the President to make a contribution to the University of California Retirement Plan (UCRP) in the current fiscal year (FY 2014-15) via an asset transfer from the Short Term Investment Pool (STIP). This contribution will fund the unfunded portion of the modified Annual Required Contribution for FY 2013-14, or the difference between modified ARC and total University (employer and employee) contributions to UCRP. (Modified ARC is the Normal Cost, or the cost for future UCRP benefits allocated to each year of service for active members, plus interest on the unfunded liability.) The contribution authorization will be in an amount not to exceed $700,000,000. The action amends a prior action of December 2012; a summary of the previous actions is shown in the Appendix. The text of the prior action authorizing FY2010-11 and FY2011-12 contributions is omitted in the Recommendation below, as shown by ellipsis.

RECOMMENDATION

The President recommends that the Committee on Finance recommend that the Regents amend *the Amendment of Authorization to Make Additional Contributions toward University of California Retirement Plan's Annual Required Contribution from One or More Multiple Sources*, as shown below.

Additions shown by underscoring; deletions shown by strikethrough

The President be delegated authority and discretion to make contributions to the University of California Retirement Plan (UCRP) to supplement scheduled employer and employee contributions beginning FY 2010-11. The amount and timing of the contributions will be guided by the goal of putting the Plan on a path toward fully funded status, with consideration of the projected budgetary impact to the University. The President may utilize borrowing from the Short Term Investment Pool (STIP), restructuring of University debt, and other internal or external sources to make these contributions to UCRP, ~~fund the gap between scheduled pension~~

~~contribution from the University and employees, and the required funding amount described above,~~ as follows:

...

F. Transfer funds from STIP to UCRP in FY 2014-15 in an amount equal to the difference between the approved total employer and employee contribution to UCRP and modified ARC for FY 2013-14. This transfer shall satisfy the requirements below and will not exceed a total of $700,000,000:

(1) The creation of an internal note receivable ("STIP Note") for the amount above, owned by STIP participants.

(2) The ability to set the repayment terms on the STIP Note, not to exceed a maximum of a 30-year amortization period.

(3) Adoption of a waiver to the STIP investment guideline's maximum of five and a half years on investments to accommodate the terms of this STIP Note.

(4) Assessment of all University fund sources making UCRP payments to include an additional amount for principal and interest payments on the STIP Note, divided proportionally based on covered compensation.

(5) For funding sources, such as federal contracts and grants, where interest payments for the STIP Note are not billable as direct program costs, campuses will be required to pay these charges using non-federal sources. These fund sources may also be excluded from the STIP loan repayment if they pre-pay their portion of the modified ARC assessment in FY 2014-15.

BACKGROUND

According to the University of California Retirement Plan Actuarial Valuation Report presented to the Regents in November 2013, as of July 1, 2013, the campus and medical center segment of the UC Retirement Plan (UCRP) is 76 percent funded, with total actuarial value of assets of $43.6 billion and total actuarial accrued liabilities of $57.4 billion. When the University and employees began to make contributions to UCRP in FY 2010-11 after a 20-year hiatus, UCRP was 87 percent funded. Despite annual increases in employer and employee contributions to UCRP, total contributions are still below the funding policy contribution approved by the Regents (also referred to as annual required contribution, or ARC, which is the Normal Cost plus amortization of the unfunded actuarial accrued liability over a 30-year period), which, along with the market losses in 2008, has resulted in consecutive declines in the Plan's funded status. In FY 2013-14 the estimated funding policy contribution was $2.5 billion, or 29 percent of covered payroll. Total UCRP contributions were approximately 18.2 percent of covered payroll (12 percent employer contribution and 6.5 percent employee contribution for most employees), estimated to be $1.6 billion. On July 1, 2014 employer contributions increased to 14 percent and employee contributions to eight percent. If contribution rates remain steady at these levels, UCRP is projected to be 91 percent funded by July 1, 2042.

On December 13, 2010 the Regents delegated authority to the President to fully fund the Annual Required Contribution for UCRP in two phases – to fund modified ARC from FY 2010-11 through FY 2018-19 and to fund ARC thereafter. The December 2010 recommendation was amended on March 17, 2011 and December 13, 2012 via interim action to give authority to the President to fund modified ARC in FY 2010-11 and FY 2011-12 through a combination of an asset transfer from STIP, external financing, and debt restructuring, the total amount of which was to not exceed $2,100,000,000. In line with this recommendation, UCRP was funded with asset transfers to fund modified ARC in FY 2010-11 and FY 2011-12. In April 2011, $1,100,766,000 was transferred from STIP to UCRP, and in July 2011, $936,515,000 was externally financed and transferred to UCRP. The STIP borrowing and the external borrowing are being paid back through campus assessments on covered payroll.

Consistent with the December 13, 2010 Regents action and subsequent actions taken by the University to fund modified ARC, this item requests authorization to make a contribution to fund modified ARC for FY 2013-14 in the current fiscal year (FY 2014-15). In FY 2013-14 total University employer and employee contributions to UCRP were approximately $1.6 billion. Modified ARC was approximately $2.3 billion. Funding the difference between modified ARC and University contributions, or approximately $700 million, in the current fiscal year would improve the Plan's funded status. An additional $700 million contribution to UCRP is projected to result in a 95 percent funded status by July 1, 2042. In addition, the item recommends modification to the December, 13, 2010 Regents action such that the President be delegated authority to make contributions to the UCRP to supplement scheduled employer and employee contributions. The amount and timing of the contributions will be guided by the goal of putting the Plan on a path toward fully funded status, with consideration of the projected budgetary impact to the University.

FINANCIAL ANALYSIS

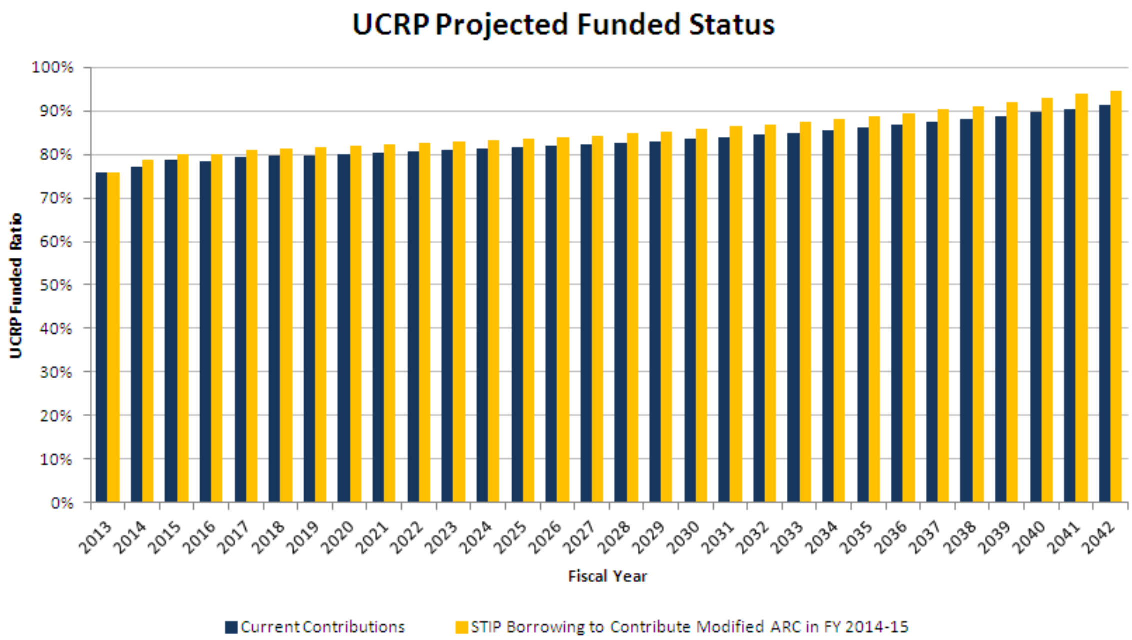
STIP Borrowing and Campus Assessment

This recommendation would utilize the University's STIP balance by borrowing up to the difference between modified ARC and University contributions to UCRP in FY 2013-14. The borrowing from STIP is to be in an amount not to exceed $700 million. Similar to the FY 2010-11 STIP borrowing, the FY 2014-15 contribution from STIP will create a STIP Note that will be repaid over the same 30-year period as the previous borrowings. Campuses and medical centers will be assessed for the repayments as a percentage of covered payroll. The repayment of the loan will be distributed proportionally among the fund sources that pay into UCRP. The interest and principal will pay back STIP Note holders and be part of monthly STIP income. For funding sources such as federal contracts and grants, where interest payments for the STIP Note are not billable as direct program costs, campuses will be required to pay these charges using non-federal sources. Principal payments, however, are an allowable cost of federal contracts and grants. These fund sources may also be excluded from the STIP loan repayment if they pre-pay their portion of the modified ARC assessment in FY 2014-15.

The interest rate for the STIP Note will be reset every July 1 for the following 12 months, based on the historical STIP rate. While repayment of the STIP Note will have to be built into the operating budgets of campuses and medical centers, the relatively low rate only slightly increases the assessment rate above the current assessment rate for the previous borrowings in FY 2010-11 and FY 2011-12. The assessment for the outstanding STIP Note and external borrowing is 0.5 percent of covered payroll in FY 2014-15, and is projected to increase to 0.55 percent to one percent over the next ten years. An additional $700 million in STIP borrowing would increase the assessment from current levels to 0.72 percent for FY 2014-15, and to 0.8 percent to 1.35 percent over the next ten years.

UCRP Projections

Beginning July 1, 2014, employer contributions to UCRP rose to 14 percent and employee contributions to 8 percent of covered compensation for most employees. If contributions remain at these levels, the campus and medical center segment of UCRP is projected to be 91 percent funded by July 1, 2042. If the University makes a contribution equal to modified ARC for FY 2013-14 in FY 2014-15, then the campus and medical center segment is projected to be 95 percent funded by July 1, 2042.



Campus and medical center segment
Assumes 7.5 percent UCRP annual returns and 0.7 percent annual active member population growth

STIP

As of May 31, 2014, the University's available STIP balance is $6.1 billion. This strong liquidity position is one of the University's major financial strengths and the University remains committed to maintaining adequate liquidity to meet daily operational needs. An analysis done in 2012 found that since FY 2004-05, 99 percent of the time the STIP daily cash balance fluctuates no more than five percent of the total STIP balance. Quarterly fluctuations are larger, with average STIP balance reductions of $1 to $1.5 billion. In addition to daily and quarterly fluctuations, cash reserves are also needed for commercial paper/variable rate bond liquidity support and Medical Center working capital reserves. Taking this into account, a STIP transfer of up to $700 million would not presently have a negative effect on the University's daily operational liquidity needs. The Total Return Investment Pool (TRIP) is an additional source of liquidity, if needed. The University continues to monitor risks, trade-offs, and possible changes in the University's day-to-day operations.

FACULTY SUPPORT

The University faculty, represented by the Academic Senate, has expressed strong support for funding UCRP with internal or external borrowings. On June 4, 2014, the Chair of the Assembly of the Academic Senate wrote a memo to the EVP – Business Operations and Interim CFO to recommend a borrowing proposal to fund UCRP. The proposal was authored by the University Committee on Faculty Welfare (UCFW) and its Task Force on Investment and Retirement (TFIR). TFIR's proposal is to borrow $1,700,000,000 in order to fully fund ARC for FY 2013-14 and FY 2014-15. The University Committee on Planning and Budget also wrote a letter lending their support to TFIR's proposal.

The June memo also acknowledges and supports the aim of the request set forth in this item. University staff will continue to work with faculty on ideas and strategies to address UCRP's unfunded liability and to put it on a path toward fully funded status.

APPENDIX

Previous Actions:

September 2008: The Regents approved a funding policy for the campus and medical center segment of UCRP.

February 2009: The Regents approved restarting University and member contributions effective on or about April 15, 2010, subject to collective bargaining as applicable.

September 2010: An Overview of University of California Post-Employment Benefits, including UCRP and the Retiree Health Program, was presented to the Regents. The Regents approved employer and member UCRP contribution rates for Plan Years beginning July 1, 2011, and July 1, 2012, subject to collective bargaining as applicable. The Regents approved a revised amortization schedule (30 years instead of 15) for UCRP unfunded liabilities.

December 2010: The Board approved changes to University-sponsored post-employment benefits including a UCRP new hire tier effective July 1, 2013. The Board also delegated to the President the authority to fully fund the UCRP annual required contribution (ARC) as quickly as practical.

March 2011: The Regents authorized the President to make contributions to UCRP in FY 2010-11 and FY 2011-12 in amounts equal to the difference between modified ARC and total University contributions via a combination of an asset transfer from STIP, external borrowing, and/or debt restructuring, not to exceed a total of $2,100,000,000.

December 2012: The Regents authorized the President to make contributions to UCRP in FY 2010-11 and FY 2011-12, authorized in March 2011, under a financing structure which would provide as low an interest cost as possible.