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Office of the President

TO MEMBERS OF THE BOARD OF REGENTS:

ACTION ITEM

For the Meeting of November 19, 2020

AMENDMENT OF THE UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM TO ACCOMMODATE WORKFORCE ACTIONS RELATED TO COVID-19

EXECUTIVE SUMMARY

In addition to the physical and emotional repercussions, the COVID-19 pandemic has acutely affected the financial resources of thousands of institutions and millions of individuals.

UC's people, its faculty and staff, are its greatest asset. As the third largest employer in the state, UC has taken measures to minimize—to the degree possible—adverse impacts on its valued employees, particularly on lower-paid personnel. By taking measured steps, the University aims to preserve jobs, health care, and retirement benefits, as well as mitigate the need for furloughs and temporary or permanent layoffs. In addition to supporting our employees, the University also is working to avoid contributing to a state unemployment rate which remains above ten percent.

While certain workforce actions are necessary to comply with shelter-in-place orders and reduced on-site operations, the health and well-being of UC employees and their families, including their long-term financial security, is of paramount importance during this trying time. The University's retirement benefits are vital to our employees' long-term financial security and should therefore be protected, to the extent possible, during any President designated COVID-19-related workforce actions.

The majority of eligible employees are covered by the University of California Retirement Plan (UCRP) and, for most, a UCRP pension will be the primary source of income in retirement. A UCRP member is vested with five years of service credit, and their pension is determined by a defined formula based on three components: years of service credit, age at retirement, and eligible pay (i.e., Highest Average Plan Compensation). Additionally, for both UCRP members and Savings Choice participants in the Defined Contribution Plan (DC Plan), service credit is also used for determining eligibility for retiree health benefits, and the percentage of the UC contribution to retiree medical and dental premiums, if any. Under current provisions, a break in service, such as due to a temporary layoff of greater than four months, can result in a change in a member's retirement tier (see Attachment 1) and retiree health group upon returning to active UC employment.

Thus, it is recommended that the University of California Retirement System (UCRS) be amended to protect service credit accruals and relax break in service rules for temporary layoffs in the event that certain COVID-19 related workforce actions as designated by the President, such as temporary layoff, unpaid furlough, or curtailment, are implemented through June 30, 2022. Due to the introduction of several new retirement tiers, the implementation of the Retirement Choice Program, and the many operational challenges associated with modifying the University's pension administration system, there are no recommended amendments to UCRS provisions regarding Covered Compensation, Highest Average Plan Compensation, or Final Salary as a result of any designated COVID-19 related workforce actions.

RECOMMENDATION

The President of the University recommends that the Regents authorize the following for COVID-19 related workforce actions that have been designated as such by the President:

A. The University of California Retirement Plan (UCRP) be amended to preserve the rate of accrual of service credit for Active Members during an unpaid furlough or curtailment through June 30, 2022.

B. The University of California Retirement Plan and Defined Contribution Plan (DC Plan) be amended to provide that a temporary layoff would not constitute a break in service through June 30, 2022, provided the temporary layoff does not exceed a period of 12 consecutive months.

C. The President be granted authority to make Plan modifications and changes consistent with these terms as may be required for their implementation, including that the Plan Administrator amend the UCRP and DC Plan documents as necessary to implement the approved changes.

For eligible represented employees, all changes are subject to any applicable collective bargaining requirements under the Higher Education Employer-Employee Relations Act.

BACKGROUND

The COVID-19 pandemic has affected nearly every University revenue source, and all UC locations are addressing budget challenges. While the campuses are implementing a number of non–workforce-related strategies, additional workforce-related cost-saving actions may be needed. At the same time, one of the University's highest priorities is to protect employees' benefits to the degree possible.

As the budgets of some UC locations have been challenged more than others, some flexibility with respect to any President-designated COVID-19 workforce actions may be required. While it is unavoidable that employees will experience some financial consequences resulting from the University's efforts to deal with the pandemic, these University of California Retirement System (UCRS) amendments are being recommended to help preserve employees' future retirement benefits.

Since retirement plan (i.e., University of California Retirement Plan [UCRP] and Savings Choice) contributions are based on a percentage of eligible pay (i.e., Covered Compensation), any workforce action that results in less eligible pay will result in less retirement plan contributions by both the University and eligible employees. However, neither University nor employee contributions count towards eligibility for, or amount of, a UCRP pension. As a defined benefit plan, UCRP provides a pension based on a formula that involves multiplying a UCRP member's years of service credit by a retirement age factor to derive a "benefit percentage," then multiplying the benefit percentage by the member's 36 consecutive month Highest Average Plan Compensation (HAPC).

The majority of eligible employees, and nearly all long-term eligible employees, are covered by UCRP. The amount of service credit they accrue is based on a ratio of their Covered Compensation to their Full-Time Equivalent Compensation (FTEC). In other words, UCRP members working full-time will earn their regular full-time equivalent pay and accrue full UCRP service credit, whereas UCRP member working less than 100 percent will earn proportional pay and service credit. Consequently, authorization of these amendments ensures that active UCRP members continue to accrue service credit based on their appointment rate prior to any designated COVID-19 related workforce actions related to unpaid furlough or curtailment through June 30, 2022, and protects one of the components used in determining UCRP members' pensions.

All provisions related to the determination of a UCRP member's Covered Compensation, HAPC, or Final Salary will remain unchanged with this action. Depending upon the type of designated workforce action implemented by a location, the component of a UCRP member's benefit calculation attributable to Covered Compensation or FTEC could be affected. Since the HAPC used in calculating a UCRP pension is based on the member's FTEC, a designated workforce action that results in a reduction in paid time worked in a month would not impact a member's HAPC. On the other hand, a salary reduction, which lowers a member's FTEC, could result in a lower HAPC if the salary reduction occurred during a period that would have otherwise represented the member's highest 36 consecutive months of FTEC prior to retiring.

While Savings Choice participants in the DC Plan earn service credit in the same manner as UCRP members for purposes of eligibility for future retiree health benefits, their service credit does not factor into their DC Plan benefits. As participants in a defined contribution plan, their Savings Choice DC Plan account balances are based on their own contributions and those made by UC, subject to investment performance, as designated by the participant. Contributions are based on a percentage of Covered Compensation and, consequently, any designated COVID-19 related workforce actions that result in less eligible pay will reduce contributions to participants' Savings Choice DC Plan account. Similarly, any reduction in the Covered Compensation of a UCRP member eligible to receive a University contribution to the DC Plan Supplement, or who makes mandatory employee contributions to the DC Plan Supplement, could result in a reduction in contributions into the DC Plan. To supplement these missed contribution opportunities, employees may make voluntary contributions into one or more of the University's Retirement Savings Plans.

Since many of the University's activities are suspended or operating in diminished capacity due to the pandemic, UC locations may need to consider implementing layoffs. With prudent and principled actions, the President hopes to limit the number of layoffs precipitated by the pandemic. Moreover, it is hoped that the majority of layoffs would be of limited duration and designated as "temporary layoffs," which require a specified date of return to work and allow continuation of employee health benefits. Under current provisions of UCRS (i.e., UCRP and DC Plan) and human resources policy, a temporary layoff in excess of four months constitutes a break in service. Consequently, employees returning from a temporary layoff that exceeds four months could be subject to more restrictive retiree health eligibility rules[1] and, if they are members of UCRP, could incur a tier break in service and earn all prospective service credit in the UCRP 2016 Tier. A tier break would result in lower future pension accruals for longer-term employees who are primarily covered by the UCRP 1976 Tier. Upon retirement, for example, their pension calculation would be subject to a split calculation based on service credit accrued under the UCRP 1976 tier, with a maximum retirement age factor attained at age 60, and service credit accrued under the 2016 Tier, in which the highest retirement age factor is not attained until age 65. Moreover, additional provisions, such as a lump sum cashout in lieu of pension and automatic post retirement survivor benefits, are not available under the 2016 Tier.

It is therefore recommended that UCRP and the DC Plan be amended to indicate that a temporary layoff related to a COVID-19–related workforce action designated by the President through June 30, 2022 not be considered a break in service, provided the temporary layoff does not exceed a period of 12 consecutive months. If eligible employees return to active retirement plan status within 12 months of their temporary layoff, they will be subject to their previous retiree health eligibility provisions and, if they are members of UCRP, will remain in their previous UCRP Tier (see Attachment 1).

COST IMPACT OF AMENDMENTS TO UCRS

Ensuring that eligible employees on pay status continue to accrue service credit at their respective appointment rates preceding any unpaid furloughs or curtailment related to any President-designated COVID-19 workforce actions through June 30, 2022 does not result in increasing University of California Retirement Plan (UCRP) benefits above what would otherwise have been expected. However, any actuarial savings associated with a reduction in the accrual of service credit would be foregone.

The main impact of the President-designated COVID-19 workforce actions would be a result of any potential reductions in actual compensation paid to the member. Since employer and member contributions to UCRP are based on a percentage of the actual compensation paid to the member, there would also be a corresponding reduction in employer and member contributions to UCRP. Based on an illustrative one percent reduction in compensation due to designated COVID-19 workforce actions, an estimated $30 million decrease in UCRP employer and

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[1] UC currently has three sets of eligibility rules for retiree health benefits, depending on date of membership in UCRP (or participation in Savings Choice) or rehire date following a break in service of 120 calendar days or more.

member contributions would be made on an annual basis during the period of the designated workforce actions.

To put this in perspective, the estimated $30 million contribution loss represents only 0.03 percent of UCRP's total Actuarial Accrued Liability of $93 billion based on the July 1, 2020 actuarial valuation for UCRP. The 0.03 percent figure also represents the anticipated decrease in UCRP's funded ratio due to the estimated contribution loss of $30 million. Note that if decreases in compensation are due to a temporary salary reduction that impacts Highest Average Plan Compensation (HAPC), then the contribution loss will be offset to some extent by a decrease in the Actuarial Accrued Liability.

Although Savings Choice participants in the Defined Contribution (DC) Plan accrue service credit towards future retiree health benefits, such service credit does not factor into the DC Plan contributions made by the University for such participants, and thus does not represent an additional DC Plan–related cost.

The recommendation to amend the University of California Retirement System (i.e., UCRP and the DC Plan) to ensure that a designated COVID-19–related temporary layoff not exceeding 12 consecutive months does not represent a break in service does not result in increasing UCRP benefits above what would have otherwise been expected. Members who are temporarily laid off (including a designated COVID-19–related temporary layoff) do not earn Covered Compensation or service credit. Additionally, for purposes of the UCRP annual actuarial valuation, members are not explicitly assumed to incur such a pandemic-related temporary layoff nor are any members that terminate employment assumed to be rehired in the future. Rather, it is assumed that current active members would have remained working and thus accruing the same amount of UCRP service credit in the same UCRP Member Tier as they were prior to any designated COVID-19–related workforce action.

Without these amendments, any members in the 1976 Tier that are temporarily laid off and then return to work more than four months after layoff would incur a break in service that would result in their accruing their future service in the lower Normal Cost 2016 Tier. However, if the temporary layoff is a designated COVID-19 related temporary layoff (not exceeding twelve months), these amendments would result in such members instead continuing to accrue service in the higher Normal Cost 1976 Tier upon their return to work. Note that there would still be no related DC Plan cost for Savings Choice participants during a temporary layoff, as they would not be receiving eligible pay on which employer (and employee) contributions are made.

Key to Acronyms

UCRS	University of California Retirement System
UCRP	University of California Retirement Plan
DC Plan	Defined Contribution Plan
HAPC	Highest Average Plan Compensation

Attachment 1: Comparison of UCRP Tiers