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Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

ACTION ITEM

For Meeting of November 13, 2019

UNIVERSITY OF CALIFORNIA RETIREMENT PLAN – MEMBER CONTRIBUTION CONSIDERATIONS

EXECUTIVE SUMMARY

At their meeting of September 18, 2019, the Regents approved changes to the actuarial assumptions for the University of California Retirement Plan (UCRP or Plan) based, in part, on results of the Plan's latest experience study. The total impact of the approved changes on the July 1, 2019 Actuarial Valuation for UCRP was to increase the total Plan's actuarial accrued liability (AAL) by $7.5 billion and the total Plan's long-term annual ongoing cost, also known as the "normal cost" (NC) by $437 million (3.1 percent of covered payroll).

To help offset the increase in UCRP costs, the Regents authorized the President to phase in a three-percent increase in the University's employer contribution rate over a period of six years, beginning July 1, 2020. The Regents also indicated that members should share in the Plan's NC increases and instructed Office of the President staff to model options for increasing member contribution rates to achieve this cost sharing, including options that lessen the impact for lower-paid employees. The Regents also requested that key actuarial assumptions be reviewed on a more frequent basis. They asked that options for both requests be submitted at their November 2019 meeting.

Since July, UCOP Human Resources has consulted with policy-covered staff groups, Academic Senate leadership, a variety of systemwide leadership councils, the Union Coalition, and the University of California Retirement System (UCRS) Advisory Board about the increases in Plan costs and the request to model member contribution increase alternatives. Letters were sent to the Regents and the President expressing their concerns, which are detailed later in this item. The major themes were: the proposed UCRP member contribution rate increase has been rushed and further study is needed; a member contribution rate increase would be an effective pay cut when salaries for many workforce segments already lag the market, which could have a negative impact on recruitment and retention; there would be fairness and equity issues between policy-covered staff and represented employees as there are currently several closed multi-year labor contracts, and member contribution rate increases are subject to collective bargaining for represented employees; a contribution increase at this time would harm morale and have unintended consequences; any increase must also be applied on contributions from Savings

Choice participants, making their contributions higher than those of employees under similar Defined Contribution (DC) plans of our comparators. Finally, feedback from the consultation process of alternative strategies included that any future increase should continue to apply equally as a percentage of pay to all members and that any threshold on which contributions are not required, to accommodate lower-paid members, should be indexed for inflation.

UCOP administration also consulted with the Plan's Actuary, Segal Consulting, concerning the directive to evaluate UCRP's key actuarial assumptions more frequently, including the possibility of reviews on an annual basis. It was determined that an annual review of all of the Plan's key assumptions was neither feasible nor consistent with recommended actuarial practice. Specifically, a statistically significant analysis of demographic assumptions relies on a set of data generally collected over a period of a few years. Thus, it was determined that the demographic assumptions could be reviewed somewhat more frequently, such as every three years, rather than the current practice of every four years.

As for the economic assumptions, including the investment return assumption, these are long-term assumptions that are not materially affected by any one year of actual experience. For that reason, the same practice of somewhat more frequent reviews is also appropriate for the economic assumptions. The only exception is that, because the investment return assumption depends critically on the Plan's asset allocation, a material change in the asset allocation could warrant an out-of-cycle review of the assumed investment return.

To comply with the Regents' request that members share increased costs resulting from the assumption changes without unduly burdening the lower-paid, and in consideration of several long-term closed labor contracts and the feedback received from the consultative process, the President's recommendation, along with alternatives, are provided below.

RECOMMENDATION

The President recommends that the Finance and Capital Strategies Committee recommend to the Regents that:

1) an increase in UCRP member contribution rate(s) of 0.25 percent a year over four years for a total of 1.0 percent on covered earnings in excess of one-half of the indexed PEPRA limit[1] be implemented effective July 1, 2022, as described in the schedule below.

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[1] The PEPRA limit used will be the limit that applies to members who are in Social Security.

Effective Date	1976 Tier* Members (less $19 monthly)	2013 Tier Members	2016 Tier Members / Savings Choice Participants	Modified 2013 Tier Members[2] / Safety Members
Increase Only Applies to Covered Earnings in Excess of One-Half of the Indexed PEPRA Limit				
July 1, 2022	8.25%	7.25%	7.25%	9.25%
July 1, 2023	8.50%	7.50%	7.50%	9.50%
July 1, 2024	8.75%	7.75%	7.75%	9.75%
July 1, 2025	9.00%	8.00%	8.00%	10.00%

*The contribution rate for UCRP 1976 Tier members is reduced by a monthly offset of $19.

The PEPRA limit is currently $124,180, so the increase would apply only to covered earnings above $62,090 currently. This amount would be indexed each year based on increases in the PEPRA limit.

As requested by the Regents, the Recommendation is designed to address cost-sharing while also mitigating the impact of the increase on lower-paid members. Additionally, by applying the rate increase only on pay over a certain limit rather than on all pay for members who earn more than the limit, the higher-paid are not subsidizing UCRP on behalf of lower-paid members. The Recommendation's effective date also coincides with the expiration of several long-term labor contracts covering many represented members. Although member contribution rate increases are subject to collective bargaining for represented employees, as contracts open up, it is intended that increases in member rates for represented employees will become equivalent to those of policy-covered staff and faculty.

Based on its design to lessen the impact of a rate increase on lower-paid members, the recommendation results in lower cost-sharing as compared to the member rate increase alternatives listed below. However, it is considered to be the least contentious member rate increase.

Should the Regents desire a different option for increases to the UCRP member contribution rates, additional alternatives are:

Alternative #1 – the UCRP member contribution rate(s) be increased, effective July 1, 2022, by 0.25 percent a year over four years according to the schedule in the Recommendation above. Since the increase would apply on all covered earnings, this alternative retains the familiar percentage of pay contribution formula and would increase the total member rate by 1.0 percent, achieving approximately one-third of the cost-sharing of the NC increase. While it achieves a greater cost-sharing than the Recommendation, unlike the Recommendation it does not lessen the impact of a cost increase on lower-paid members.

Alternative #2 - the UCRP member contribution rate(s) be increased, effective July 1, 2020, by 0.25 percent a year over six years for a total of 1.5 percent, as described in the schedule below.

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[2] Includes 1976 Tier Members covered by certain bargaining units.

Effective Date	1976 Tier* Members (less $19 monthly)	2013 Tier Members	2016 Tier Members / Savings Choice Participants	Modified 2013 Tier Members[3] / Safety Members
July 1, 2020	8.25%	7.25%	7.25%	9.25%
July 1, 2021	8.50%	7.50%	7.50%	9.50%
July 1, 2022	8.75%	7.75%	7.75%	9.75%
July 1, 2023	9.00%	8.00%	8.00%	10.00%
July 1, 2024	9.25%	8.25%	8.25%	10.25%
July 1, 2025	9.50%	8.50%	8.50%	10.50%

*The contribution rate for UCRP 1976 Tier members is reduced by a monthly offset of $19.

This alternative would achieve the 50 percent cost sharing of the NC increase desired by the Regents, but would not lessen the impact on lower-paid members and could not be implemented effective July 1, 2020 for a significant number of represented members currently covered under long-term, closed bargaining contracts.

In light of the negative feedback received from faculty and staff and their consensus that UCRP member contribution rates should not be increased at this time, the President is putting forward the following additional alternative**:**

Alternative #3 - an increase in UCRP member contributions *not* be approved or implemented at this time.

2) if the Recommendation, Alternative #1, or #2 are approved, authorize the Plan Administrator to implement the recommended changes.

3) a full experience study of both economic and demographic assumptions be completed every third year, rather than the current practice of every fourth year. Any more frequent reviews of the Plan's actuarial assumptions would be limited to the Plan's investment return assumption, which will be reviewed only when the Plan's asset allocation strategy is materially changed and that change would have a material impact on the investment return assumption.

BACKGROUND

Based on the results of the latest UCRP Experience Study, initially presented to the Regents in July 2019, the Regents approved changes to the actuarial assumptions for UCRP at their meeting of September 18, 2019. The changes included the adoption of 6.75 percent investment return assumption, a 2.50 percent inflation assumption and a benefit weighted mortality table with a "generational" projection of mortality improvement. The total impact of the changes on the July 1, 2019 Actuarial Valuation for UCRP was to increase the total Plan's actuarial accrued liability by $7.5 billion (resulting in an approximately seven percent decrease in funded percentage) and the total Plan's long-term annual ongoing cost (i.e., normal cost or (NC)) by $437 million, which can be represented as 3.1 percent of payroll.

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[3] Includes 1976 Tier Members covered by certain bargaining units.

In order to help mitigate the effect of these impacts on the Campus and Medical Centers (C/MC) and the Lawrence Berkeley National Laboratory (LBNL) segments of UCRP, primarily the estimated 3.1 percent increase in the NC, the Regents authorized a three-percent increase in the employer contribution rate to be phased in over a six-year period, along with corresponding increases in the unfunded actuarial accrued liability (UAAL) surcharge rate,[4] effective for Plan Year 2020-21. Employer contributions for the LANL and LLNL Retained Segments of UCRP will continue to be governed by the terms of each Laboratory's contract with the Department of Energy.

Based on the directive from the Regents that members should share in the increase in NC, Systemwide Human Resources considered a number of alternatives with varying objectives. The original design aimed at phasing in a member rate increase totaling, in aggregate, 1.5 percent over six years; half as much as the UCRP employer contribution increase over the same six-year period, thereby achieving the cost-sharing desired by the Regents. However, this option did not lessen the impact of the rate increase on lower-paid members, which is also desired by the Regents. In order to lessen the impact of a rate increase on lower-paid members while still increasing the member contribution in total by 1.5 percent would require contributions by higher-paid members to increase by more than 1.5 percent over six years to account for the contribution shortfall attributable to lower-paid members. Another alternative considered was designed to lessen the impact on lower-paid members without resulting in a tiered contribution schedule in which the contribution rate is higher for highly paid members. The result of such an alternative, while more fair and proportionate for all members, would fail to increase the member rate, in aggregate, by 1.5 percent over six years.

Considerations for Increasing Member Contribution Rates – Consultation Feedback

In consultation between UCOP administration and staff and faculty groups since the Regents meeting last July, many concerns have been raised, and memorialized in letters sent to the Regents, with respect to the prospect of increasing the UCRP member contribution rate(s) at this time. The groups consulted objected to increasing the UCRP member contribution rate(s) without a thorough analysis of the impact on employees' take-home pay/total remuneration and on the University, and more specifically, on UCRP. They equate a contribution rate increase to a decrease in total remuneration and feel that such an increase would impair the University's recruitment and retention efforts and that it could have the effect that more faculty and staff would seek outside offers and leave the University.

Another primary concern raised is the likelihood that a contribution rate increase would be applied to policy-covered staff and faculty members several years before it would be applied to represented members, if at all. Member contribution increases are subject to collective bargaining for represented members, many of whom are currently covered under closed, long-term bargaining contracts. Approximately 25 percent of all active, retirement-eligible

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[4] The "UAAL Surcharge" is the employer contribution to UCRP on behalf of active employees who elected "Savings Choice" as their primary retirement benefit and are current participants in the Defined Contribution Plan. The UAAL Surcharge pays down UCRP's Unfunded Actuarial Accrued Liability (UAAL).

employees, most of whom are in UCRP, are represented by UPTE, CNA and the Teamsters, with closed contracts that do not expire until late 2022 (CNA, Teamsters) or late 2024 (UPTE). Additionally, the contracts for members represented by AFSCME have expired and contract negotiations are in-progress. Most employees represented by AFSCME are in UCRP, constituting roughly 20 percent of UCRP's active membership. Implementing a rate increase for policy-covered members' years before represented members would certainly raise equity and fairness issues, and would be perceived negatively by policy-covered members that the University has strived hard to motivate and remain engaged. To address this concern and to also be responsive to the Regents' request for cost-sharing, the President is recommending that the member rates not be increased until July 1, 2022 to allow better coordination with upcoming labor contracts.

The groups consulted also noted that UCRP has historically applied a consistent member contribution formula to all UCRP members, within the same UCRP tier, regardless of annual compensation levels. Under existing contribution schedules, highly paid members contribute more in terms of dollars, but all member contributions in each member tier are the same percentage of pay. Based on the Regents request for options that lessen the impact on lower-paid members, there are concerns about the implementation of a tiered-UCRP contribution schedule in which higher earners would pay more, as a percentage of pay, for a benefit based on the same UCRP formula applicable to lower-paid members. While those consulted understand the impact a contribution rate increase would have on lower-paid members, they do not feel that it should be the responsibility of higher-paid members to subsidize UCRP on behalf of lower-paid members. If there is a desire to accommodate lower-paid members, it is the University that should make up the shortfall in contributions, not other UCRP members. The President's first alternative to her recommendation addresses this concern by equally applying a one percent increase, phased in over four years, on all covered pay for all UCRP members.

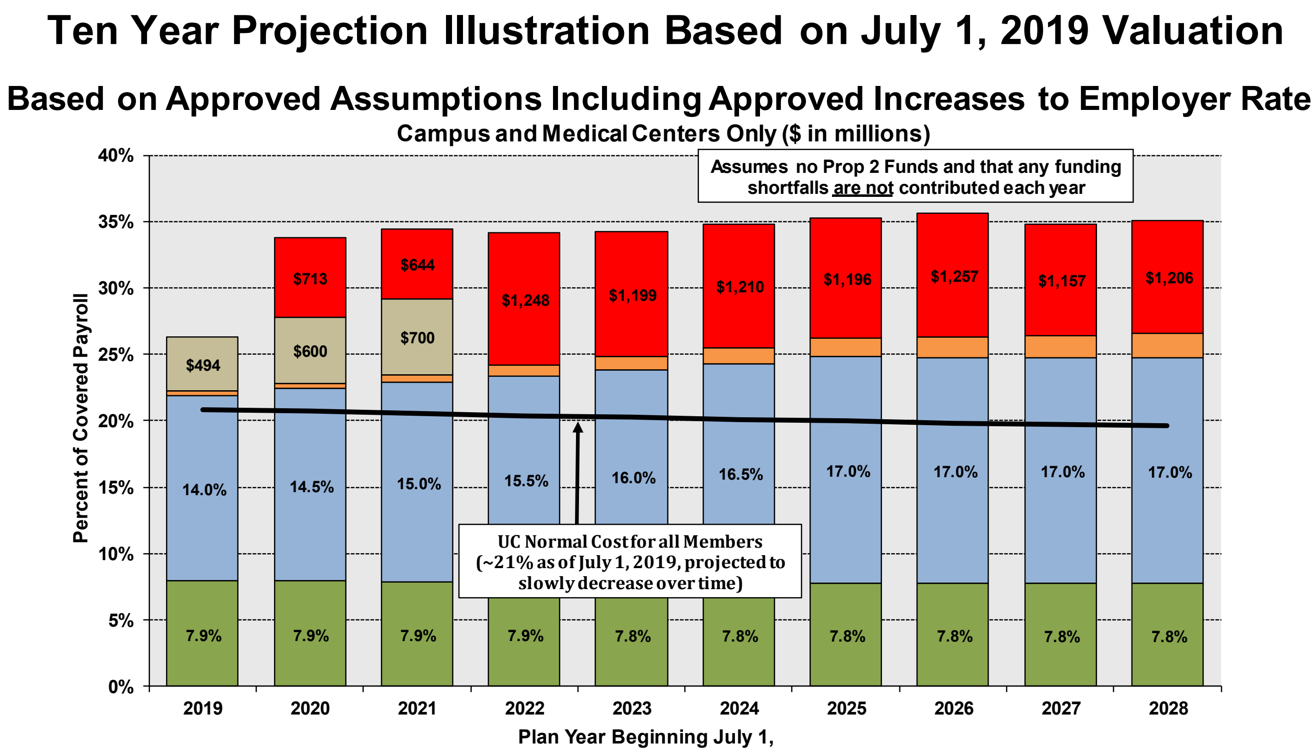
It should also be noted that Internal Revenue Code (IRC) provisions that allowed the University to offer the Retirement Choice Program require that employee contributions to the UCRP 2016 Tier (i.e., Pension Choice option) be the same as those of employee contributions to the Savings Choice option. Therefore, the same member contribution rate increase that is applied to UCRP 2016 Tier members would also have to be applied to the employee contribution of Savings Choice participants. Consequently, those consulted indicated it is likely that prospective new employees who learn of an impending UCRP member rate increase would opt for the Savings Choice Program. While their contribution to either program would be the same, their ultimate benefit under the 2016 Tier would not improve while their contributions and balance would increase under the Savings Choice Program. It was strongly felt that the impact, both to UCRP and employee retention, of such a potential shift towards Savings Choice needs further analysis and modeling.

Finally, feedback from the consultation process is that a broader analysis of an overall funding plan for the UCRP, including additional state funding and further internal transfers/borrowing, is appropriate prior to the Regents considering increases to the member contribution rates.

The President understands the Regents' concern over the recent increase in the Plan's NC and their obligation to ensure that the Plan is sufficiently funded to pay promised benefits. Based on feedback from the consultative process and correspondence she has received, she is also mindful of the potential adverse impacts of increasing UCRP member contribution rates, especially on the lower-paid, and the inequity of applying a rate increase on policy-covered members before it could be applied to most represented members. The Recommendation and alternatives provided are fashioned to address both the member cost-sharing desired by the Regents and the concerns raised by faculty and staff.

Financial Impact of Increasing the UCRP Contribution Rates

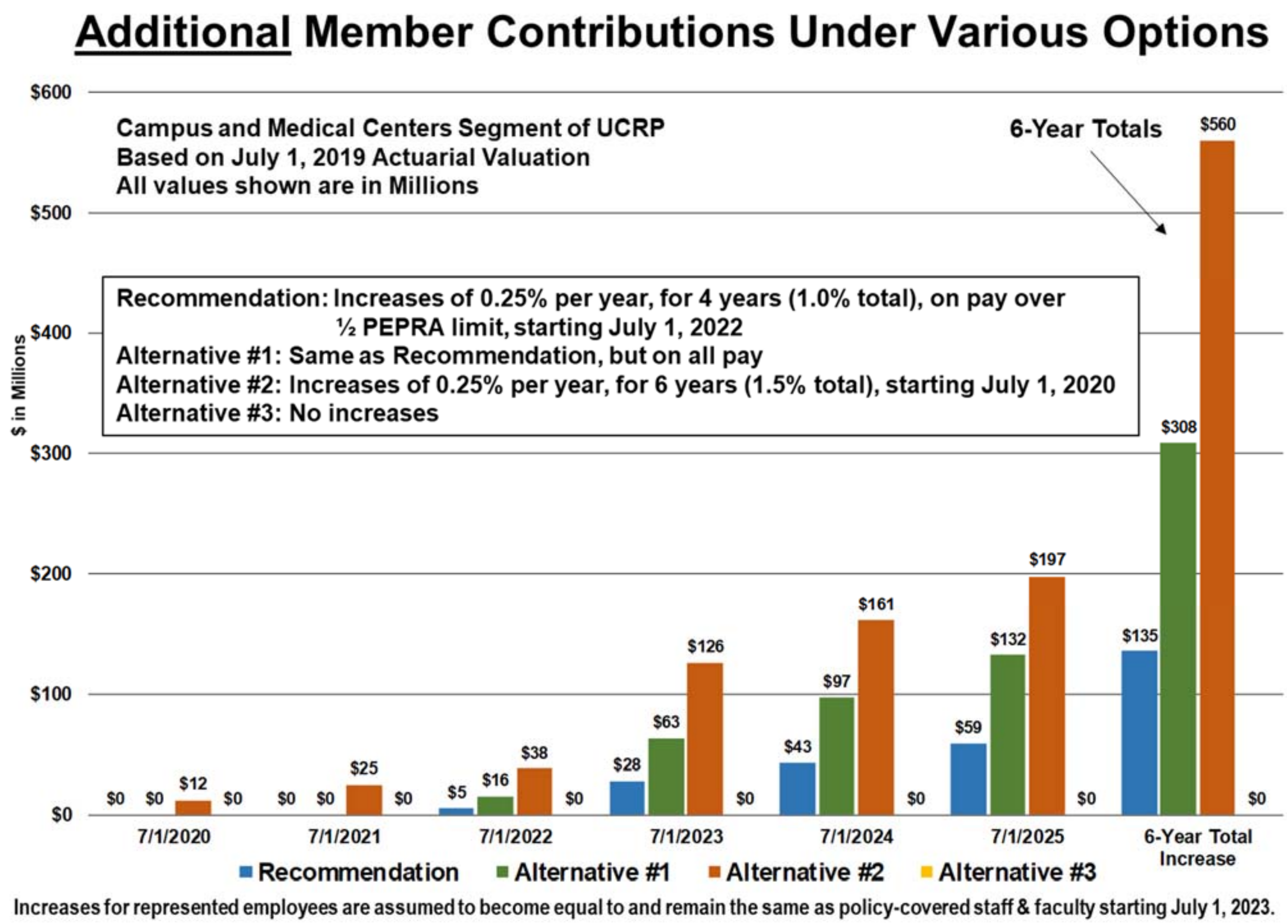
The chart that follows shows the funding elements and projected total funding policy contribution for the campus and medical centers segment of UCRP broken into various components over the next ten years, if all of the assumptions below are met.



- Assumes total UCRP and Savings Choice active member population grows by 0.7% per year.
- Assumes market value return of 6.75% starting July 1, 2019.
- Includes STIP (or other sources) transfers through 2021/2022.
- Includes 2016 Tier and a 35% Savings Choice election rate.

The difference between the total funding policy contribution (total of each bar) and the approved contributions is the funding shortfall, which is represented by the red bars. Projected total contributions to UCRP will not meet future funding policy levels and the projected shortfalls are over $1 billion per year starting with the Plan Year 2022-2023. This projection assumes no increases in member contributions.

The chart below shows the increase in member contributions ($ in millions) over a six-year period beginning July 1, 2020 in order to reflect the increases under the Recommendation and each of the alternatives. The increases in member contributions start out small as the increases are being phased-in. In addition, for purposes of modeling, only policy-covered staff and faculty are assumed to start on July 1, 2020 or July 1, 2022 depending on the Recommendation or alternative. Increases in member rates for represented employees are assumed to become equal to and then remain the same as policy-covered staff and faculty starting July 1, 2023 under all alternatives.



Any increases in member contributions would reduce the contribution shortfalls ("red bars") shown in the previous stacking bar chart. However, potential increases in member contributions under any of the alternatives are not close to fully eliminating the contribution shortfalls.

For the Recommendation and each of the alternatives, the following table compares the estimated increase in Normal Cost for the campus and medical centers segment of UCRP due to the changes in actuarial assumptions adopted by the Regents to the increases in member contributions in the first year of the increase under the Recommendation (2022-2023).

Plan Year 2022-2023			
Campus and Medical Centers Segment of UCRP	Increase in Normal Cost ($ in Millions)	Increase in Member Contributions ($ in Millions)	Increase in Member Contributions as % of Increase in Normal Cost
Recommendation – 1% over ½ PEPRA Limit 2022	$386	$5	1.3%
Alternative #1 – 1% All Pay 2022	$386	$16	4.1%
Alternative #2 – 1.5% All Pay 2020	$386	$38	9.8%
Alternative #3 – No Increase	$386	$0	0.0%

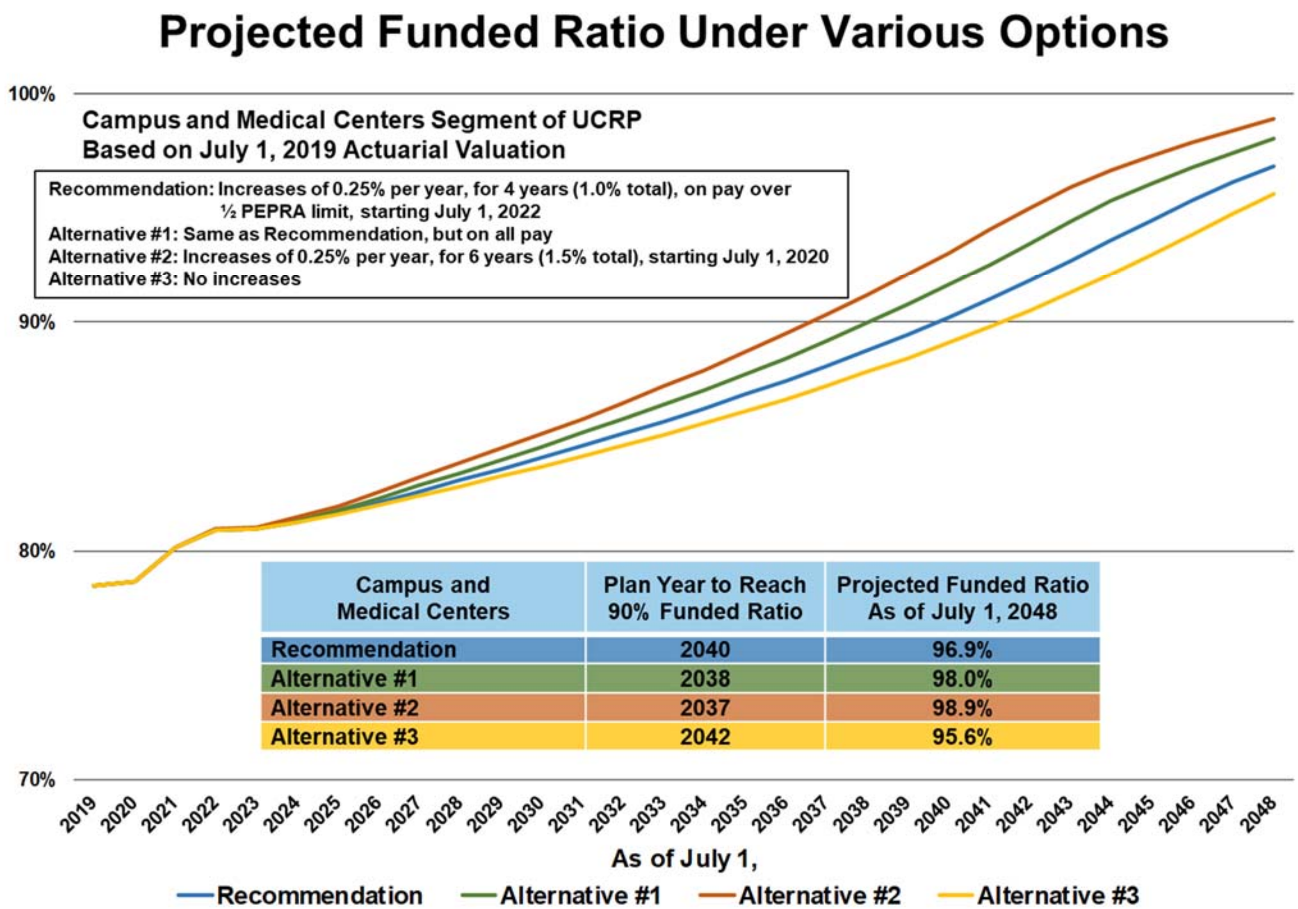
The table shows that in 2022-2023, the increase in member contributions is only a small percent of the total increase in Normal Cost due to the changes in actuarial assumptions. The next table contains similar information, but for the last year of the increase (2025-2026).

Plan Year 2025-2026			
Campus and Medical Centers Segment of UCRP	Increase in Normal Cost ($ in Millions)	Increase in Member Contributions ($ in Millions)	Increase in Member Contributions as % of Increase in Normal Cost
Recommendation – 1% over ½ PEPRA Limit 2022	$410	$59	14.4%
Alternative #1 – 1% All Pay 2022	$410	$132	32.2%
Alternative #2 – 1.5% All Pay 2020	$410	$197	48.0%
Alternative #3 – No Increase	$410	$0	0.0%

This table shows that in 2025-2026, the increase in member contributions is about 14 percent of the increase in Normal Cost under the Recommendation, about one-third of the increase in Normal Cost under Alternative #1 and almost one-half of the increase in Normal Cost under Alternative #2.

The projected funded ratio of the campus and medical centers segment over thirty years under the Recommendation and each of the alternatives is shown in the graph below. The table displayed in the graph shows the year in which the campus and medical center segment of UCRP is projected to reach a 90 percent funded ratio under the Recommendation and each of the alternatives. Also shown is the projected funded ratio after thirty years.

The projections are based on all of UCRP's actuarial assumptions being met in future years, including the 6.75 percent per year investment return. The projections reflect a 0.7 percent per year growth in the total (UCRP and Savings Choice) active member population.



Notice

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. The changes in member contribution rates to UCRP for represented employees are subject to collective bargaining requirements.

KEY TO ACRONYMS

AAL	Actuarial Accrued Liability
ADC	Actuarially Determined Contribution
AFSCME	American Federation of State, County and Municipal Employees
AVA	Actuarial Value of Assets
C/MC	Campus and Medical Centers
CNA	California Nurses Association
DC	Defined Contribution
FY	Fiscal Year

LBNL	Lawrence Berkeley National Laboratory
LANL	Los Alamos National Laboratory
LLNL	Lawrence Livermore National Laboratory
NC	Normal Cost
PEPRA	California Public Employees' Pension Reform Act
STIP	Short Term Investment Pool
UAAL	Unfunded Actuarial Accrued Liability
UC	University of California
UCOP	University of California, Office of the President
UCRP	University of California Retirement Plan
UCRS	University of California Retirement System
UPTE	University Professional and Technical Employees