The Regents of the University of California

SPECIAL COMMITTEE ON COMPENSATION
May 18, 2006

The Special Committee on Compensation met on the above date at UCSF–Laurel Heights, San Francisco.

Members present: Regents Dynes, Hopkinson, Juline, Moores, Parsky, and Schilling; Advisory members Coombs and Oakley

In attendance: Regents Gould, Island, Kozberg, Preuss, Rominger, Rosenthal, and Ruiz, Regent-designate Schreiner, Faculty Representative Brown, Associate Secretary Shaw, General Counsel Holst, Interim Treasurer Berggren, Acting Provost Hume, Senior Vice President Darling, Vice President Gomes, Chancellors Carnesale, Córdova, Fox, and Vanderhoef, and Recording Secretary Bryan

The meeting convened at 3:15 p.m. with Committee Chair Hopkinson presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of March 16, 2006 were approved.

2. **APPROVAL OF TREASURER'S OFFICE ANNUAL INCENTIVE PLAN RECOMMENDED CHANGES TO PERFORMANCE OBJECTIVES FOR FY 2006-07**

The President recommended that the Special Committee on Compensation recommend to The Regents that the Treasurer's Office Annual Incentive Plan asset class investment performance objectives be modified as indicated in the Attachment, page 15.

The Committee was informed that as the portfolios evolve in composition and complexity, it is necessary to add or modify some of the performance objectives (target performance over the benchmark) previously established by the Regents. Mercer Investment Consulting and Mercer Human Resource Consulting have been involved in the development of this plan since inception in 2002 and have reviewed and recommended these modifications.

These changes include the following: performance objectives for three new mandates: High Yield Bonds, Emerging Market Debt, and Global Equity, and a modification to the objective for Emerging Market Equity. In addition, the performance objective for the "UC Entity," i.e., the aggregate performance of all assets managed by the Treasurer, will be modified to recognize the change in asset composition and increase in actively managed assets since last year.

In accordance with the Plan document, the Treasurer is also presenting a list of eligible participants, and the mix and weighting of performance components for each position, for the fiscal year 2006-07.

The Regents' Investment Consultant, Richards and Tierney, explained the key features of the Annual Incentive Plan to the Committee on Finance in January 2006.

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

3. **AMENDMENT OF THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN TO FACILITATE THE TRANSITION OF THE LOS ALAMOS NATIONAL LABORATORY TO THE LOS ALAMOS NATIONAL SECURITY, LLC AND TO CLARIFY THE UCRP FIDUCIARY OVERSIGHT STRUCTURE**

The President recommended that, effective June 1, 2006, UCRP be amended as necessary to:

A. Allow all active LANL employees who are UCRP members, including those who previously retired and suspended their UCRP retirement income upon reemployment, to take advantage of any of the retirement options provided for by the RFP and/or contractual obligations with LANS and the DOE/NNSA. Such options include:

- Voluntary transfer of accrued benefits and service credit under UCRP through May 31, 2006 (with the exception of the CAP benefit) to the LANS defined benefit plan, on the condition that such transferred service credit may not be re-established upon subsequent employment with UC and that such transfer extinguishes all rights to further UCRP benefits (other than CAP).

- Retain rights to UCRP benefits, if eligible, by either retiring or electing inactive membership under UCRP.

- If the second option is chosen, retain rights to have unused sick leave converted to UCRP service credit upon retiring under UCRP (within 120 days of separation of UC employment) by electing to leave unused sick leave at UC or waiving such rights by transferring unused sick leave to LANS.

B. Provide that if a LANL member elects to participate in the LANS defined benefit plan, and a designated payee named in a domestic relations order (DRO) is entitled to a share of the member's UCRP benefits, the designated payee may elect to have his or her benefits retained in UCRP and distributed under UCRP terms, including the lump sum option, which is not available in the LANS defined benefit plan.

C. Provide the appropriate UCRP service credit for LANL employees returning from military leave.

D. Allow subsequent transfers of UCRP assets and liabilities to the LANS defined benefit plan on behalf of UC employees who transition employment to LANS after June 1, 2006 for reasons deemed critical to LANL's ongoing mission.

E. Retain the CAP benefit in UCRP for LANL members who transfer their UCRP accrued benefit and service credit to the LANS defined benefit plan and, based on Internal Revenue Service (IRS) guidance, prohibit distribution of their CAP benefits until they separate employment with LANS.

F. Arrange for an initial transfer of UCRP assets or 'seed money' to the LANS defined benefit plan, consistent with the current contract with the DOE, in the event LANL employees who have transferred employment to LANS or their eligible survivors become eligible for benefit payments under the LANS defined benefit plan prior to the final transfer of assets and liabilities from UCRP.

G. Clarify the fiduciary obligations of the plan administrator, the Office of the Treasurer, and The Regents with respect to UCRP similar to the action previously taken by The Regents in March 2005 with respect to UC's Retirement Savings Program plans (the Defined Contribution Plan, the 403(b) Plan, and the 457(b) Plan).

H. Delegate authority to the President to implement these plan amendments, including the action on buybacks for eligible LANL employees approved at the January 18, 2006 meeting of the Board of Regents.

It was recalled that on April 30, 2003, the U.S. Secretary of Energy Spencer Abraham announced that the DOE would open to competition the management and operations contract for LANL that will take effect after the DOE's contract with UC expires on May 31, 2006. UC announced on May 11, 2005 that it had entered into an agreement with Bechtel National, Inc. (Bechtel), a global engineering, construction, and project management company, to prepare for the RFP competition. The DOE issued the final RFP, which required that LANL be operated and managed by a separate corporate entity, on May 19, 2005. Shortly following the release of the RFP, The Regents authorized UC to participate in submitting a proposal at its meeting of May 26, 2005. The Los Alamos National Security, LLC formed by UC, Bechtel, Washington Group International, and BWX Technologies, Inc. (i.e., the LANS) filed its response to the RFP on July 19, 2005. The DOE/NNSA announced on December 21, 2005, that the UC-Bechtel team (i.e., LANS) was chosen as the future manager of LANL.

Voluntary Election to Transfer UCRP Accrued Benefits and Service Credit

The RFP and subsequent LANS contract dictate that LANS must sponsor a site-specific defined benefit pension plan that incorporates key provisions of the UCRP for those

LANL employees wishing to transfer their accrued UCRP benefits to LANS. In February 2006, LANS submitted its benefit packages for approval to the NNSA that included a defined benefit plan within Total Compensation Package #1 (TCP1) as well as a market-driven defined contribution plan within Total Compensation Package #2 (TCP2). On March 9, 2006, the NNSA formally approved the LANS benefit packages, determining that the defined benefit plan in TCP1 provided substantially equivalent benefits to those of UCRP.

As stipulated in the RFP, LANL employees were given sixty days to evaluate the LANS benefit packages. Consequently, decision packets were mailed by both UC and LANS in mid-March and LANL employees were given until May 15, 2006 to decide whether to accept a job with LANS and either (1) waive rights to future UCRP benefits, with the exception of any CAP benefit, by transferring their accrued UCRP benefits and service credit to the LANS defined benefit plan, or (2) retain future rights to receive their accrued UCRP benefits by retiring or electing inactive membership under UCRP and participating in the LANS market-driven defined contribution plan. Additionally, those who elect inactive membership in UCRP may choose to transfer any unused sick leave balance to LANS or to keep it with UC for later conversion to UCRP service credit if the inactive member opts to retire within 120 days following separation from UC, similar to current UCRP provisions. Unused sick leave may not be converted to UCRP service credit if it is transferred to LANS or, if kept at UC, the retirement date of the inactive UCRP member is more than 120 days after his or her separation from UC.

The RFP also states that LANL employees who elect to retire on or before June 1, 2006 will not be eligible for a guaranteed job offer from LANS, although LANS may still offer them a job. For purposes of the LANS employment offers only, LANL employees electing a lump sum cashout under UCRP that will be effective on or before June 1, 2006 will be considered to have made a UC retirement election. Although the RFP does not specifically address domestic relations orders (DROs), it is recommended that a designated payee who is eligible for UCRP benefits pursuant to a DRO be given the choice of having benefits retained in UCRP or transferred to the LANS defined benefit plan if the UCRP member named in the DRO transfers his or her UCRP accrued benefit and service credit to the LANS defined benefit plan.

Employees on military leave generally are entitled to restoration of benefits that otherwise would have accrued during the period of military leave, provided they return to employment with the employer and make up any employee contributions that would have been required during that time. LANL employees on military leave as of May 31, 2006, will not be able to return to UC employment at LANL. Thus, UCRP will need to be amended to reflect the transition to LANS and provide for the appropriate benefit accruals and service crediting under UCRP through May 31, 2006, for those LANL veterans who return to employment with LANS following a military leave.

Under the RFP, participation in the LANS defined benefit plan is limited to existing LANL employees, determined at May 31, 2006, who accept employment with LANS and elect to participate in the LANS defined benefit plan. In order to accommodate the future needs of LANL, and the possibility that participation in the LANS defined benefit plan will be expanded as needed to further LANL's mission, it is recommended that UCRP be amended to allow subsequent transfers of UCRP assets and liabilities to the LANS defined benefit plan on behalf of a UC employee who transfers employment to LANS after June 1, 2006, if such employee is designated by LANS as eligible to participate in the LANS defined benefit plan. Any such transfer would be authorized only upon approval by the DOE and upon a finding that the employee's transition to LANS is critical to the furtherance of LANL's ongoing mission.

UCRP assets and liabilities attributable to the benefits of LANL employees who accept employment with the LANS and choose to participate in the LANS defined benefit plan will be transferred when all the necessary and appropriate regulatory approvals have been obtained, consistent with the terms of UC's current contract with the DOE/NNSA. The recommended amount of assets and liabilities to be transferred to the LANS defined benefit plan will be determined through negotiations with the DOE/NNSA and in consultation with internal and external counsel and UC actuaries. UC administration will come back to The Regents to discuss the methodology and actuarial factors used in the actuarial valuation required by the current contract and to seek authority to transfer the final amount of assets and liabilities from UCRP to the LANS defined benefit plan.

Interim Funding for LANL Employees Retiring from LANS

It is expected that a process will need to be established for paying benefits of UCRP members from LANL who transfer employment to LANS and become eligible for benefit payments under the LANS defined benefit plan prior to the completion of the final transfer of assets and liabilities from UCRP. In order to maximize the investment return in the UCRP for the benefit of all members, it is recommended that UCRP assets be transferred to the LANS defined benefit plan on a monthly basis, in advance, following the transition to cover liquidity needs for benefits for these employees and their eligible survivors that will be paid from the LANS plan. This interim funding or 'seed money' would be accounted for in the determination of the final amount of UCRP assets and liabilities that will eventually be transferred to the LANS defined benefit plan.

Retention of CAP Benefits in UCRP

The IRS considers the CAP benefit to be similar to a type of cash balance formula and is unlikely to issue a favorable determination letter to a plan with a cash balance feature until Congress resolves issues with respect to cash balance plans. Since a favorable determination letter on the LANS defined benefit plan is likely to be a prerequisite before UCRP assets can be transferred to it, no CAP benefits will be transferred to the LANS defined benefit plan.

Further, guidance issued by the IRS indicates there could be an issue raised by distributing CAPs remaining in UCRP if part of a member's UCRP benefits (e.g., the assets and liabilities supporting retirement income) are transferred to the LANS defined benefit plan. In that instance, the member's break in service from UC and the successor employer may not be deemed sufficiently complete to permit a distribution of the remaining CAPs until the member terminates employment with LANS. Current UCRP provisions provide that, upon a member's break in service from UC employment, the CAP benefit may remain in UCRP only if the member is vested, and therefore an inactive member of UCRP. If the member is not vested at the time of separation or elects to retire (or is approved for UCRP Disability), the CAP benefit must be distributed to the former employee or rolled over to an IRA or another employer's plan on his or her behalf. Thus, UCRP needs to be amended to make retention of the CAP benefits mandatory for LANL employees who elect to participate in the LANS defined benefit plan.

Fiduciary Oversight

Based on consultation with the Office of General Counsel and an independent review by external counsel Orrick, Herrington & Sutcliffe, LLP, the President proposes to amend UCRP to clarify the distinction between primary fiduciary responsibility for investment management and administrative functions and secondary fiduciary responsibility, which encompasses ongoing monitoring of the performance of those with primary fiduciary responsibility. It is recommended that primary authority for implementing investment policy for UCRP be assigned to the Office of the Treasurer and that primary authority for administrative functions for UCRP be assigned to the Associate Vice President–Human Resources and Benefits. The Regents and its respective Committees will continue to determine investment policy and will continue to retain broad oversight responsibility for those who have been allocated primary responsibility for the investment and administrative functions of the UCRP. The Regents approved a similar clarification of fiduciary oversight for the Retirement Savings Program at its meeting on March 17, 2005.

Further, as part of the clarification of the fiduciaries' roles, it is proposed that specific provisions governing the trust that is part of UCRP be incorporated in the plan document for UCRP and that UCRP be amended to remove specific references to advisory groups not included in the fiduciary oversight structure.

Implementation

It is proposed that the delegations be granted to amend UCRP only as described above. If, in the course of obtaining the necessary and appropriate governmental rulings for the actions described above, it becomes necessary or desirable to make additional amendments to UCRP, the 415(m) Restoration Plan and/or the Retirement Savings Program plans to facilitate the LANL transition, interim action may be necessary. UC administration will come back to The Regents later this year, following consultation with faculty leadership, the DOE/NNSA, internal and external counsel and UC actuaries, to discuss the special actuarial valuation and to request authority to transfer applicable assets and liabilities to the LANS defined benefit plan. The Regents will continue to be updated concerning the LANL transition and any interim action.

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 and UC policy.

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

4. **UPDATE ON THE FUNDED STATUS OF THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN**

Mr. Bob Miller of Mercer Human Resource Consulting provided a brief update on the funded status of the University of California Retirement Plan. He recalled that at the March 2006 meeting, The Regents had approved a long-term funding policy that attempts to target 100 percent funded status for the plan while allowing for oscillations within a range of 95 percent to 110 percent. Also approved were contributions starting in July 2007 that would gradually increase to 16 percent of covered earnings, which is the level necessary to keep the plan fully funded over time. Resumption of contributions is subject to collective bargaining and to the availability of funding and completion of the budget process.

Mr. Miller reported that starting contributions in July 2007 and gradually increasing them to 16 percent by 2013 will bring the plan in for a "soft landing." By starting contributions while the plan is still somewhat above 100 percent funding, ultimately it will stay close to the Regents' target.

Mr. Miller noted that periodically it is appropriate to review the funded status projections and update them if significant changes have occurred, including such things as either above target or below target investment results for the plan upon which the funding assumptions are based. There could be changes to retirement patterns or turnover that would affect the liabilities of the plan. The funding projections have been updated to reflect actual investment performance through March 31, 2006. The plan for the first nine months of the fiscal year earned 8.5 percent on its assets. Some minor refinements have been made to reflect the impact of catch-up pay increases.

Neither the University nor the plan members are contributing to the plan. Plan members are contributing 2 percent of their salaries up to the Social Security wage base and 4 percent thereafter into a defined contribution plan that is an account for their own benefit. This contribution strategy would suggest that starting in July 1, 2007, a total of 4 percent of covered earnings would go into the plan. It does not specify whether that would come from the members or the University or the proportions from each. To the 4 percent would be added 2 percentage points a year out to the year 2013. If no contributions were to go into the plan, it would dip below 100 percent in about 2010 and be about 60 percent in 2023; however if contributions are made as scheduled, the funded status will dip below 100 percent but then level out to just above 95 percent, which is within the Regents' corridor of 95 percent to 110 percent

Chairman Parsky commented that this is an important subject for the University and the community to understand. He noted that the return assumptions are 7.5 percent, which can vary, and people need to understand the risks that are involved. The University's plan is in the enviable position of being overfunded, and that status should be preserved. Educating people over the course of the next six to twelve months will be very important.

The meeting adjourned at 3:20 p.m.

Attest:

Associate Secretary