The Regents of the University of California

COMMITTEE ON FINANCE
November 19, 2015

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

Members present: Regents Davis, Island, Kieffer, Makarechian, Ortiz Oakley, Reiss, and Ruiz; Ex officio members Lozano and Napolitano; Advisory members Hare and Ramirez; Staff Advisors Acker and Richmond

In attendance: Regents Blum, De La Peña, Elliott, Gorman, Lansing, Oved, Pattiz, Pérez, Sherman, and Zettel, Regents-designate Brody and Schroeder, Faculty Representative Chalfant, Secretary and Chief of Staff Shaw, General Counsel Robinson, Provost Dorr, Executive Vice President and Chief Financial Officer Brostrom, Executive Vice President and Chief Operating Officer Nava, Senior Vice Presidents Henderson and Peacock, Vice Presidents Brown, Budil, Duckett, Humiston, and Sakaki, Chancellors Block, Blumenthal, Dirks, Gillman, Hawgood, Katehi, Khosla, Leland, Wilcox, and Yang, and Recording Secretary Johns

The meeting convened at 2:20 p.m. with Committee Chair Ruiz presiding.

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

Upon motion duly made and seconded, the minutes of the meeting of September 17, 2015 were approved.

2. **UNIVERSITY OF CALIFORNIA FINANCIAL REPORTS, 2015**

The President of the University recommended that the Regents adopt the 2014-15 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 provided 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 Peggy Arrivas provided a brief overview of the UC financial reports for 2015. Overall, the University's assets continued to grow due to investment returns and capital investments. Liabilities increased as a result of additional debt, pension obligations, and retiree health obligations. The University's net position remained level compared with the previous year. The University's revenue sources continued to grow, as did expenses, consistent with UC's increased operations. Overall, the loss from operations, when State appropriations are considered, was level with the previous year. Assets and liabilities also continued to grow for the medical centers. A significant portion of revenue growth for UC, more than 50 percent, came from the medical centers. Of the $652 million in income from medical center operations, $400 million was transferred to the medical schools to support the cost of educating students.

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

3. **AUTHORIZATION TO FUND UNIVERSITY OF CALIFORNIA RETIREMENT PLAN ANNUAL REQUIRED CONTRIBUTIONS FOR FISCAL YEAR 2015-16, FISCAL YEAR 2016-17, AND FISCAL YEAR 2017-18 WITH CONTRIBUTION FROM SHORT TERM INVESTMENT POOL**

The President of the University recommended that the Regents amend the Regents' July 2014 action, *Authorization to Fund University of California Retirement Plan Modified Annual Required Contribution with Contribution from Short Term Investment Pool*, as follows:

Additions shown by underscoring; deletions shown by strikethrough

The President of the University be delegated authority and discretion to make contributions to 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 of the University 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, as follows:

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G. Transfer funds from STIP to UCRP in FY 2015-16, FY 2016-17, and FY 2017-18, in amounts equal to the difference between the approved total UCRP contribution and ARC. Should STIP have insufficient funds, funds will be transferred from TRIP to STIP. These transfers shall satisfy the requirements below and will not exceed $563,600,000 in FY 2015-16, $481,000,000 in FY 2016-17, and $391,800,000 in FY 2017-18:

(1) Maintenance of a minimum balance in STIP of $5 billion at all times.

(2) Receipt of State Proposition 2 funds for UCRP of $96,000,000 in FY 2015-16, $170,000,000 in FY 2016-17, and $170,000,000 in FY 2017-18.

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

(4) The ability to set the repayment terms on the STIP Note, which will have a final maturity no later than FY 2041-42.

(5) 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.

(6) 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.

[Background material was provided 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 and Chief Financial Officer Brostrom explained that this item requested authorization for further borrowing from the Short Term Investment Pool (STIP) to the UC Retirement Plan (UCRP) over the three coming fiscal years. This, in combination with potential monies from the State, would bring the total Annual Required Contribution to the level needed.

The UCRP funded status had improved as a result of strong investment performance and actions by the Board. Two years earlier, UCRP was funded at 76 percent; it was now 81 percent funded on an actuarial value of assets basis. The most important action by the Board was to increase contribution rates. The Board had also authorized three borrowings, two from STIP, and one external borrowing. This alone had brought about a five percent improvement in the funded ratio. Without the internal borrowing, the UCRP would be funded at 75 percent. The Board had also authorized a new pension tier that went into effect in July 2013, and the possibility of another new modified tier was being considered.

The University was now proposing to borrow additional funds from STIP. Combined with the funds UC expects to receive from the State, this should allow the UCRP to reach a 90 percent funded level by 2025, and full funding by 2040. STIP borrowing would be repaid by a payroll assessment to the campuses which would rise to about 1.76 percent.

Mr. Brostrom asserted that the proposed borrowing would not jeopardize the University's liquidity over the next three years, but the University would have to monitor the situation diligently. UC has communicated to the rating agencies that it would always maintain at least $5 billion of liquidity; it currently had $6.1 billion. The University had also implemented a new asset allocation model for the Total Return Investment Pool (TRIP) which should provide UC more credit for liquidity. He concluded that borrowings from STIP have had a positive effect on the UCRP.

Regent Makarechian observed that TRIP returns are higher than STIP and asked why the University would not move more funds to TRIP. Mr. Brostrom responded that TRIP was relatively new and had not existed six years earlier. He concurred that UC should move its funds as much as possible into TRIP or UCRP because of the higher returns. A certain portion of STIP funds cannot be moved, such as bond proceeds and campus foundation funds. The University needed to maintain $5 billion in STIP.

Regent Makarechian questioned this approach, which left $5 billion earning almost no interest when it might earn as much as three percent. Mr. Brostrom expressed understanding of this view. If one considers UC's cash forecasting, even in the case of an extreme, catastrophic event, UC would not have $5 billion in needs. On average, compared to other medical centers in the nation, UC medical centers have a low number of days' cash on hand, but the University is able to address this situation by having $5 billion in its system that can be injected.

Regent Makarechian underscored that the UC medical centers in fact have many days' cash on hand; UC San Diego, for example, has about 119 days' cash on hand. Mr. Brostrom countered that the rating agencies would like to see 180 days' cash on hand. He stated that he would like to lower the amount of funds in STIP.

Regent Makarechian objected that UC was losing an opportunity to generate money. He referred to the lowered expected rate of return on the UCRP, and asked what UC would do with excess returns. Mr. Brostrom responded that excess or greater-than-expected returns would remain in the system.

Regent Makarechian suggested that the University might reach 100 percent funding of the UCRP much sooner than 2040 and that it might be preferable not to lower the expected return threshold. Mr. Brostrom responded by referring to the employer contribution to the UCRP, a significant expense that UC had not had five years earlier, and noting that it would be a great help to the campuses and the medical centers to lower the normal cost.

Regent Makarechian asked when the University would examine the relationship of STIP and TRIP in the interest of saving money. Mr. Brostrom responded that this study was already going on.

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

The Committee recessed at 2:30 p.m.

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The Committee reconvened at 3:25 p.m. with Committee Chair Ruiz presiding.

Members present:	Regents Davis, Island, Kieffer, Makarechian, Ortiz Oakley, and Ruiz; Ex officio members Lozano and Napolitano; Advisory members Hare and Ramirez; Staff Advisors Acker and Richmond
In attendance:	Regents De La Peña, Elliott, Gorman, Lansing, Oved, Pattiz, Pérez, Sherman, and Zettel, Regents-designate Brody and Schroeder, Faculty

Representative Chalfant, Secretary and Chief of Staff Shaw, General Counsel Robinson, Chief Investment Officer Bachher, Provost Dorr, Executive Vice President and Chief Financial Officer Brostrom, Executive Vice President and Chief Operating Officer Nava, Senior Vice Presidents Henderson and Peacock, Vice Presidents Budil, Duckett, and Sakaki, Chancellors Block, Blumenthal, Dirks, Gillman, Hawgood, Khosla, and Yang, and Recording Secretary Johns

4. **UPDATE ON THE UNIVERSITY OF CALIFORNIA'S CAPTIVE INSURANCE COMPANY – FIAT LUX**

[Background material was provided 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 and Chief Financial Officer Brostrom proposed that this update on the University's captive insurance company be postponed until a later meeting.

5. **AMENDMENT TO FORMATION OF A CAPTIVE INSURANCE COMPANY**

The President of the University recommended that the following section in the Regents' action of May 2012, *Formation of a Captive Insurance Company*, be revised as follows:

Additions shown by underscoring; deletions shown by strikethrough

2. Authorize the President, following consultation with the General Counsel, to create other captive insurance companies, as needed, with the Captive Insurance Company's Board's approval pursuant to the Captive Insurance Company's Bylaws, and approve the University's participation in such other companies provided that: a) they are established and operated for University-related purposes; and, b) each such company's Bylaws give the University the right to appoint ~~all directors of such company.~~ <u>a sufficient number and class of directors of the company so as to maintain control of any activities related to the University's reputation, control of services, and assumption / management of risk in the captive proposition.</u>

[Background material was provided 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 and Chief Financial Officer Brostrom explained that the Regents' action of May 2012 forming the University's captive insurance company, Fiat Lux, includes a provision allowing the creation of additional captive insurance companies subject to certain conditions. One of the conditions concerns the University's right to appoint boards of directors of subsequent companies. UC was now creating a captive insurance company, a Risk Retention Group, to provide insurance for voluntary attending physicians. UC was also considering a captive insurance collaboration with the California State University. The boards of these entities would include non-UC members.

Regent Makarechian asked about capital guarantees for Fiat Lux and about back-up capital. Mr. Brostrom responded that Fiat Lux is funded by the premiums UC charges on insurance. The Risk Retention Group, a separate captive insurance company for medical malpractice, would have no access to Fiat Lux capital.

Regent Makarechian asked about the chosen domicile for the insurance. Mr. Brostrom responded that Washington, D.C. has been a good domicile for the UC program. The University decided early on that it would not move its captive insurance offshore. Among domestic domiciles, Washington, D.C. offers the most benefits.

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

6. **UNIVERSITY OF CALIFORNIA MORTGAGE ORIGINATION PROGRAM AND SUPPLEMENTAL HOME LOAN PROGRAM – PROPOSED REVISIONS TO PROGRAM POLICIES**

The President of the University recommended:

A. Expansion of Mortgage Origination Program and Supplemental Home Loan Program (SHLP) eligibility to include UC Hastings College of the Law faculty.

B. Establishment of a centrally-funded pool available for SHLP loans, with an initial allocation of $5.5 million from the Faculty Housing Programs Reserve Fund.

C. Rescission of the current SHLP policy for renovation loans.

[Background material was provided 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 and Chief Financial Officer Brostrom explained that the Mortgage Origination Program is a significant benefit for faculty and helps faculty recruitment. One of the proposed revisions to this Program and the Supplemental Home Loan Program was to expand eligibility to include UC Hastings College of the Law faculty. The loan volume for these faculty members was anticipated to be in the range of $3 million to $5 million annually. The second revision would create a central fund to assist with down payments for qualified applicants, using existing housing reserves. Many UC campuses are located in areas with high real estate costs, and faculty often have difficulty with the down payment on their homes. The third revision would eliminate the policy for renovation loans, or home equity loans.

Regent Ortiz Oakley asked if these programs are monitored to ensure that all faculty have equal access to them. Director Ruth Assily responded that these programs are available only to faculty and members of the Senior Management Group. Ninety-seven percent of loans are made to faculty.

Regent Ortiz Oakley asked if faculty who need the programs the most are benefiting from them, taking account of factors such as gender and ethnicity. Ms. Assily responded that the University tracks these factors. Decisions about loans are made at the campus level. Mr. Brostrom added that UC offers allocations to the campuses, so that one campus alone could not use up more than its share of available program amounts.

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

7. **AMENDMENT OF GROUND LEASE WITH U.S. DEPARTMENT OF ENERGY, WILSON TRACT, INTEGRATIVE GENOMICS BUILDING, LAWRENCE BERKELEY NATIONAL LABORATORY**

The President of the University recommended that:

A. The President be authorized to approve and execute an amendment to the ground lease dated September 1, 1948, for the Wilson Tract (Parcel 1), Berkeley, California, between the Regents as lessor and the U.S. Department of Energy (DOE) as lessee, to extend the lease term of Parcel 1 for the purpose of allowing DOE to erect and use the Integrative Genomics Building (IGB) and associated improvements for fifty (50) years effective from the date of approval by DOE of the construction of IGB, currently anticipated for June 2016 (Amendment).

B. The President, after consultation with the General Counsel, be authorized to approve the legal description for the Amendment and execute any ancillary documents related to the Amendment described in A. that do not substantially increase the Regents' obligations under the above ground lease.

[Background material was provided 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 Sandra Kim explained that the purpose of this ground lease extension was to allow the Department of Energy (DOE) to construct the Integrative Genomics Building at Lawrence Berkeley National Laboratory and occupy the building for its anticipated useful life of 50 years. The design of the building was discussed at the May meeting and approved by interim action in June. The DOE was expected to formally approve construction of the building in June 2016.

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

8. **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 provided 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, 2015, the UC Retirement Plan (UCRP) had more than 123,000 active members. In Plan Year 2014-15 it had paid out benefits of $3 billion to over 67,000 annuitants. UCRP had an actuarial accrued liability of $66 billion, which was 82 percent funded by the Plan's assets on an actuarial value of assets basis, compared to the 80 percent funded level of the previous year. This increase was mainly due to the recognition of prior investment gains that had been deferred under the University's actuarial smoothing method. The funded ratio on a market value of assets basis decreased from 87 percent to 84 percent, primarily due to changes in actuarial assumptions, such as moving from a 7.5 percent to a 7.25 percent discount rate, and due to increased longevity rates among UCRP membership. UCRP assets were $55 billion on a market value basis, including $700 million transferred from the Short Term Investment Pool (STIP) in July 2014, resulting in an overall unfunded liability of $11 billion. The unfunded liability for the campus and medical center segment was $10 billion; the total funding policy contribution rate for Plan Year 2016-17 is approximately 28.4 percent of covered payroll for this segment. This consists of 18.3 percent for normal cost and 10.1 percent for unfunded liability amortization. Contribution rates during Plan Year 2015-16 are 14 percent for the University locations other than Lawrence Berkeley National Laboratory (LBNL), and eight percent for most members, for a total of 22 percent. As authorized by the Regents at the September meeting, the LBNL employer contribution rate is 11.5 percent, based on the LBNL segment's 96 percent actuarial value of assets funded ratio. Mr. Duckett recalled a number of measures adopted to sustain UCRP well into the future and that the University borrowed internally to fund UCRP. UC planned to borrow internally over the next several years to fund UCRP at the policy rate. UCRP was expected to be 90 percent funded by 2025 and 95 percent funded by 2032, assuming a 7.25 percent return.

Regent Pérez asked about the University's confidence in the assumption of a 7.25 percent rate of return. The California Public Employees' Retirement System (CalPERS) had also recently reduced its return assumptions. Segal Consulting representative John Monroe responded that CalPERS had taken action only a few days earlier. CalPERS' assumed rate of return was 7.5 percent, and CalPERS would reduce this rate slowly over a long period, using a different method than UC. Executive Vice President and Chief Financial Officer Brostrom added that the University had carefully considered its move to a lower assumption of 7.25 percent; UC might seek another reduction the following year. The Chief Investment Officer was carrying out a portfolio assessment that would help determine what the assumption should be. Regent Pérez urged the University to be cautious in these assumptions.

Regent Makarechian observed that when CalPERS lowers its return assumptions, the State pays for the shortfall, while in the case of the University, it is the employees who must pay. Regent Pérez responded that this was true in general, although the situation was rather more complex. CalPERS has portions contributed by employer and employees. In calculating the rate of unfunded liability the University must be mindful of its long-term plans, and the likelihood of arriving at different percentages of unfunded liability regardless of payer.

Regent Makarechian stressed that both the University and its employees have to contribute to the shortfall when UCRP return assumptions are lowered. He expressed hope that the assumed rate of return would remain at 7.25 percent.

Regent Pérez asked how UCRP's unfunded liability is tracked to keep pace with the expectations of Proposition 2 funding. Mr. Brostrom responded that the Annual Required Contribution is the UCRP's normal cost, plus a portion of the unfunded liability. Using UCRP's assumptions, the actuary projected the Annual Required Contribution over the next three years. The borrowing from STIP discussed earlier that day was the Annual Required Contribution minus the amount UC anticipated it would receive from the State, minus the sum of expected employer and member contributions. The expected rate of return had been reduced from 7.5 percent to 7.25 percent, which has the effect of increasing the liabilities and increasing UC's expenses for funding.

Regent Makarechian expressed concern about the possibility of fraud involving payment of UCRP benefits to those not eligible. Mr. Duckett responded that UC verifies addresses and other information for its employees and retirees. He could provide more detail on this.

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

[Background material was provided 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 provided some highlights of the annual actuarial valuation of the UC Retiree Health Benefit Program, which is administered on a pay-as-you-go basis, part of UC's overall post-employment benefits program. The University actively manages Program costs each year and evaluates the Program in order to deliver benefits more effectively and efficiently at a lower cost. The Program's projected cash costs for the 2015-16 fiscal year were $287 million, compared to actual cash costs of $271 million for fiscal year 2014-15. The increase was primarily due to growth in the number of retirees. Future costs would continue to be managed through cost containments and design adjustments. A number of factors can influence the University's long-term estimates of unfunded liability. As of July 1, 2015 the unfunded liability was $17.3 billion, compared to $14 billion the previous year. This increase was accounted for mainly by a change in the discount rate assumption from 5.5 percent to 4.5 percent, which was necessary to align with the new asset allocation policy and more conservative investment strategy in the Short Term Investment Pool and the Total Return Investment Pool. Following Regents' action on post-employment benefits in December 2010, the University began certain cost containment measures, gradually reducing the University's maximum contribution to retiree healthcare premiums by three percent annually until a floor of 70 percent is reached. For calendar year 2016 the maximum contribution for retirees as a percentage of total premiums, including standard Medicare Part B premiums, would be 74 percent for Medicare-eligible retirees and 70 percent for non-Medicare-eligible retirees under the age of 65. The University has communicated to employees and retirees over the years that retiree health benefits are not an accrued or vested benefit, and can be changed by UC at any time.

The meeting adjourned at 3:45 p.m.

Attest:

Secretary and Chief of Staff