The Regents of the University of California

COMMITTEE ON COMPENSATION
COMMITTEE ON FINANCE
February 5, 2009

The Committee on Compensation and the Committee on Finance met jointly on the above date at UCSF–Mission Bay Community Center, San Francisco.

Members present: Representing the Committee on Compensation: Regents Hopkinson, Johnson, Kozberg, Lozano, Pattiz, and Varner; Ex officio members Blum and Yudof; Advisory members Croughan and Stovitz
Representing the Committee on Finance: Regents Garamendi, Gould, Hopkinson, Island, Kozberg, Lozano, Scorza, Varner, and Wachter; Ex officio members Blum and Yudof; Advisory members Bernal and Croughan; Staff Advisors Abeyta and Johansen

In attendance: Regents De La Peña, Lansing, Makarechian, Marcus, O'Connell, Reiss, Ruiz, Schilling, and Shewmake, Faculty Representative Powell, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Executive Vice Presidents Darling and Lapp, Senior Vice President Stobo, Vice Presidents Broome, Dooley, Foley, Lenz, and Sakaki, Chancellors Block, Blumenthal, Fox, Kang, Vanderhoef, and White, and Recording Secretary Johns

The meeting convened at 10:25 a.m. with Committee on Finance Chair Gould presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of November 20, 2008 were approved.

2. **PROPOSED REINSTATEMENT OF CONTRIBUTIONS TO THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN AND ASSOCIATED AMENDMENT OF THE DEFINED CONTRIBUTION PLAN**

The President recommended that the Committee on Finance and the Committee on Compensation recommend that:

A. University contributions and member contributions be reinstated effective on or about April 15, 2010 as follows:

(1) The University contribution rate for the fourth quarter of Plan Year 2009-2010 (starting on or about April 15, 2010) and for Plan Year 2010-2011 be as shown below:

Member Class	Number of Members July 1, 2008	University Contribution Rate on Covered Compensation	
		Fourth Quarter of Plan Year 2009-2010*	Plan Year 2010-2011
Coordinated with Social Security	111,254	4%	TBD**
Noncoordinated	2,556	4%	TBD**
Safety	411	4%	TBD**
Tier Two	21	2%	TBD**

* Starting on or about April 15, 2010
**The University contribution rate for Plan Year 2010-2011 will be at least 4 percent and may be higher as decisions are made about moving towards the entire recommended total contribution rate.

(2) The member contribution rates for the fourth quarter of Plan Year 2009-2010 (starting on or about April 15, 2010) and for Plan Year 2010-2011 be as shown below, subject to collective bargaining, if applicable, for represented members. These are the same as the current rates for member contributions that are being redirected to the Defined Contribution Plan.

Member Class	Member Contribution Rate on Covered Compensation for the Fourth Quarter of Plan Year 2009-2010* and for Plan Year 2010-2011
Coordinated with Social Security	2% up to Social Security wage base, then 4% over Social Security wage base, minus $19/month
Noncoordinated	3% minus $19/month
Safety	3% minus $19/month
Tier Two	None

*Starting on or about April 15, 2010

B. The current redirection of member contributions to the Defined Contribution Plan be terminated effective on or about April 15, 2010, subject to collective bargaining, if applicable, for represented members.

C. The University contributions and the member contributions for the Lawrence Berkeley National Laboratory (LBNL) segment of UCRP be made on the same basis as determined for the non-laboratory segment of UCRP (i.e., campuses, medical centers and Hastings College of the Law), effective on or about April 15, 2010, subject to the terms of the University's contract with the Department of Energy and subject to collective bargaining, if applicable, for represented members at LBNL.

D. For members participating in the Staff and Academic Reduction in Time (START) Program at any time between April 15, 2010 and June 30, 2010, the applicable University fund source be assessed and be liable for the additional amount of University contributions and member contributions that would have been contributed by and on the behalf of such members had such members not participated in the START program, in accordance with Regental approval of the START program.

E. UCRP be amended effective April 15, 2010 to allow members who are not vested in their basic retirement benefit to leave their contributions on deposit with the Plan following a break in service.

F. Authority be delegated to the Plan Administrator to amend UCRP and the Defined Contribution Plan as necessary to implement these changes.

[Background material was mailed to Regents in advance of the meeting, and copies are on file in the Office of the Secretary and Chief of Staff.]

[Regents were provided with a packet of correspondence received in the Office of the Secretary and Chief of Staff regarding this item.]

Committee on Finance Chair Gould emphasized the critical nature of this recommendation and the need to act on it.

Executive Vice President Lapp recalled that there have been no employer contributions to the UC Retirement Plan (UCRP) for nineteen years. This includes contributions from the State, the medical centers, and federal and private contracts and grants. There have also been no member contributions to the UCRP during that period. Eighty percent of current UC employees have never made a contribution. There has been a decline in the funded status of the Plan. Based on data through December 2008, the actual market value of the UCRP is at approximately 80 percent. At the next actuarial valuation, the University anticipates that it will be funded at 95 percent.

In September 2008 the Regents approved a policy for UCRP funding which concerned actuarial smoothing of surplus and liabilities. At that meeting, the actuary recommended that contributions begin at 11.6 percent of covered payroll. This would represent $875 million from all funding sources. The State's portion of this amount would be $228 million. Of the 11.6 percent, 2 percent would come from employees. The Governor's 2009-10 budget included 4 percent funding or $96 million over the fiscal year. The Governor has reduced this amount to $20 million in the budget proposed in January. Assuming a $20 million State contribution and an employer contribution target of 4 percent, a logical implementation date for contributions would be April 15, 2010. All other employer payroll funding sources would also start at 4 percent. In fiscal year 2010-11, the University would expect an employer contribution of at least 4 percent and would request at least 6 percent from the State. This would raise the State's share to $150 million.

Ms. Lapp then turned to member contributions. When employee contributions were suspended in the early 1990s, the 2 percent contribution was redirected to the Defined

Contribution Plan. The contributions are generally 2 percent, with some employees contributing a little more or less. As an example, an employee earning $30,000 contributes approximately 1.24 percent. Higher-paid employees are contributing around 3 percent. The current recommendation would redirect this 2 percent contribution and would not bring about a reduction in take-home pay. The University was proposing that this 2 percent rate remain in effect through fiscal year 2010-11. Over the following several years, the employee contribution would gradually be increased to parallel the California Public Employees' Retirement System (CalPERS) member rate, currently at 5 percent. This would be subject to collective bargaining. Ms. Lapp noted that the University's tentative agreement with the American Federation of State, County and Municipal Employees (AFSCME) recognized the redirection of the 2 percent contribution. She reported the Academic Council's support for the reinstatement of contributions, in spite of the fact that it will reduce total remuneration. The Academic Council requested that the Regents pay particular attention over the next year to total remuneration analyses, to ensure that appropriate salary improvements for 2010-11 be a paramount concern.

Ms. Lapp concluded by remarking that the current presentation and discussion assumed an increase in the employer contribution rate of 2 percent every year over the next several years. It also assumed a 20 percent decline in the market value of the UCRP this fiscal year, but a 7.5 percent return next year and every year thereafter.

Mr. Paul Angelo of the Segal Company, the Regents' actuary, discussed a chart displaying both the contributions recommended under the UCRP funding policy, or "policy contributions," and the actual proposed contributions. The proposed 4 percent contribution only begins in the last quarter of 2009-10, and thus represents a 1.24 percent contribution on an annualized basis.

In response to a question asked by President Yudof, Mr. Angelo confirmed that, according to the chart, by 2013, 40 percent of covered compensation would be required to ensure full funding of the UCRP.

President Yudof questioned whether a 40 percent contribution rate was within the realm of the possible.

Ms. Lapp responded that a 40 percent contribution rate would be highly unlikely for the University to achieve, based on its operating budgets. It would also depend on assumptions of employer and employee contributions. A 40 percent contribution rate was not realistic at the present time, nor would it be in five years.

Committee on Finance Chair Gould alerted the Regents that even the rational, measured, proposed increases in contribution rates would lead to a point that would not be acceptable.

Chairman Blum pointed out that, in the past, the University was able to assume a 7 percent return due to the availability of high-quality bonds. A few years ago, the return on these bonds decreased to 3 percent or 4 percent. He noted the risky nature of alternative investments and emphasized how significant the challenge was for the University's investment strategy to restore the UCRP to equilibrium, even with larger contributions.

Committee Chair Gould concurred and underscored the current unfavorable market environment. He called attention to the assumption in this presentation that annual returns on the UCRP would be restored to 7.5 percent by July 1, 2009.

Chairman Blum added that, even if these numbers were correct, the University did not have a reliable strategy to ensure full funding.

Committee Chair Gould warned that, even with incremental increases in contributions, the unfunded liability of the UCRP would grow.

Mr. Angelo then discussed a chart showing UCRP funding as a ratio, with a funded status of just over 100 percent in 2008 and decreasing by 2013 to a 60 percent funded status. If the University were to make the "policy contributions" presented earlier, the ratio at that point would be 72 percent, rather than about 60 percent.

Committee Chair Gould noted that, with the policy contribution rate of 40 percent, the UCRP would be fully funded by 2013.

Mr. Angelo responded that the UCRP would then be making progress toward full funding. In that case the UCRP would be at a 72 percent funded status, and on track to 100 percent funded status by the end of a 15-year amortization period. He then discussed a chart with projections of the UCRP actuarial accrued liability, which the University is seeking to fund at 100 percent; the market value of assets, which showed a 20 percent loss in value as of the 2009 valuation; and the value of assets with five-year actuarial smoothing. The spread between the actuarial accrued liability and the smoothed value of assets represented the unfunded liability.

Ms. Lapp explained the following chart, which indicated the increasing liability in normal cost of the UCRP annually from 2008 to 2013 and the actuarial value of assets for the same period. The UCRP assets are projected to decrease each year, even if the UCRP achieves a 7.5 percent return each year. In five years, there will be an unfunded liability in the UCRP of $18 billion. Ms. Lapp emphasized that the University must consider how it plans to address this problem, which will worsen over the next ten to fifteen years.

Chairman Blum asked about the University's total annual obligation to its retirees. He suggested that at some point in the future, this funding might have to come from the University's operating budget. Mr. Angelo estimated this obligation to be approximately $1.5 billion.

Regent Schilling asked if it was necessary for all UC employees to participate in the reinstatement of contributions. She noted that faculty wish to resume contributions, while union workers appear not to wish to do so. She asked if it would be possible to segregate the fund. Ms. Lapp expressed the general sentiment of UC employees that all employees should contribute at the same time. She stated that UC staff are aware of the relevant data and also supportive of the reinstatement of contributions, but acknowledged concerns that the reinstatement of contributions might reduce total compensation. It would be difficult for the University to request that faculty resume contributions and others not. It would also be difficult to separate portions of the UCRP. A task force is now being formed by the President to consider UCRP policy for current and future employees.

Regent Lozano requested a clarification of the statement that employees would not experience a reduction in income under the proposal for the first year. Mr. Angelo responded that the redirected contributions now going into the Defined Contribution Plan would go into the UCRP. This amount is already being deducted from paychecks and thus there would be no change in take-home pay.

Committee Chair Gould added that this situation would obtain as long as the contributions remained at 2 percent; there might be an impact on salaries as the contributions increased to 3 percent or 4 percent.

Regent Pattiz requested clarification of the 40 percent contribution rate discussed earlier. Mr. Angelo responded that this was 40 percent of that portion of compensation that UCRP benefits are based on. This portion includes most components of compensation.

Regent Pattiz asked if 40 percent of what employees are paid would have to be contributed to the UCRP. Mr. Angelo responded that this would be the case under the previously discussed “policy contributions.”

President Yudof stated that the 2 percent contribution to the Defined Contribution Plan equals $8 billion. He saw this as one indication of how much better the UCRP would fare had there been a reasonable plan in place, with a small contribution, during the past nineteen years. One could not expect a retirement benefit program to perform well without contributions from employees or employer for almost twenty years. The UCRP currently pays out $1.5 billion annually. As more employees retire, this number will increase. President Yudof asked at what point, given a 2 percent contribution rate, the income from the retirement endowment will no longer be sufficient and the University will need to take money from its operating budget to pay for retiree benefits. Mr. Angelo responded that, in rough terms, this would occur in the early 2020s, assuming that contributions did not reach the “policy contributions” level.

Committee Chair Gould underscored the clarity of the need to begin contributions and to examine the structure of the system.

Ms. Lapp then discussed the retiree health benefit program liabilities, which have been increasing significantly in recent years. Under a new Governmental Accounting Standards Board (GASB) statement, the University is required to report accrued liability for retiree health benefits. She pointed out on a chart that this liability was approximately

$13 billion in 2008 and was projected to grow to almost $19 billion by 2013. The actual pay-as-you-go cost paid by the University was $225 million for 2008. This cost would increase to $416 million in five years. She stressed that this money came directly from the University's operating budget. As State support declines, the University urgently needs to address this increasing liability.

Committee Chair Gould drew attention to the projected liability for 2013. The University would be requesting this significant amount of money from the State simply to sustain the University's retiree benefits program, with no improvement whatsoever.

Regent De La Peña opined that the University could significantly improve its operations in this area. He suggested that the University should consider self-insurance. The University could self-insure, as some large companies do, rather than pay private businesses like HMOs and insurance companies. There could be substantial savings through such an action.

Regent Garamendi asked about the relationship between the UC retiree health care benefits and Medicare benefits. Director Schlimgen responded that, if a retiree is eligible for Medicare, then at age 65 Medicare becomes the primary coverage; the UC coverage becomes secondary.

Regent Garamendi asked if the liability figures being discussed represented the net difference between assumed Medicare coverage and the additional benefit package offered by UC. Mr. Schlimgen responded that the University is aware of which employees are coordinated with Social Security and will be eligible for Medicare. The figures factor in and assume Medicare eligibility. The University's projections also consider the growing number of retirees, cost-sharing, and future increases in the pay-as-you-go cost.

Regent Garamendi asked if the University can modify the benefit package it provides. Mr. Schlimgen responded in the affirmative.

Regent Garamendi asked if the University could do so unilaterally, or if this would require negotiations with employee unions. Mr. Schlimgen responded that it would require negotiations for members currently in bargaining units, but not for those already retired.

Regent Garamendi asked if the University could change the benefit package for individuals who are already retired. Mr. Schlimgen stated that there was flexibility in this area.

Regent Garamendi asked if this flexibility included totally withdrawing the benefits. Mr. Schlimgen responded that the benefits program is a promise to retirees. There is flexibility in cost-sharing and coverage.

Committee Chair Gould observed that recognition of the increasing pay-as-you-go cost did not address the rapidly growing unfunded liability. If the University wished to sustain the plan in its current form, it would not be enough merely to cover pay-as-you-go cost.

Regent De La Peña asked about the process by which the University negotiates its contracts with private health providers to ensure the best possible discount. He cited allowable rate negotiations for Medicare and Medicaid.

Ms. Lapp responded that the Office of the President would provide that information. She added that the task force being formed by the President would examine questions like this one. Changes made in this area could help the University to reduce costs.

Regent Varner noted the need for approval of the present recommendation, but emphasized that the University needs to consider a complete restructuring of the UCRP. A contribution of 40 percent of payroll was clearly not possible. Major restructuring was an urgent priority for immediate consideration. The present discussion was based on assumptions about market performance that might not turn out to be accurate. Without prompt action, the University might find itself in a worse situation.

President Yudof stated that there was no alternative to the restructuring of the University's benefits program, and that this would be a concern of the task force he is forming. It might be possible to adjust the vesting period, employee contributions, and benefits offered to new employees. He emphasized his own and the Board's fiduciary obligation to restore the UCRP to a good condition. He wished to assure retirees that the University is not running out of money, but that the UCRP must be fixed in order to ensure the University's long-term ability to provide the benefits it promises to them. Faculty and staff would be consulted on this topic. President Yudof noted in particular the expertise of faculty, such as the University Committee on Faculty Welfare of the Academic Senate. He cautioned that the reinstatement of contributions was a small portion of the overall, longer-term problem. The restructuring of the UCRP would require a difficult set of decisions.

Committee Chair Gould emphasized the importance of effective communication with employees about the reasons for decisions being made.

Regent Makarechian referred to the Annual Financial Report of the University for 2007-08, and asked about a line item, a $1.1 billion obligation for retiree health benefits, which did not exist in 2006-07.

Committee Chair Gould observed that this was due to the new GASB reporting requirement.

Mr. Schlimgen responded that the University's balance sheet obligation grows every year. This balance sheet obligation was $1.08 billion as of July 1, 2007 and increased to $2.3 billion as of July 1, 2008. He attributed the increase to the new reporting requirements and the fact that the University was not making the annual contribution necessary to fund retiree medical benefits.

Regent Makarechian asked if this were a one-time item. Mr. Schlimgen responded that the balance sheet obligation increases every year by approximately $1 billion. He distinguished this obligation from the GASB liability and the pay-as-you-go cash cost.

Regent Makarechian asked about the likely amount of this balance sheet obligation in 2009. Mr. Schlimgen responded that the obligation was now $2.3 billion and anticipated that it could increase by $1 billion or more.

Faculty Representative Croughan concurred with Committee Chair Gould on the importance of good communication. Faculty were well informed on these issues through the work of the Academic Senate's University Committee on Faculty Welfare, Task Force on Investments and Retirement, and University Committee on Planning and Budget. She praised the transparent and collaborative nature of the work these groups do with the administration. It was this communication and transparency which led to faculty support for the reinstatement of contributions. Faculty recognized that total remuneration would have to be compromised in the best interests of the University and that faculty salary issues would have to be decoupled from the retirement program. She urged that information about the reasons for the reinstatement of contributions be made available to broader groups of employees. She noted that the Academic Senate would request that the Department of Human Resources and Benefits issue a statement urging employees not to take a lump sum cashout at retirement.

Staff Advisor Johansen concurred with Ms. Croughan. He expressed regret that there had been a delay in the reinstatement of contributions and that it was not possible to implement faculty and staff salary increases. He expressed concern that future increases in contributions to the UCRP might take away from salary increases for faculty and staff. He asked if the actuarial data presented during the discussion took into account possibly lower numbers of FTE in the future.

Mr. Angelo responded that the actuarial projections assumed a slight growth in the UC employee population. This has been an assumption in the data over the last several years. The data have not been revised based on any projected future reductions. He cautioned that reductions can have a number of different effects. One possible effect is that the amount of liability, funded by a smaller payroll, requires a larger percentage of payroll.

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

The meeting adjourned at 11:10 a.m.

Attest:

Secretary and Chief of Staff