



**Final Report of the
President's Task Force on
Post-Employment Benefits**

July 2010

Table of Contents

Message from the Chair of the President’s Post-Employment Benefits ask Force..... 1

Task Force Membership

 Steering Committee and Administrative Support.....3

 Work Teams.....4

Introduction..... 5

 Overview of Issues and Process.....6

 Task Force Structure.....7

 Presidential Task Force on PEB – Charge to the Task Force.....7

 Process.....8

 Triggering Issues.....9

 The Fiscal Problem.....12

 Summary of Task Force Recommendations.....16

Pension Work Team..... 18

 UCRP Background.....19

 Process, Other Considerations and Conclusions.....23

 Benchmarking.....23

 Plan Design.....24

 Income Replacement.....28

 Recommendations.....30

 Steering Committee Pension Considerations and Recommendations.....42

Retiree Health Work Team..... 45

 Retiree Health Background.....46

 Process, Other Considerations and Conclusions.....47

 Current Financing.....47

 Benchmarking.....47

 Graduated Eligibility.....48

 UCRP Members Nearing or Eligible for Retirement.....49

 Contributions.....49

 Blended Premiums.....49

 Retirees Age 65 and Older not Eligible for Medicare.....50

 Members Receiving UCRP Disability Income.....51

 Longer Service Retirees with Small Pensions.....52

 Recommendations.....53

 Funding Impact of Retiree Health Recommendations.....57

Finance Work Team..... 61

 Finance Background.....62

 Process, Other Considerations and Conclusions.....62

UCRP Funding Components.....	63
Impact of PEB Costs on Budget Planning.....	64
Consequences of Delayed UCRP Contributions.....	65
Fund Sources.....	68
Changing UCRP’s Actuarial Methods.....	69
Debt Financing Capacity and Pension Obligation Bonds.....	70
Benchmarking and Competitive Analysis.....	71
Recommendations.....	73
Impact of Finance Recommendations.....	81
Total Remuneration Impact.....	83
Background and Overview.....	84
Total Remuneration Analyses of PEB Changes (charts).....	89
Workforce Behavior.....	94
Implementation Issues.....	97
Collective Bargaining.....	98
Communications (for Choice Models).....	98
Systems and Operating Resources.....	98
Communication and Consultation	100
Website.....	101
Location Forums.....	101
Consultation.....	101
Surveys.....	102
Retirees – a Vital Part of the University Community.....	104
In Summation and Next Steps.....	105
Appendices and Internet Links.....	106

**Message from the Chair of the
President's Post-Employment Benefits Task Force,
Provost and Executive Vice President Lawrence H. Pitts, M.D.**

The University of California is deeply committed to providing competitive salary and benefit programs to attract and retain the excellent faculty and staff needed to achieve its mission of teaching, research and public service for the people of California. As a public institution, it is incumbent upon us to be fiscally responsible stewards of the public trust, ensuring that University benefit programs are well-managed and sustainable for current and future retirees.

To that end, the President appointed a Task Force on Post-Employment Benefits (PEB) in March 2009. This Task Force was charged with formulating a comprehensive series of recommendations that reflected these principles:

- Rewarding faculty and staff who serve a full career with the University;
- Providing competitive benefit programs to aid in recruiting and retaining the highest quality faculty and staff; and
- Sustaining the University's commitments to its current and future retirees.

The Task Force Steering Committee and its work teams included broad representation and significant subject matter expertise from across the University. As needed, external consulting firms were engaged to provide specific analyses to further the deliberations of the Task Force.

Throughout this process, the Task Force consulted widely and evaluated the complex financial and workforce issues that could be affected with changes to the University's Post-Employment Benefits programs. Over the last sixteen months, we have met with stakeholders across the system and participated in forums at each location. We listened carefully to comments and suggestions to best determine ways of making the University's Post Employment Benefits sustainable and competitive over the long term. As a result of these deliberations, the University's belief in the importance of defined benefit pension and retiree health benefits as critical factors in the recruitment and retention of faculty and staff has been reaffirmed. Additionally, consultation has reinforced the University's belief that the benefits plans must be at a cost that is sustainable for the decades ahead.

The Task Force considered multiple alternatives and has proposed a series of recommendations that are detailed in the Final Report. The Report and its recommendations are intended to spark extensive discussions about the future cost and sustainability of Post-Employment Benefits. Some

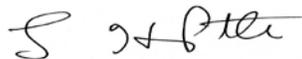
PEB issues contained in the Task Force Final Report remain unresolved and are presented as options or are left open for further evaluation. (Two members of the Steering Committee recommended for inclusion in the final report, a statement that was developed by a subset of task force members outlining their views of four new pension designs that were considered by the Steering Committee. Two of these were forwarded to the President by the Task Force.)

Extensive consultation with the Academic Senate has been important in the development of these recommendations and will continue to be critical as The Board of Regents considers the President's recommendations from the Task Force Report for future action. Consultation within the University community, with the Union Benefits Coalition, and with other stakeholders will also continue during the next phases of decision-making and implementation.

To support this process of review and discussion within the University community, a comprehensive communications plan is being implemented. The UCRP Future website <http://www.universityofcalifornia.edu/news/ucrpfuture/> contains the Task Force Executive Summary, Final Report, Appendices and multiple supporting documents. In addition, this website provides mechanisms for providing direct feedback on the Task Force recommendations.

I am impressed with and grateful for the Task Force members' hard work, their willingness to participate in literally hundreds of hours of meetings, including two series of system wide forums, to clearly represent their views, and to listen to and understand other viewpoints to reach common ground. I thank every one of them for their dedication to the University of California, and their diligence in this critical effort to secure the benefits of our current and future retirees. No task force can be successful without the support and professional counsel of extraordinary staff, and I offer my appreciation and thanks to Randy Scott, Gary Schlimgen, Eleanor Skarakis, Maria Anguiano, Barbara Clark and Kim Blodgett.

Knowing the spirit of cooperation within the University community which has marked this work to date, and with the sincere desire to do what is right for the future of the University, I am pleased to present on behalf of the Task Force its Executive Summary and Final Report.



Lawrence H. Pitts Chair,
Post-Employment Benefits Task Force

Task Force Membership – Steering Committee and Administrative Support

<p>Lawrence Pitts, M.D. Task Force Chair Provost and Executive Vice President, Academic Affairs Office of the President</p> <p>Marie Berggren Chief Investment Officer and Vice President Office Treasurer of The Regents Office of the President</p> <p>George Blumenthal Chancellor, UC Santa Cruz</p> <p>Nathan Brostrom Executive Vice President Business Operations Office of the President</p> <p>Dwaine B. Duckett Vice President, Human Resources Office of the President</p> <p>Charles E. Hess Professor Emeritus and Chair, Council of UC Emeriti Associations (CUCEA) UC Davis</p>	<p>Mark Laret Chief Executive Officer UC San Francisco Medical Center</p> <p>Patrick Lenz Vice President Budget & Capital Resources Office of the President</p> <p>David Odat Chief Administrative and Human Resources Officer UC San Francisco Medical Center</p> <p>Henry Powell Chair, Universitywide Academic Senate, Office of the President and Professor, Pathology UC San Diego</p> <p>Charles G. Robinson Vice President and General Counsel, Office General Counsel of The Regents</p> <p>Daniel Simmons Vice Chair, Universitywide Academic Senate, Office of the President and Professor, School of Law, UC Davis</p>	<p>Jack Stobo, M.D. Senior Vice President, Health Sciences & Services Office of the President</p> <p>Peter Taylor Chief Financial Officer Finance Office Office of the President</p> <p>Larry Vanderhoef Chancellor Emeritus UC Davis</p> <p>Frank Yeary Vice Chancellor UC Berkeley</p>
--	---	--

Post-Employment Benefits Task Force – Staff Support

Randolph R. Scott - Executive Director, Talent Management and Staff Development, Human Resources
 Gary Schlimgen - Director, Pension and Retirement Programs, Human Resources
 Eleanor Skarakis - Director, Strategic Planning, Human Resources
 Maria Anguiano - Associate Director, Finance Office
 Karla Campbell - Project Manager, Business Operations
 Michele French - Managing Editor, Human Resources
 Jeffery Blair - Deputy General Counsel, Office of General Counsel
 Barbara Clark - Principal Counsel, Office of General Counsel
 Kim Blodgett - Administrative Analyst, Human Resources

A Special Thanks

To all the location teams who helped organize and coordinate the PEB forums at their locations.
 To UC Office of the President staff who provided administrative, technical and other support to the PEB Task Force.

Task Force Membership – Work Teams

RETIREE HEALTH	PENSION	FINANCE
<p>Charles E. Hess – Team Lead Professor Emeritus and Chair, Council of UC Emeriti Associations (CUCEA) and UC Davis</p> <p>Edward Abeyta Staff Advisor to The Regents, UC San Diego</p> <p>Helen Henry Professor Emerita Biochemistry UC Riverside</p> <p>Karen Hull Associate Vice Chancellor Chief Human Resources Officer, UC Davis</p> <p>David Kliger Executive Vice Chancellor and Provost; Professor, Chemistry and Biochemistry, UC Santa Cruz</p> <p>Richard G. Kronick (Until January 2010) Chair, Faculty Welfare Health Care Task Force and Professor, Family and Preventive Medicine UC San Diego</p> <p>Robert May (since March 2010) Chair, Faculty Welfare Health Care Task Force and Professor, Philosophy, UC Davis</p> <p>Daniel Simmons Vice Chair, Universitywide Academic Senate, Office of the President and Professor, School of Law, UC Davis</p> <p>Jack Stobo, M.D. Senior Vice President Health Sciences & Services Office of the President</p> <p>Larry Vanderhoef Chancellor Emeritus, UC Davis</p>	<p>David Odató – Team Lead Chief Administrative and Human Resources Officer UC San Francisco Medical Center</p> <p>Robert Anderson Chair, Faculty Welfare Task Force on Investment and Retirement; Professor, Economics and Mathematics, UC Berkeley</p> <p>George Blumenthal Chancellor, UC Santa Cruz</p> <p>Marian Gade Chair, Council of UC Retirement Associations (CUCRA) UC Berkeley</p> <p>Lin King Chair, Council of UC Staff Assemblies UC Davis</p> <p>John Meyer Associate Vice President, UC Davis</p> <p>Henry Powell Chair, Universitywide Academic Senate, Office of the President and Professor, Pathology, UC San Diego</p> <p>Patricia Price Interim Executive Director, Academic Advancement Office of the President</p> <p>Shane White (since Sept. 2009) Chair, Faculty Welfare, Academic Senate and Professor, School of Dentistry, UC Los Angeles</p>	<p>Peter Taylor – Team Lead Chief Financial Officer Finance Office Office of the President</p> <p>Marie Berggren Chief Investment Officer and Vice President of Investments Office Treasurer of The Regents Office of the President</p> <p>James Chalfant Professor, Agricultural and Economic Resources, UC Davis</p> <p>Mark Laret Chief Executive Officer UC San Francisco Medical Center</p> <p>Patrick Lenz Vice President Budget & Capital Resources Office of the President</p> <p>Debora Obley Associate Vice President Budget & Capital Resources Office of the President</p> <p>John Plotts Senior Vice Chancellor, Finance and Administration UC San Francisco</p> <p>Melvin Stanton Associate Chief Investment Officer Office Treasurer of The Regents Office of the President</p> <p>Frank Yeary Vice Chancellor, UC Berkeley</p> <p><i>[Finance Team members were asked to participate in and support the work of the Pension and Retiree Health Teams.]</i></p>

Introduction

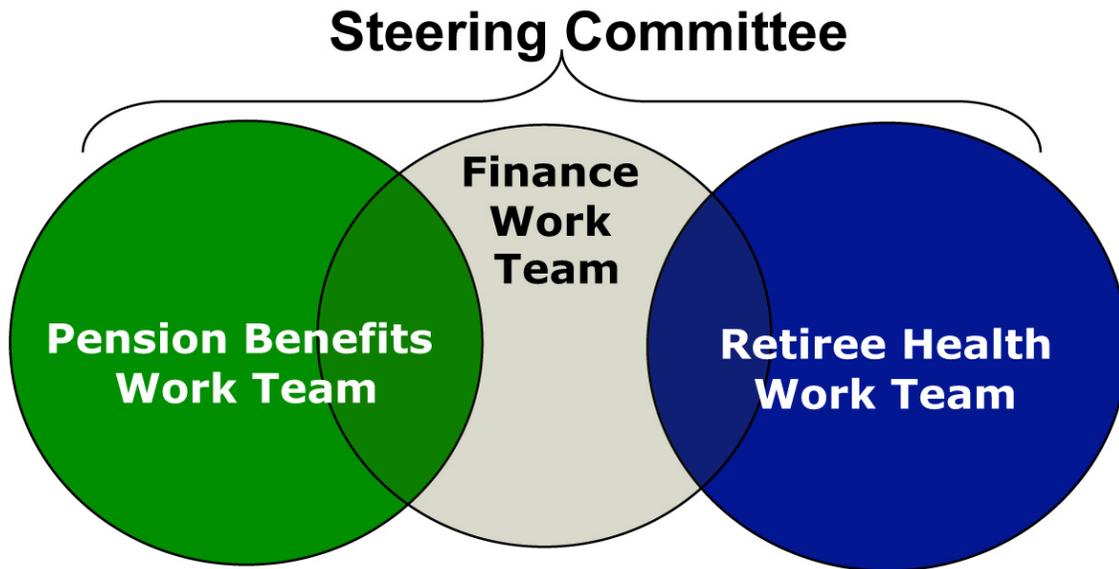
Overview of Issues and Process

The University's Post-Employment Benefits (PEB) are a cornerstone of the University community and serve as a common bond across all levels of its workforce. For many years, PEB programs have provided a key competitive advantage as the University sought to recruit and retain the highest quality faculty and staff – often times compensating for the lack of competitive salaries. The University plans to continue these programs to maintain that advantage and meet its commitments to faculty, staff and retirees. Because PEB programs are critical to accomplishing the University's mission, they must provide excellent benefits after retirement at a cost the University can sustain in the future. To that end, in 2009, the President of the University commissioned a Task Force on Post-Employment Benefits to develop a comprehensive approach and related recommendations that assure long-term PEB program quality and viability.

A Steering Committee and three Work Teams were formed with broad University representation. Shared governance with the Academic Senate was an integral part of the process. Special meetings were held with the Academic Senate's committees on Planning and Budget and Faculty Welfare, as well as the Academic Senate Divisional Executive Committees. Throughout the Task Force work, there was extensive participation by faculty representatives on the three Work Teams and on the Steering Committee. The Task Force process also included periodic briefings and meetings with a variety of stakeholder groups – unions, retirees, staff and administration.

Each Team was asked to focus on a specific area: pension, retiree health or finance, and make recommendations to the Steering Committee. In this report, the Steering Committee forwards a series of recommendations to the President of the University who will discuss the report and may make recommendations to The Regents based on the Task Force's work. As communicated to the Task Force members, the President will determine what to take to The Regents for consideration and approval. The President may alter or modify cost and/or design elements in his recommendations to The Regents.

Task Force Structure



Presidential Task Force on Post-Employment Benefits Charge to the Task Force

Background

At its February 6, 2009 meeting, The University of California Board of Regents (Regents) approved the restart of contributions to University of California Retirement Plan (UCRP). As part of that action, a Presidential Task Force on Post-Employment Benefits (Task Force) was authorized to develop a comprehensive, long-term approach to UC obligations for all Post-Employment Benefits. This Task Force was directed to consider the impact of issues such as, but not limited to, market competitiveness, talent management, workforce development and renewal, workforce behavior, affordability and sustainability and to make recommendations for submission to the President for his review and endorsement or change before subsequent submission to The Regents.

Task Force Charge

In its charge, "The Task Force was directed to provide recommendations with specific features:

"The Task Force benefits policy and design recommendations will include an analysis based on multiple criteria including cost, long-term funding options, cash flow, as well as an assessment

of the impact on the long-term financial integrity of the University.

The Task Force recommendations should seek to enhance the capability of The Regents to meet their educational obligations to attract and retain outstanding faculty and staff, as well as fiduciary obligations for all current and future University of California Retirement System plans.

Mission

The University of California is committed to providing competitive pay and benefits programs to attract and retain excellent faculty and staff to accomplish its mission for the people of California, while ensuring sustainable post-employment benefits for current and future retirees.

The complete statement of the charge, mission, operating and guiding principles for the Task Force can be found in Appendix A.

Process:

All three Work Teams began with broad issues and, through iterative, interactive work among them and with the Steering Committee, began to develop a smaller set of options. With support from four consulting firms – Deloitte, Hewitt, Mercer and Segal – they refined models and projections. Benchmarking against other public sector employers and specific market comparators was an important part of the analyses, along with survey and UC location forum feedback. Modeling changes within financial parameters was a critical factor as the designs narrowed. The Work Teams also recognized the need for an array of short and long-term solutions. Faculty Task Force members provided expert input and many of their proposals shaped the final recommendations.

The critical challenge facing the Task Force was balancing the current and future financial environment (since growing unfunded liabilities dramatically increase the funding requirements) with the need to recruit and retain the highest quality faculty and staff talent to accomplish the mission of the University and sustain commitments to current and future retirees. It is important to note that some costs are fixed, such as the accrued pension liability, while others are discretionary and within the scope of policy and design to change, such as benefits for new hires and retiree health programs.

Triggering Issues

The University of California has long provided valuable Post-Employment Benefits, principally a Defined Benefit¹ (DB) pension plan (University of California Retirement Plan or UCRP) and Retiree Health program. These benefits have been critically important for recruiting and retaining outstanding faculty and staff – a key component in the University's excellence. In particular, UCRP provides incentives for long careers at the University and promotes recruitment of talented young people to develop a career with the University. The PEB Task Force participants are unanimous in advocating the preservation of UCRP as a Defined Benefit plan but realize the necessity of providing a DB plan that is sustainable and can be maintained within the confines of the University's operating budget.

UCRP's advantages extend beyond recruitment. The value of PEB benefits that would be forfeited (the pension income for all future service and Retiree Health coverage) makes it economically unattractive for faculty and staff to leave the University in midcareer, thus helping UC retain faculty and staff who receive outside offers. The DB plan provides career faculty and staff with enough income security to afford to retire from service when the time is right for them.

While a Defined Contribution (DC)² plan may also provide senior faculty the means to retire when the time is right, it provides little incentive for retirement. Concerned that faculty were retiring too late, some competing academic institutions with DC plans have initiated supplemental buy-out plans to provide a retirement incentive for faculty. With a Defined Benefit plan such as UCRP, there is no need for supplemental buy-outs. Clark Kerr, in advocating the establishment of UCRP in 1961, recognized the valuable contribution to renewal of the University provided by the Defined Benefit approach. For faculty in particular, voluntary retirement of senior members allows for renewal by making space for talented young faculty and the cycle is repeated. This renewal has been one of the great strengths of the University of California. We hire talented young people, provide an opportunity for them to develop their skills, maintain a strong economic incentive for them to remain with the University for a full career; and then provide the security and incentive to retire when the time is right. Also, post-employment health benefits are an important element of retirement security available to long-term employees.

¹ A Defined Benefit plan (DB) guarantees a benefit based on a formula, usually based on some combination of age, years of service, and pre-retirement earnings. The amount of retirement income is not affected by market fluctuations. The employer bears the investment risk and benefits are funded by combined employer/member contributions and investment earnings.

² A Defined Contribution plan (DC): contributions are put into funds whose investments are directed by the member and are subject to market fluctuations. Participants bear the investment risk. Defined contribution plan benefits generally are more portable than other types of retirement plans.

UCRP reduces investment risk for University employees caused by market fluctuations. The University is in a better investment position to adjust for market losses because it has a long-term investment horizon that better permits it to recover from losses. The impact of market loss on the plan's unfunded liability can be amortized over 15 to 30 years. The University's assumption of risk proved valuable to employees during the recent market downturn. While UCRP lost about \$16 billion of assets during 2008 and 2009, there was no reduction in retiree pension benefits.

An employee nearing retirement age may not have enough time to recover from market losses (such as the economy suffered in 2008 and 2009) and maintain retirement security. This individual risk would damage the ability of faculty and staff to retire with adequate retirement security. At the other end of the spectrum, the University's operating budget benefits from strong market performance, an effect that permitted the University, faculty and staff to avoid contributions to UCRP for nearly twenty years.

On an annual basis, UCRP was fully funded since its establishment in 1961 until 2008. University and member contributions³ were made each year to cover the "Normal Cost" (the present value of the benefits allocated to service credit earned in that year) even though those benefits would be paid out years and decades later.

In the late 1980s, as a result of historical University and member contributions and large investment gains, UCRP became substantially overfunded. University and member contributions were reduced, and then stopped entirely in the early 1990's. The total cessation of contributions, which seemed desirable at the time for a variety of reasons, has created a serious problem today. The absence of contributions created an illusion that the University and the State could finance the University's growth and operations using funds that should have been contributed to UCRP. For almost twenty years, faculty and staff continued to earn additional benefits as they accumulated service credit, while no funds were being set aside to cover this growing liability. It has been clear since at least 2005 that prompt resumption of contributions is necessary to cover the Normal Cost of additional service credit accrued each year. Unfortunately in 2007 the State of California was unwilling to re-start UCRP contributions due to the Plan's overfunded status at that time.

³ See table on page 20 and Appendix L, "University of California Retirement Plan Contributions 1976 – 1993."

For UCRP, covered compensation is base pay from the University for a regular appointment at the full-time rate. This includes pay for sabbaticals or other paid leave, as well as stipends. It does not include such things as overtime, summer session pay, uniform allowances or amounts over the established base pay rates or pay above the limits established in the Internal Revenue Code (IRC), except to the extent that the implementation of UCRP 401(a)(17) raises or eliminates those limits.

Had the Regents' targeted funding level adopted in September 2008 been in place and funded since 1990, contributions would have been reduced, but never eliminated. If UC had fully implemented the 2008 targeted funding level, contributions of 11.6% of covered compensation⁴ would have been required in 2009-10 fiscal year⁵. However, once the investment losses of 2008-09 and UCRP's very large unfunded liability are accounted for, substantially higher contributions are needed. It is critical that the University start to address UCRP's unfunded liability right away, as delay only makes the problem much worse. The problem can be addressed over 30 years, but the 30 years needs to start immediately.

One aspect of UC's Post-Employment Benefits impact on the workforce is its facilitation of early retirement. When Social Security was established, normal retirement age was 65. At its inception in 1961, UCRP provided its maximum "age factor" at age 63. An employee could retire before age 63, but the age factor⁶ would be reduced, reducing the pension accordingly. Since July 1992, the maximum age factor has applied at age 60. Faculty retire on average at about 66, but staff retire on average at about 60. One consideration in Task Force discussions is that staff's tendency to retire early may be detrimental to the University. Many employees remain energetic, engaged, and effective beyond age 60. Any minor losses in productivity associated with the aging process are, in our view, more than offset by gains in experience and institutional knowledge. Early retirement, something the current UCRP design facilitates, increases the cost of Post-Employment Benefits. Pensions are paid over longer periods of time and the cost of funding the pensions is spread over fewer years of employment. Both factors raise the Normal Cost⁷ of the plan.

When the University began providing active employee and retiree health care, health care costs were relatively low. The University has paid for retiree health care on a "pay-as-you-go basis". Each year, the current Retiree Health program costs are paid from an assessment on covered compensation paid by all funding sources. Virtually all large public and private employers in the United States who offer retiree health benefits take a "pay-as-you-go" approach. As health care costs have risen, the University's liability for Retiree Health has grown. These unfunded liability costs now represent a very

⁴ For UCRP, covered compensation is base pay from the University for a regular appointment at the full-time rate. This includes pay for sabbaticals or other paid leave, as well as stipends. It does not include such things as overtime, summer session pay, uniform allowances or amounts over the established base pay rates or pay above the limits established in the Internal Revenue Code (IRC), except to the extent that the implementation of UCRP 401(a)(17) raises or eliminates those limits.

⁵ The 11.6% does not take account of the investment losses in the 2008-09 Fiscal Year.

⁶ Age factor: In the UCRP retirement benefit formula, the percent of pay for each year of credited service.

⁷ Normal Cost is the cost of an additional year of service credit for all active UCRP members.

large problem for the University financial planning and budget areas. This problem is underscored by accounting rules adopted by the Government Accounting Standards Board (GASB) requirement that these liabilities be reflected on public entities' financial statements.

The University's Retiree Health benefits have been more than competitive because they were provided at very low cost to University retirees. Most of our competitors provide similar benefits and health plan choices for their retirees but, of these, many provide "access-only" coverage, meaning that the retiree must pay 100% of the premium for medical coverage. Other competitors pay part of the premium cost, but substantially less than what the University contributes for premiums and almost none of them follow the University practice of contributing towards all or part of the Medicare Part B premiums.

Early retirement also adds cost to the Retiree Health benefit. Individuals who retire while they are still able to provide effective service to the University (or to other employers that could pay their health care costs) create additional costs since health benefits have to be paid to both the early retirees and their replacements.

The Fiscal Problem

Not restarting contributions to UCRP over the last five or six years has exacerbated the UCRP funding problem. The unfunded liability of UCRP, on a market-value⁸ basis, was \$12.9 billion as of July 1, 2009; the plan was 71.4% funded using a market valuation. On an actuarial⁹ basis, which recognizes losses over five years, the plan was 95% funded on July 1, 2009. An updated actuarial valuation is presented each November to the Board of Regents¹⁰. Because the 2009 actuarial funding ratio excludes 80% of the 2008-2009 losses, the funding ratio¹¹ will drop significantly as those losses are taken into account over the following four years.

⁸ Market Value is the price at which a plan's assets could be traded at a particular point in time.

⁹ Actuarial Value: a mathematical calculation of a pension plan's status using assets, liabilities, contributions and actuarial assumptions about future investment earnings, retirements, terminations and mortality.

¹⁰ Actuarial Valuation for UCRP – 2009: <http://www.universityofcalifornia.edu/regents/regmeet/nov09/f5.pdf> and Actuarial Valuation for UCRP – 2008: <http://www.universityofcalifornia.edu/regents/regmeet/nov08/f10.pdf>

¹¹ Funded ratio or status: A percentage based on plan assets divided by plan liabilities. It indicates relative financial stability.

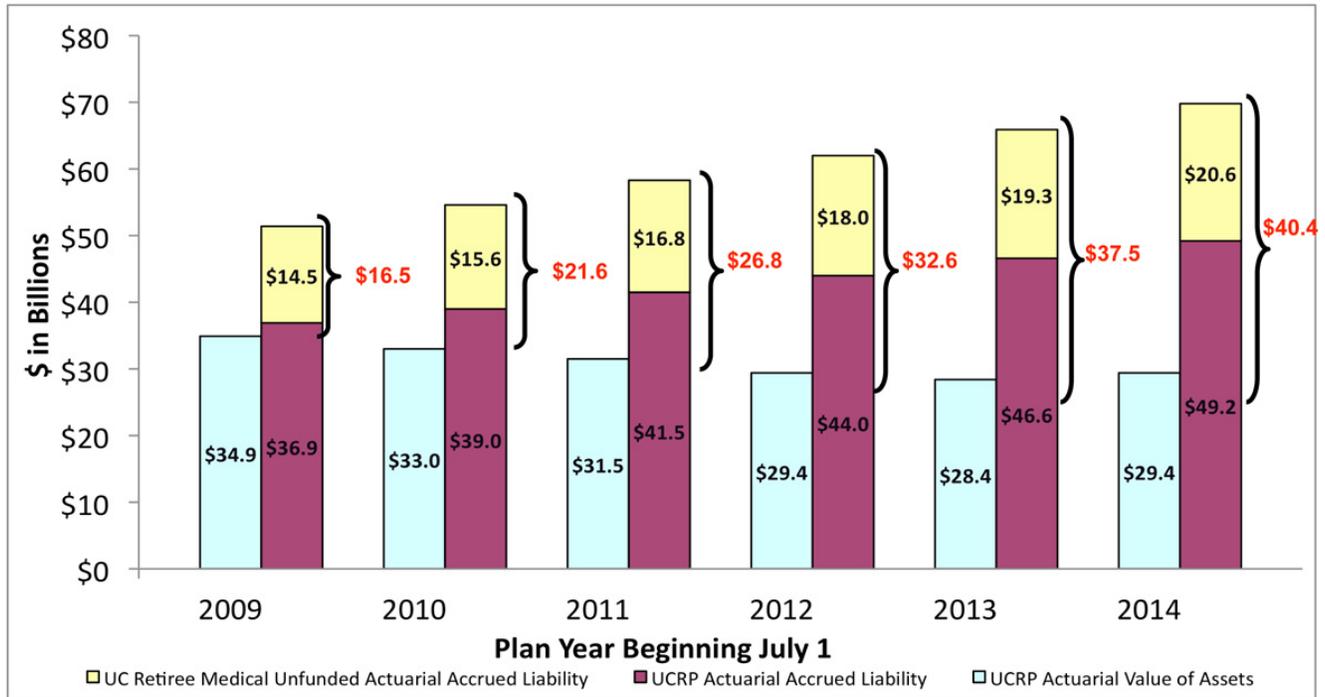
Returning UCRP to a sound footing requires contributions equal to the “Annual Required Contribution” (ARC)¹², consisting of Normal Cost, plus an amortization charge for the unfunded liability. The Regents’ actuary, The Segal Company, prepared estimates of ARC using the Regents’ targeted funding level and based on the July 1, 2009, actuarial valuation. The estimated ARC rises to over 20% in 2010-11, and to approximately 37% of covered compensation in 2014-15, as the losses incurred in 2008-09 are fully taken into account. After 2015, the ARC declines slowly. If the University were to follow its previous plan of slowly ramping up contributions, ARC would eventually rise well above 50% of covered compensation since the slow ramp-up creates a shortfall each year that adds to the unfunded liability. Contributing the full ARC out of the current operating budget would be devastating in the short-run, but delay makes the problem much, much worse.

Amortizing UCRP’s unfunded accrued actuarial liability – the difference between the actuarial value of assets and the amount needed to pay the total accrued benefits over the current members’ lifetimes – is projected to cost 8% of payroll starting in FY 2011-12 and rise to a maximum of 19% of payroll by FY 2015-16. This annual cost is in addition to our current Normal Cost of 17.6% of payroll.

The unfunded liability for Retiree Health was \$14.5 billion on June 30, 2009. The annual UC “pay-as-you-go” cost of the Retiree Health program is currently \$250 million. The Retiree Health liability consists entirely of benefits accrued to date by current faculty, staff and retirees based on past service, but none of this amount is prefunded. Each year, the University’s share of the current year’s premiums for retirees is paid from the University’s operating budget. Retiree Health unfunded liability will grow from \$14.5 billion in 2009 to \$20.6 billion in 2014 without any program changes, although the Task Force thought fully funding UCRP’s liability took precedence over funding the Retiree Health liability. The combined unfunded liabilities for UCRP and the Retiree Health programs are estimated at over \$40 billion in 2014 as shown in the chart that follows:

¹² ARC: A measure of needed plan funding used by GASB (Governmental Accounting Standards Board). The ARC has two parts: the Normal Cost (see footnote 4, page 10) and the Amortization, which is the amount needed to fund benefits already accrued by retirees currently receiving benefits and by employees for past service.

PEB Assets and Liabilities for Campuses and Medical Centers



The University must show the cumulative unfunded Annual Required Contribution or ARC for both programs on its balance sheet. These costs affect the immediate budget plans of University departments, locations and The Regents. Large liabilities on University balance sheets may impact the availability of unrestricted net assets and the University’s credit rating.

California’s severe budget issues further complicate this bleak situation, along with the lack of current State funding for UCRP. The State, in addition to the University and UCRP members, has benefited from a nearly 20-year period of zero contributions to UCRP for state-funded members and now finds restarting contributions problematic. The restart of full employer contributions to UCRP has been delayed due to the lack of funding from the State for its share of these costs. About one-third of all active members in UCRP are state funded, with fully two-thirds of active member salaries funded by non-State sources.

Not collecting money from the State means we also do not collect money from the other sources that provide active members’ salaries – the Clinical Enterprises, contracts and grants, auxiliaries, etc. The University does not and cannot charge various fund sources differing rates for the same benefit costs – thus, for each dollar not collected from the State or captured from University operations, we lose over two dollars from other fund sources. Because the financial viability of the retirement plan required contributions to restart without further delay, contributions from both members and University

fund sources began in spring 2010. The State's share of employer contributions for 2009-2010 fiscal year was funded from a combination of student fee revenue and redirection of funds from existing programs. Employer contributions to UCRP restarted at 4%, but the total combined University and member contributions are far less than the Normal Cost.

The State of California is not expected to contribute its share of this cost in 2010-2011. At this time, it is unclear when State contributions will resume, as the State's fiscal situation is not expected to improve significantly for several years. Nonetheless, the University will continue to actively seek funding from the State for its share of these costs.

National health care reform¹³ added another layer of complexity to the issues the Task Force considered. Major elements of reform such as exchanges, high risk pools and other features are still in development, so the full impact on the University's health programs and its Clinical Enterprises cannot be fully assessed. It is important to note that the University is both a provider and a consumer of health care, with the University's Clinical Enterprises participating in the health plans offered to its faculty and staff. As health care providers, our hospitals and medical professionals will be impacted by national reform in ways that we cannot predict now, thus affecting the University health programs.

One recent national health care reform provision that UC is participating in is the Early Retiree Reinsurance Program (ERRP). ERRP is a program that was established by national health care reform, Patient Protection and Affordable Care Act (PPACA), enacted in March 2010. ERRP creates a temporary reinsurance program to help offset employer costs of medical, pharmacy and behavioral health benefits provided to retirees age 55 or older and not eligible for Medicare, and their dependents, even if they are under age 55 and/or eligible for Medicare. The program reimburses participating employers for 80% of the costs of qualifying benefits provided in excess of \$15,000 and below \$90,000. The program starts June 1, 2010 and ends the earlier of January 1, 2014 or whenever the \$5 billion maximum appropriation for the program is exhausted. The University's participation in the program is subject to approval by the Department of Health and Human Services (HHS). The first year any potential reimbursement could impact the UC program is calendar year 2012. UC Staff is actively working to finalize the required written agreements with its health plans regarding disclosure of information, data, documents, and records necessary to comply with the program.

¹³ See Henry J Kaiser Family Foundation three page summary of national health care reform and the implementation schedule at: <http://www.kff.org/healthreform/8060.cfm>

Other external forces affect the process, as well. The Task Force's work has been done during ongoing, highly critical media reports of growing public concern over the cost and generosity of benefits for public sector retirees – a concern exacerbated by the recent economic recession and a long private-sector trend of reducing or eliminating Post-Employment Benefits (PEB). Public employers across the nation are examining their funded status and liabilities, most with even grimmer results than the University.¹⁴ The University, through the formation and work of the Task Force, is at the forefront of re-examining PEB commitments but there is a shifting environment for public sector and higher education organizations as they begin to act to assess and manage their PEB costs and liabilities.

¹⁴ The State of California has an estimated Unfunded Accrued Actuarial Liability of \$50 billion for its Retiree Health program.

Also see the Pew Report on States' unfunded pension liabilities at: http://www.pewcenteronthestates.org/report_detail.aspx?id=56695 and the report on state and local government unfunded retiree health liabilities from the Center for State and Local Government Excellence at http://www.slge.org/index.asp?Type=B_BASIC&SEC=%7B3A23B0F5-96FC-40AE-91D1-0DE488D5F17E%7D&DE=%7B9CED9932-83D5-4183-B5F3-16C59BA66A12%7D

Summary of Task Force Recommendations

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 for represented employees.

Benefit levels and the member contribution rates modeled in this report are dependent on the specified implementation dates, subject to approval by The Regents. Variations in the implementation date of the recommendations for a group may impact that group's benefit levels and member contribution rates.

RECOMMENDATIONS		
Pension Work Team	Retiree Health Work Team	Finance Work Team
1. Increase University and member contributions to UCRP more quickly.	12. Adopt new eligibility formula multiplying an age factor times service credit (does not apply to current retirees).	20. Amortize UCRP gains and losses over 30 years instead of 15.
2. Provide predictable contribution levels.	13. Grandfather under current eligibility rules faculty and staff with age plus service equal to or greater than 50 with UCRP service credit equal to or greater than 5 years as of July 1, 2013.	21. Increase University and member UCRP contributions more quickly. (See Pension, #1.)
3. Implement a UCRP New Tier for new hires effective July 2013.	14. Phase in a 3% per year reduction in maximum University contribution with a 70% floor.	22. Implement a UCRP New Tier for new hires effective July 2013. (See Pension, #3.)
4. Offer current UCRP members choice of current UCRP at a higher cost or the New Tier for future service beginning July 2013 if IRS approves.	15. Continue blended premiums for non-Medicare retirees.	23. Offer current UCRP members choice. (See Pension, #4.)
5. Explore feasibility of Defined Contribution option for Clinical Enterprises.	16. For retirees age 65 and older without Medicare, provide UC contributions at the same level as actives.	24. Fully fund UCRP ARC more quickly by: <ul style="list-style-type: none"> ▪ Paying UCRP Normal Cost plus interest only until 2018 ▪ Restructuring debt using STIP interest ▪ Borrowing from STIP
6. Monitor labor market trends and retirement age ranges for Safety members; review potential change to 3% at age 50 formula.	17. Continue the status quo for UCRP members receiving Disability Income, subject to administration's broader review of disability benefits.	25. Reduce Retiree Health Normal Cost to 3%-4%; increase campus assessment. Contribute to unfunded liability after fully funding UCRP liability. (See Retiree Health, #18.)
7. Implement ad hoc COLA and permanent COLA for PERS plus 5 retirees.	18. Increase Retiree Health assessment fee by an amount to apply towards the unfunded liability. Fund ARC after full financing of UCRP unfunded liability.	
Steering Committee 8. 415(m) Restoration Plan – eliminate lump sum cashout restoration for new hires, those not eligible to retire as of July 1, 2013. 9. Develop flexible policies to address unfunded liability of employing departments.	19. Continue monitoring national health care reform.	
10. 401(a)(17) Restoration benefits – establish a restoration formula with a uniform compensation cap. 11. Develop non-pension options for local use with salaries above cap.		

Pension Work Team

UCRP Background

The University created its first pension program in 1924 for faculty and in 1937 for staff through CalPERS. In 1961 a Defined Benefit plan, UCRP, was established for all career employees. Members of the plan in 1976 and 1977 were offered the choice of coordinating with Social Security; new hires were required to join Social Security. As a result of the plan's significantly over-funded status, in 1990 The Regents authorized suspension of the University's annual contribution and redirection of member contributions to the Defined Contribution plan, a supplemental retirement investment vehicle. UCRP's over-funded status and zero employer/employee contributions lasted nearly two decades.

As of April 2010, UCRP had over 115,000 active members and 54,000 retirees, survivors and disabled members receiving benefits. Currently, one-third of the University workforce, approximately 35,000 faculty and staff, is eligible to retire. The plan has actuarially valued assets of \$47 billion, a funded ratio of 86% (smoothed basis¹⁵) and pays \$1.6 billion/year in benefits. However, without accelerated contributions or plan design changes, the estimated funded status of the campus and medical center segment of UCRP in 2015 is estimated to be only 60%.

The Regents are UCRP's sponsor and fiduciary. They have delegated limited authority to the President for Plan administration functions, but The Regents must approve any amendments to the Plan. Each year, the administration and The Regents' actuary report to the Board of Regents on UCRP's valuation through the previous fiscal year.

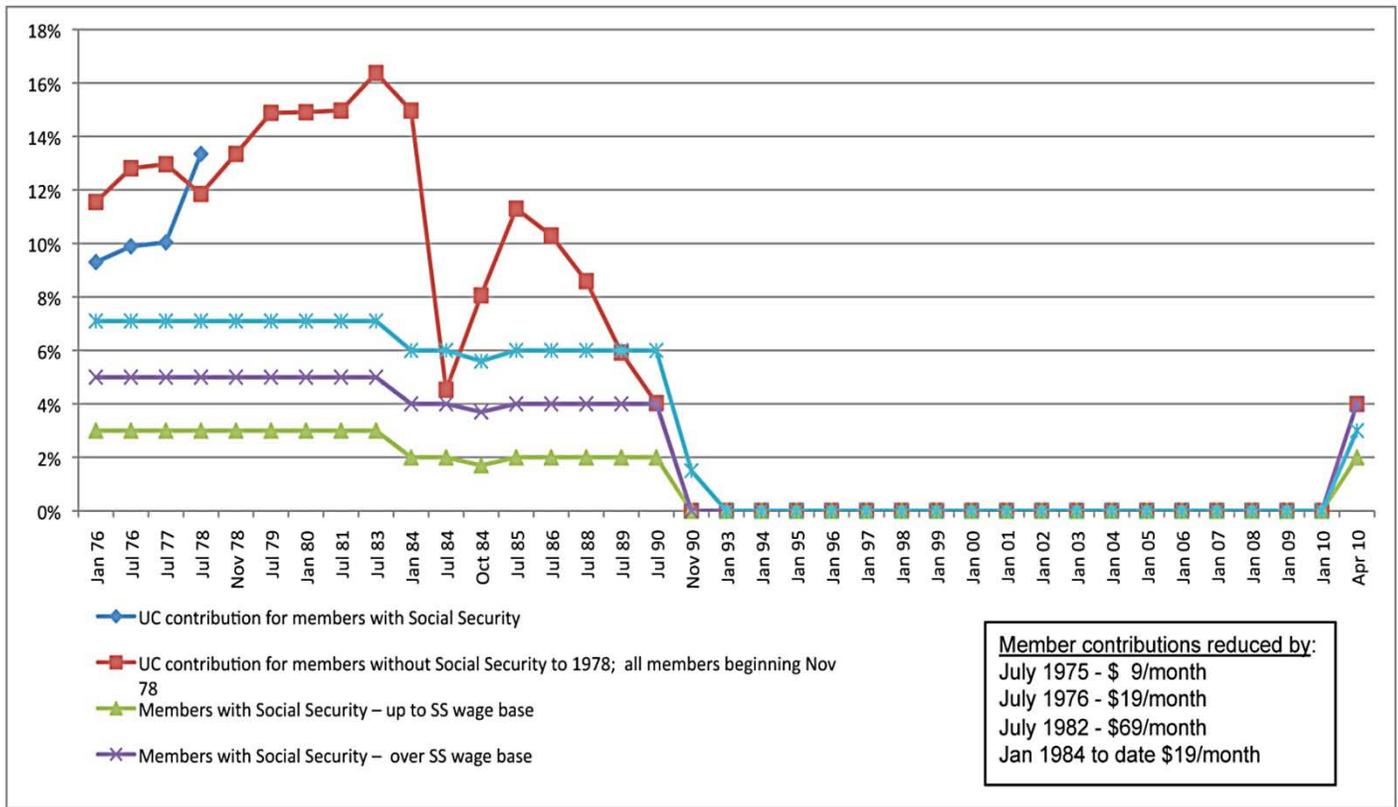
Benefits already accrued¹⁶ by members are constitutionally protected and must be paid. Thus, potential changes to UCRP do not affect the liability for benefits already accrued.

Generally, employer and member contributions to a pension plan are set to cover the plan's Normal Cost, plus amortize any unfunded liability. Between 1976 and 1992, contributions to UCRP varied; faculty and staff paid as much as 5%-7% and the University contributions were as high as 16.37% as shown in the following chart:

¹⁵ UCRP "smooths" or spreads investment gains/losses over five years to avoid short-term effects of market swings on planning based on thirty-year projections.

¹⁶ Accrued benefits: benefits earned to date by plan members under the plan's provisions.

University and Member Contributions to UCRP: 1976 to 2010



Currently, UCRP’s Normal Cost is 17.6% of covered payroll. Absent significant additional funding and/or program changes, the University cost for 2014 for example, is projected to be \$1.4 billion – the equivalent of salary and benefits for 15,000 staff, 7,300 faculty, operating costs for two medium-sized campuses, or gross revenues of a Medical Center.

In October of 1990, The Regents adopted a “full funding limit,” or targeted funding level, under which contributions would be suspended when UCRP’s surplus was enough to cover the plan’s Normal Cost. When contributions were suspended in 1990, UCRP was 137% funded, meaning, at that time, the system had more than enough to pay out all benefits accrued to date, plus the annual Normal Cost. The annual Normal Cost was “paid” using the UCRP surplus each year, causing the Plan’s funded ratio to decline to 95% by 2009. As a result of the contribution holiday it is estimated that as of July 1, 2010, the campus and medical center segment of UCRP is 85% funded based on an actuarial value of assets basis and 71% on a market value basis (\$11.3 billion shortfall).

In September 2008, The Regents adopted a UCRP Funding Policy, directing that

- Each year's recommended UCRP contributions be based on Normal Cost adjusted by any surplus or underfunding;
- Actual contributions, and the share paid by the University and by the members, be set annually as part of the budget process and in the context of total remuneration. University contribution rates will not be lower than the members' rate.
- Changes in any surplus as of the date of the item or unfunded liabilities be amortized over 15 years; and
- Any future surpluses be amortized over 30 years.

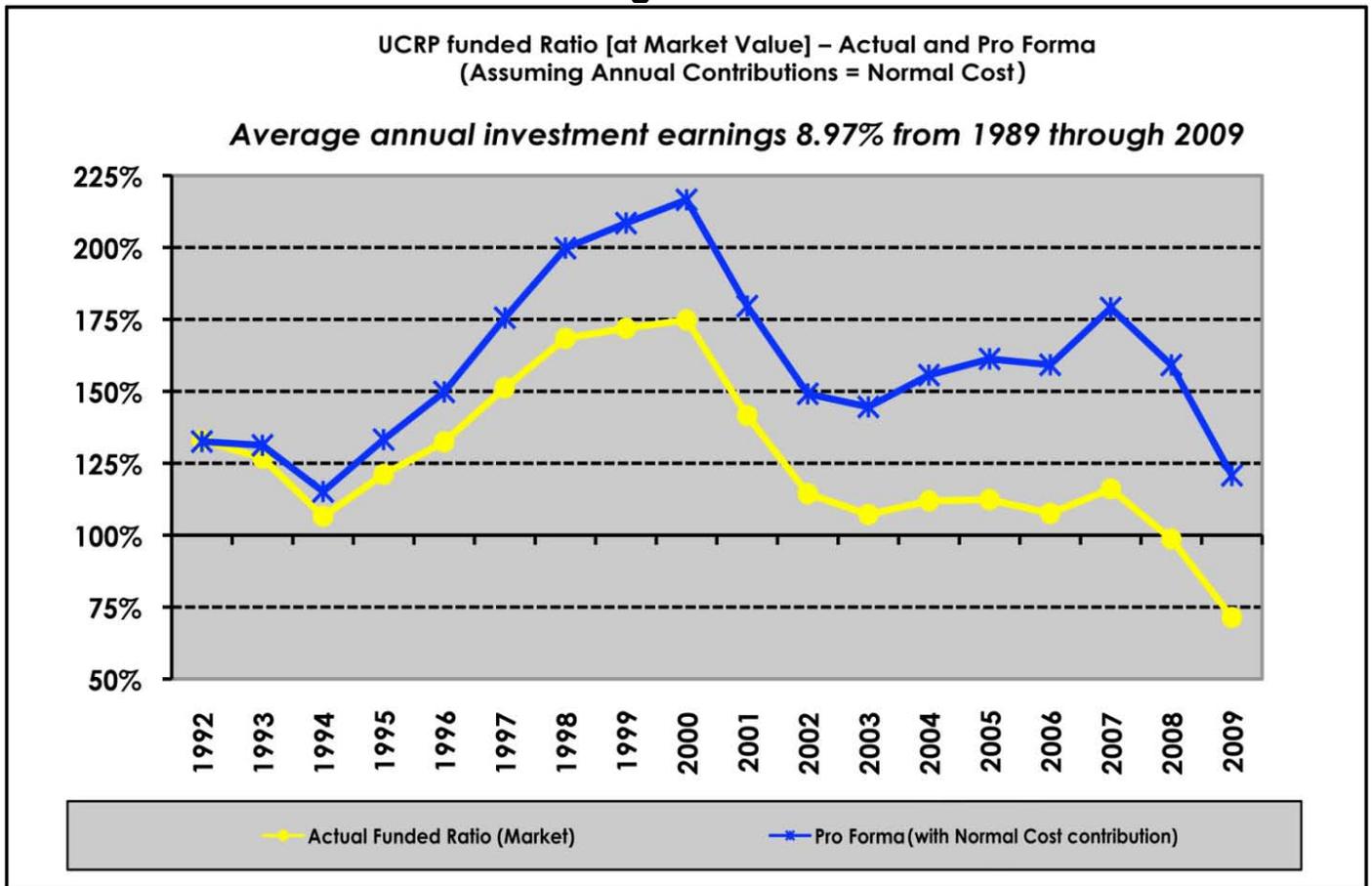
In February 2009, The Regents authorized (subject to collective bargaining as applicable) restarting UCRP contributions at 4% of covered pay for UC and 2%/4%¹⁷ for members beginning on or about April 15, 2010 with the intent to review the contribution level each year. Due to lack of State funding, limited availability of other funds and the potential impact of member contributions on total remuneration, the combined authorized University and member contributions (about 6% in total) do not cover the full 17.6% Normal Cost so the unfunded liability continues to grow.

Investment returns are one of the largest drivers of assets available to pay benefits and, as such, are a major part of any pension plan. The University Treasurer's Office performance consistently has been above its benchmark institutions and the UCRP assumed rate of return¹⁸, averaging 8.97% from 1989 through 2009 as shown in the following chart.

¹⁷ UCRP members with Social Security contribute 2% of covered pay below the Social Security wage base and 4% above it (less \$19 per month). Member contribution changes are subject to collective bargaining for represented employees. The initial rate is the same as the rate for redirection of member contributions to the DC Plan (in effect since 1990). The redirection of contributions ended when UCRP member contributions were restarted so net pay was not affected. For represented employees, the effective date of restarted contributions and the rates are subject to collective bargaining.

¹⁸ UCRP's assumed rate of return on investments is 7.5%.

UCRP Funding Ratio: 1992 - 2009



- The yellow line shows UCRP’s funded ratio from 1992 through 2009 based on market value.
- The blue line is what the funded ratio based on market value would have been if the University and plan members’ contributions covered UCRP’s Normal Cost. Hypothetically, had contributions been made to UCRP during each of the prior twenty years at the Normal Cost level, UCRP would be more than 120% funded today.

The Treasurer’s goal is to achieve average returns at or above the UCRP’s assumed earnings rate and that has been done. But **investments alone cannot overcome a twenty-year lack of contributions**. Even if annual Normal Cost contributions were made starting now, the Plan would need substantial, sustained investment returns far above the UCRP assumed earnings rate of 7.5% for many years to return UCRP to 100% funded status.

Process, Other Considerations and Conclusions

Benchmarking

Initially, the Pension Work Team's foremost concerns were:

- How could the plan's unfunded liability be addressed and
- How quickly could Normal Cost funding be achieved?

Strategies for dealing with funding issues ultimately were deferred to the Finance Work Team with the observation that the University should return to full funding as soon as possible. The Team then turned to plan design, starting with very broad questions: should the University prospectively offer only a Defined Benefit plan, only a Defined Contribution plan or some combination of the two? Did differing workforce segments have differing benchmarks and, thus, different solutions, e.g., the Clinical Enterprises? Should the changes apply to new hires only or should current employees have a choice? The Team discussed the interrelationship between UCRP and Social Security and considered the adequacy of replacement income from both sources for those with a full University career.

To understand what other public entities were doing in the pension arena, including retirement plan alternatives and trends in retirement benefits, Hewitt Associates researched publications and other materials. Their findings can be found in "Appendix K, "Background Articles," under "Trends in Retirement Benefits, Hewitt Associates."

In the pension arena, most states had made relatively minor changes, modifying their Defined Benefit plans rather than implementing fundamental redesign. States increased member contributions, lengthened the period used to calculate salary for a pension benefit, increased age and/or service requirements for benefits eligibility, modified cost-of-living provisions and increased the service credit required for benefits to vest¹⁹. Alaska replaced their Defined Benefit plan with a Defined Contribution (DC) plan and Georgia moved to a hybrid plan. Only three states use a DC plan as their basic program; four offer a DC plan alternative and three include a DC plan in their mandatory hybrid plans.

Subsequently, other actions have been taken or are being proposed within the State of California and its counties and municipalities. Most recently, San Francisco passed Measure D, increasing city

¹⁹ Vest or vesting: a right to an asset, such as pension benefits earned to date, that cannot be taken away by any third party.

employees' contributions to PERS²⁰ from 7.5% of covered pay to 9% and increasing the salary period on which pensions are based from one year to two for new hires. Governor Schwarzenegger has proposed an increase in PERS member contributions from 5% of covered pay to 10%, requiring 20 years service credit for a full employer contribution to retiree health premiums and reducing the maximum contribution to 85% (from 100%) of the retiree health premium. (See Appendix L, "UCRP Background" for a "Comparison of Current and New Plan Provisions for Various California Entities," "Proposed Pension Reform Highlights from Current Governor and Selected Gubernatorial Candidates," and "Summary of Recent Plan Design changes for Various State Plans".)

Based on the Finance Team's input, the Pension Team then developed several New Tier designs for newly hired faculty and staff with a total Normal Cost target of 12% (7%-9% University-paid with the balance paid by members).

While a New Tier does not impact the current unfunded liability, there are several important reasons to consider implementing such a plan. A lower employer Normal Cost New Tier, if fully funded by both the employer and member upon hire, would reduce the pressure on operating budgets and the University seeks to amortize the unfunded liability. In addition to lowering the total long-term employer funding costs, the lower Normal Cost could allow University fund sources to pay more towards the amortized cost of the unfunded liability. A New Tier also could modernize the plan by eliminating non-standard benefits such as lump-sum cash out options and cost-of-living-increases for inactive members. The new designs might also encourage later retirements for better coordination with Social Security and Medicare eligibility ages.

Conclusion: Though it does not impact UCRP's unfunded liability, there are other compelling reasons to implement a New Tier within UCRP.

Plan Design

The Team looked at Defined Benefit (DB), Defined Contribution (DC), Cash Balance and Hybrid plans and the University's role in providing pension benefits.

In general, DB plans provide a specific, formula-based benefit at retirement for each eligible member, while DC plans specify the amount of contributions to be made by the employer toward an employee's retirement account. Cash balance and hybrid plans blend elements of DB and DC plans.

²⁰ PERS or CalPERS: the California Public Employees' Retirement System.

Retirement income for a Defined Benefit plan member does not depend on the plan's investment returns. Instead a formula, usually based on an age-related percent of average pay for each year of service, determines a lifetime annuity²¹. The employer bears the risk in a Defined Benefit plan for both investment risk and life expectancy (defined as longevity risk). This is because each member's pension is based on the plan's formula and must be paid for the member's lifetime without regard to the return on investments or whether the member lives longer than the average life expectancy. Individuals directing management of their own Defined Contribution account investments generally have lesser investment returns compared to Defined Benefit plans whose professional account managers oversee large, pooled funds for a group. A member's pension from a Defined Benefit plan is based on the pension formula, not the return on asset investments.

In most Defined Contribution plans, the employer makes a matching contribution based on the level of employee participation. A Defined Contribution plan shifts the investment risk to the member whose benefits depend on the value of the individual account's investment return. If the member does not convert the individual account to an annuity at retirement, there also is the risk of outliving the funds in the individual account. Defined Contribution plans are more portable since the member has access to the funds at any time after leaving the employer, subject to applicable tax laws.

A cash balance plan is considered a hybrid plan in that it has elements of both DB and DC plans. The employer still has the investment risk but the benefit looks more like a DC plan since it is based on a specific account balance. Typically, a member's account is credited each year with a pay credit (such as 5% of compensation from the employer) and an interest credit (either a fixed rate or a variable rate that is linked to an index such as the one-year Treasury bill rate). Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to members; they earn the guaranteed rate of return regardless of the market performance. Thus, the investment risks and rewards on plan assets are borne solely by the employer. When a member is eligible for benefits under a cash balance plan, the benefits are defined in terms of an account balance and payable as an annuity.

Cash balance plans are far more common in the private sector among hospitals and health systems. Only one state, Nebraska, is known to offer a cash balance plan and they are relatively uncommon in higher education, though one of the University's comparator institutions maintains such a plan. After

²¹ Annuity: payment of an income in regular installments. For UCRP, a retirement annuity is paid each month.

careful consideration, modifying UC's pension program to a cash balance plan was not further considered due to the significant cultural shift such a design would have.

DB plans are strong tools for retention of quality faculty and staff until members reach the age at which they are eligible for the plan's maximum percent per year of service, currently 2.5% at age 60 for UCRP. Members who terminate service or retire before age 60 forfeit substantial pension benefits: pension income for all future services and Retiree Health. DB plans also provide a known level of income replacement at retirement. With DC or cash balance plans, members have limited ability to attain specific income replacement levels; these programs focus more on capital accumulation.

There is a mix of Defined Benefit and Defined Contribution plans among the University's comparator institutions, but moving towards a Defined Contribution or cash balance/hybrid model as the primary retirement plan would be a dramatic change for the University, though it might be closer to the market comparators for the UC hospitals. In general, DC plans, while very common in private higher education organizations still are rare among public sector employers. Shifting to a DC only pension program would be a major departure for the University for several reasons:

- The portability of DC plans means that employees who terminate and withdraw their funds receive a greater immediate plan value. If they leave before vesting, funds in a DB plan remain with the plan; if they have vested, they must wait until reaching retirement age to claim benefits.
- Often, DC plan members must select and manage their own investment portfolios, thus assuming the full risk. In a DB plan, professionals manage pooled funds and the members' benefits are insulated from risk.
- DC plan members have no assurance that their account balance will be adequate to provide lifetime benefits.

Moving to a DC-only structure also has significant financial implications. Long-term, the employer cannot underfund this type of plan nor does it accumulate unfunded liability. However, in the short-term, the employer must fund a new DC obligation plus the liabilities of the previous plan.

Additionally, some Task Force members thought such a shift would be less competitive for faculty.

While a Defined Contribution plan may provide the means to retire, faculty observed that it provides little incentive for their peers to retire. In *A University for the 21st Century*, James Duderstadt, the

former President of the University of Michigan, remarks, "Most universities provide faculty and staff with "defined contribution" retirement plans, in which a certain amount each year is placed into a tax-deferred investment account for each employee. As one becomes older, usually earning a higher salary, the value of yet another year's university contribution to the retirement plan becomes considerable. In addition, increasing age can have a major actuarial impact on the value of retirement annuities. Both of these factors create very strong incentives to delay retirement as long as possible. As a result we have created a situation in which de facto age discrimination will be a feature of academic life for a generation – age discrimination not against the old but rather against the young as we deprive them of the opportunity for academic careers."²²

Concerned that faculty was retiring too late, some competing academic institutions with DC plans have initiated supplemental buy-out plans to induce timely retirement of faculty. With a Defined Benefit plan such as UCRP, there is no need for supplemental buy-outs. Stanford created such a program when mandatory retirement ages for faculty were raised in 1984, then eliminated in 1994. This "buy-out" program now costs \$7 to \$10 million per year, with about 20% of eligible Stanford faculty electing it.

Generally, the Team did not favor shifting investment and longevity risks to members since one of the key guiding principles was providing a secure, adequate retirement for a full University career. A major concern for faculty representatives was the competitiveness of the design and the impact on total remuneration.

All of the Team's members noted the importance of analyzing the effect of recommended UCRP changes on competitive market position, recruitment and retention of quality faculty and staff. However, given current budget constraints, a lower Normal Cost for newly hired faculty and staff could allow contributions towards the existing unfunded liability and is essential for University operating budgets in the short-term. The Finance Work Team discussed the funding issues in more detail.

Conclusion: The Work Team should develop a sustainable Defined Benefit plan for new hires as well as a choice for current faculty and staff but also recognize that, based on market comparisons, a Defined Contribution plan might be a more appropriate design for particular workforce segments (e.g. the Clinical Enterprises).

²² Duderstadt, James J. *A University for the 21st Century* (pp. 155-156 – "Retirement and the Impacted Wisdom Group"), Michigan, Ann Arbor Press, University of Michigan. 2000.

Income Replacement

Income replacement was a central concern in developing plan designs; both the Pension and Finance Work Teams discussed the appropriate level of replacement income from UCRP plus Social Security. Generally, people need less income after retirement for several reasons (though individual situations vary): they no longer have deductions for such things as Social Security and non-medical benefits, they may have lower income taxes, Social Security benefits are partly tax-free and they are no longer saving for retirement. A 78% to 94% replacement ratio of retirement income from all sources will provide the same after-tax income in retirement as while working; the exact ratio depends on income level. Since inflation erodes the purchasing power of pensions, a pension initially providing the same after-tax income initially will fall short over time. To protect pension purchasing power, the current UCRP plan design has a Cost-of-Living Adjustment provision, as do the New Tier design options proposed by the Task Force.

It is important to note that Social Security's benefit formula provides a higher ratio of replacement income for those at lower pre-retirement income levels. For low-income UCRP retirees with a long career retiring at age 65, total retirement income may exceed 100% when Social Security and UCRP income are combined.

It has been standard guidance in retirement planning that there are three sources of retirement income: Social Security, personal savings, and employer pension income. Social Security is a base retirement income (highest for lower earners) that an employee could build on with personal savings and any pension from an employer. Social Security, when combined with a UCRP pension and personal savings, can provide adequate retirement income. For higher earners, Social Security alone provides a very low percent of income replacement.

Employers seeking to provide retirement income that replaces a level percentage of pre-retirement income for all employees may coordinate their benefits with those provided by Social Security. The Pension Team considered the concept of pension and Social Security combined benefits in developing some of the New Tier designs. The Team developed pension-coordinated designs that evolved from concepts developed by its faculty members. The intent of these design discussions was to develop options, some of which could provide equivalent replacement income from UCRP plus Social Security across all income groups. While there was agreement around some elements of the proposed options, there were mixed views about the age factors, the maximum University

contribution and the level of member contributions. Thus, the Task Force developed and submitted in the Final Report two coordinated New Tier designs for newly hired faculty and staff.

Conclusion: Integrating UCRP benefits with those of Social Security is a cost-effective way to provide an adequate total income replacement ratio across all income levels. The employee can retire comfortably provided that he or she accumulates additional savings while working.

Pension Recommendations

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 for represented employees.

Benefit levels and the member contribution rates modeled in this report are dependent on the specified implementation dates, as approved by The Regents. Variations in the implementation date of the recommendations for a group may impact that group’s benefit levels and member contribution rates.

The Pension Work Team discussed recommendations addressing the primary issues of funding full Normal Cost, dealing with UCRP’s unfunded liability and creating a competitive and sustainable pension plan for new hires. They also considered offering the plan as a less expensive choice²³ for current employees. While not all recommendations have a high immediate budget impact, long-term, they improve the University’s financial position around pension benefits and sustain the program for current and future faculty, staff and retirees.

1. Increase UCRP Contributions More Rapidly.

The Task Force recommends increasing University and member contributions to UCRP for both current employees and new hires more quickly than initially projected to capture dollars from all fund sources and reduce growth of the unfunded liability as shown in the table below.

Recommended University and Member UCRP Contributions

Effective Date	University	Member
July 1, 2011	7%	3.5% (less \$19)
July 1, 2012	10%	5.0% (less \$19)
July 1, 2013	2% additional per year	Choice

Safety member²⁴ rate: July 1, 2011: 4.5% (less \$19); July 1, 2012: 6% (less \$19)

Raising member contributions to 3.5% in 2011-12 and 5% in 2012-13 adds more funding into UCRP sooner. Starting in 2013, member contributions would be based on their choice between the current UCRP plan and the New Tier (provided the University is successful in its discussions with the Internal Revenue service concerning the tax issue.) However, a more rapid increase in member contributions represents a substantial impact on the Total Remuneration²⁵ of current employees, varying by workforce segment. It also is problematic for the University, raising employer contributions to 23% by 2018-19.

²³ Assuming a favorable response to the tax issue from the Internal Revenue Service (see footnote 28, page 32).

²⁴ Safety Members: UCRP members who are appointed to eligible police or firefighter positions.

²⁵ Total Remuneration: The market measure of the dollar value of cash compensation, health, welfare and retirement benefits to faculty and staff.

One of the expected and predictable results of the collective bargaining process is that there will be uneven or lagging start times for increased employee contributions to UCRP. Some faculty representatives advised that the Academic Senate has stated that full contributions should be paid, regardless of the employee group. The Pension Work Team concurred with the view that the key principle in resolving this issue should be one of equity; namely, members who receive the same UCRP benefit should ultimately contribute the same amount for the benefit. The administration, amount and timing of implementation should be determined through the collective bargaining process for represented employees.

2. **Provide Predictable Contribution Levels** for the University and UCRP members. Projecting and publicizing the proposed UCRP contribution levels well in advance of implementation allows members and University departments time to plan for them.

3. **Implement a New Tier Defined Benefit Plan for Faculty and Staff Hired on or after July 1, 2013.**

Task Force Points of Consensus for New Tier Design

The Pension Team considered multiple designs, narrowing them down to four alternatives. Each of the designs had common features, including shifting the minimum age factor to 55 and the maximum to 65 (from 50 and 60). Two designs were integrated with Social Security and two designs had a common age factor across all salary levels, similar to UCRP today. Ultimately, the designs similar to UCRP were not recommended by the Steering Committee because they did not reduce the total long-term Normal Cost significantly below the current 17.6% of covered salary (around \$1.4 billion annually). The two designs that were advanced integrate the UCRP benefit with a career employee's Social Security benefit so that the total combined benefit replaces roughly the same ratio of pre-retirement income across all salary levels in a cost-effective way. The Pension Team did not target a specific income replacement ratio under this integrated approach, however. The integrated concept designs were structured, wherever possible, to mirror the current UCRP benefit in areas such as reciprocity, disability benefits, and vesting, while shifting the age factors for better coordination with Social Security.

The Team agreed on what current design features should be eliminated. They did not reach general agreement on specifics of the benefit formula or contribution rates.

After extensive discussion and analysis over several meetings, the Pension Team reached consensus on the following design features of a New Hire Defined Benefit tier:

New Tier Design Features

Provision	Agreed-upon Design Features Common to All New Tier Options
Overall	New Tier within UCRP effective for new hires July 1, 2013 and later for non-Safety members (See footnote 24, page 31 for definition of Safety member.).
Reduction for early retirement	5.6% per year; same as current UCRP reduction
HAPC ²⁶	36 consecutive months; same as current UCRP
Maximum Benefit	100%, same as current UCRP
Vesting	5 years; same as current UCRP
Post-Retirement COLA	Cost-of-Living-Adjustment up to 2% per year, based on inflation; ad hoc increases to retain 80% of original purchasing power
Disability Benefits	Included; same as current UCRP (subject to review by administration)
CalPERS Reciprocity ²⁷	Included; same as current UCRP
Choice ²⁸	Offer current UCRP members a one-time choice between applying the New Tier to their future service or remaining under the current UCRP terms with a higher member contribution starting in 2013.
CURRENT FEATURES NOT INCLUDED in the NEW TIER DESIGNS	<ul style="list-style-type: none"> ▪ Lump sum cash out ▪ Inactive member cost-of-living increase ▪ Subsidized survivor benefits ▪ Social Security supplement²⁹ ▪ \$133 offset to HAPC ▪ \$19 offset to member contributions.

²⁶ HAPC or Highest Average Plan Compensation is the eligible earnings, or UCRP covered compensation, averaged over 36 consecutive months. It is used to calculate UCRP pension benefits.

²⁷ Reciprocity: Agreements between pension plans to coordinate benefit calculations.

²⁸ The University is working with the Internal Revenue Service to determine whether offering employees a choice between the two options will result in inclusion of employee contributions in gross income. The Office of the General Counsel believes it is possible that the IRS will provide assurance that the employee contributions will retain their pretax status but if the IRS does not, current UCRP members will stay in UCRP under the current terms with a higher employee contribution rate. Employees newly hired on or after the recommended effective date of the New Tier, 7/1/13, will be placed in the New Tier option.

²⁹ Social Security Supplement: Members with Social Security who retire before age 65 receive a temporary supplement from UCRP, paid through the month of their 65th birthday (or through the month of death, if earlier). This supplement temporarily restores the \$133 reduction applied to a member's Highest Average Plan Compensation (HAPC) to account for the University's contributions to Social Security. The supplement is calculated as follows: Benefit percentage x \$133 = monthly temporary supplement (not to exceed \$133.)

Options for the New Tier within UCRP begin with the basic current structure of UCRP. Like current UCRP, the new tier would:

- Multiply an age factor times the years of service credit times Highest Average Plan Compensation (HAPC), the highest average covered compensation³⁰ over a consecutive 36-month period, to determine the Basic Retirement Income;
- Limit the Basic Retirement Income to no more than 100 percent of HAPC (total pension would be UCRP Basic Retirement Income plus Social Security plus any other sources of income available to the member);
- Provide Disability Benefits, though these might be provided outside UCRP, a decision that the Task Force deferred to the administration;
- Provide Cost-of-Living-Adjustments (COLAs) to retirees; and
- Allow retirees to designate an individual to receive benefits after the death of the retiree, subject to a reduction in the pension paid to the retiree.

The New Tier would make the following changes in the current benefit structure of UCRP:

- No choice of a Lump-Sum Cashout (LSC); retirees must take the pension as monthly income;
- No Inactive COLA, which provides an inflation adjustment to HAPC for individuals who leave UC employment but retire at a later point;
- No free survivor benefit. Currently, UCRP provides a partial survivor benefit to spouses or domestic partners who survive the retiree, without an actuarial reduction in the pension paid to the retiree. The retiree may still choose to provide an additional survivor benefit, subject to an actuarial reduction in the pension paid to the retiree;
- Replace the current retiree COLA provision with the following: each year, a retiree receives a COLA consisting of the lesser of inflation, or 2%, with a guarantee that purchasing power will never fall below 80% of the initial purchasing power;
- No temporary Social Security supplement for retirees under age 65 to replace the \$133 offset to HAPC; no \$19 per month offset to member contributions. This is a modest increase in benefits and member contributions.

³⁰ See footnote 4, page 11.

Currently, UCRP members are eligible to retire at age 50, with age factors rising from 1.1% at age 50 to 2.5% at age 60. The design would shift the minimum retirement eligibility age to 55, with age factors rising from age 55 to 65; the 5.6% reductions in age factors for retirement at ages 55 to 64 are the same as the reductions applied at ages 50 to 59 under the current UCRP formula.

The Pension Work Team considered multiple New Tier designs, focusing on four, without delivering a recommendation on any single plan. Two designs were structured to take Social Security benefits into account and two designs had a uniform age factor, similar to the current UCRP design. One New Tier, integrated with Social Security, was designed to provide roughly the same percentage of replacement income after a full UC career (when combined with Social Security) across all salary levels. But, since the age factor is applied to covered compensation, an amount that excludes such pay as staff overtime, faculty summer salary and a large part of health science faculty income, employees with substantial non-covered income will need additional savings to replace their pre-retirement income. For those employees at higher salaries, a higher employee contribution would be required to provide a UCRP benefit that would attain this goal. While the Pension Team agreed on many common design features of a New Tier, there was not a consensus among the Task Force members on the appropriate long-term employer Normal Cost or the minimum age factor.

New Tier Integrated Plan Designs

New Hire Benefit Formula	Estimated Long-Term Total Normal Cost	Member Contribution Rate(s)	Estimated Long-Term Employer Normal Cost
A: 1.5%/3.0%	11.9%	3.5% / 9.5%	7.3%
B: 2.0%/3.0%	13.8%	4.0% / 8.2%	9.0%*

**If Long-term Employer Normal Cost is changed to 8%, then members contribute the difference (i.e., additional 1% is added to Member Contribution Rate(s)).*

Design Features:

- (A) Age Factor and contribution
 Member contribution 1.5% of HAPC below Social Security Covered Compensation³¹; 3.5%
 Member contribution 3.0% of HAPC above Social Security Covered Compensation; 9.5% contribution
 Maximum Accrual Factor – 2.50% of all Highest Average Plan Compensation
- (B) Age Factor and contribution
 Member contribution 2.0% of HAPC below SS Covered Compensation; 4% contribution
 Member contribution 3.0% of HAPC above SS Covered Comp; 8.2% contribution
 Maximum Accrual Factor – 2.50% of all Highest Average Plan Compensation

Results are from New Tier forecast for new hires only. Based on current UCRP actuarial assumptions. Exception: new retirement rates developed by Deloitte and Segal that assume later retirements than current UCRP assumptions.

³¹ Social Security Covered Compensation: For each year, the average Social Security wage base for the 35 years ending in that year. Each year, the amount is adjusted for inflation.

The benefit formula under both plan designs multiplies the age factor x UCRP service credit x HAPC. Both designs would limit the total retirement benefit to 2.5% of HAPC. The benefit formulas under designs A and B are meant to provide a relatively level pre-retirement replacement income for all income levels so one age factor applies for HAPC up to the Social Security Covered Compensation (currently about \$60,000, and growing roughly with average US wages) and another for HAPC above it. To provide the same after-tax income, the employee will need additional savings to maintain a constant standard of living as inflation erodes the value of the UCRP pension. A cost-of-living adjustment is included in the design to help mitigate the impact of inflation.

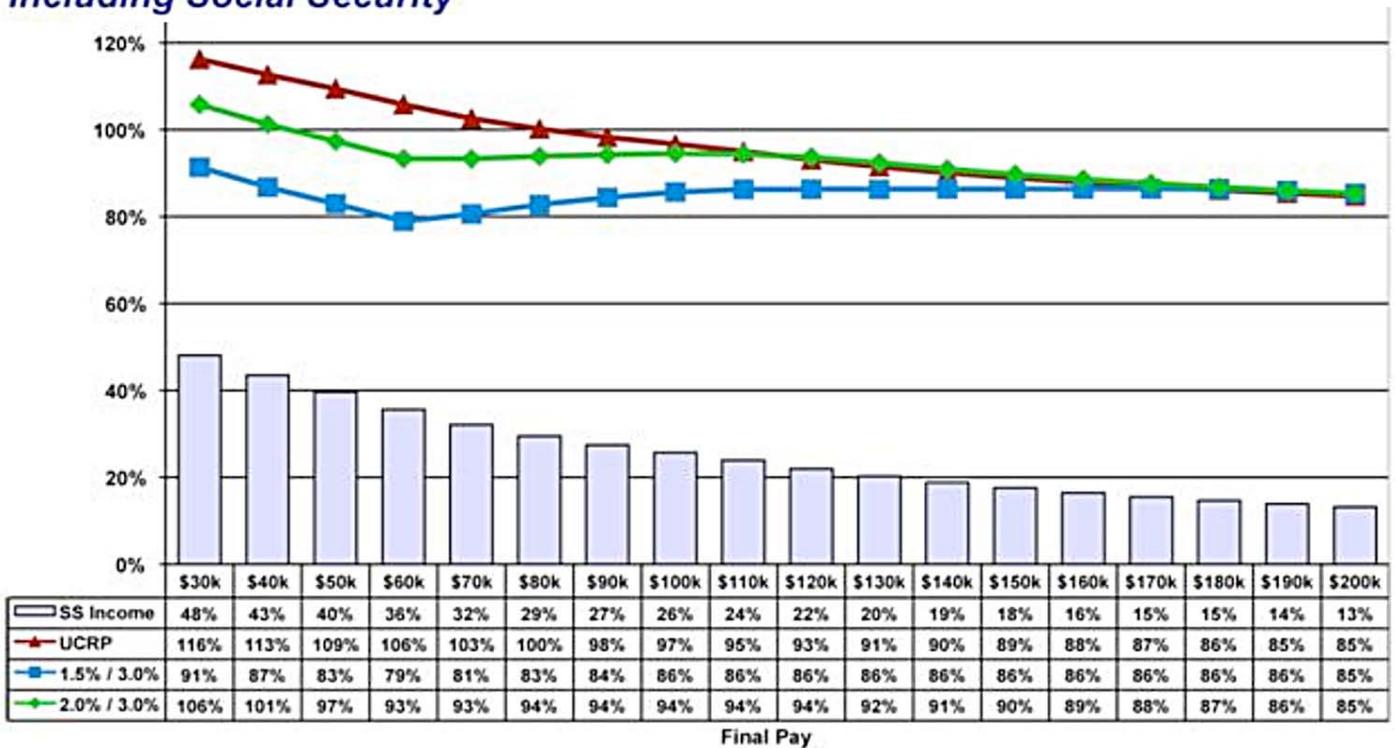
Plan design A adopts a formula that provides a benefit at age 65 of 1.5% of HAPC up to the Social Security covered compensation and 3.0% above that amount (currently approximately \$60,000 and increasing on an annual basis). Under Plan design A, income replacement for an employee at age 65 with 30 years of service and final salary \$60,000 is 79% when combined with Social Security income.

At age 65, Pension design B would provide a benefit of 2.0% of HAPC up to the Social Security covered compensation and 3.0% above that amount. Plan design B reduces the dip in income replacement at around \$60,000 salary present in Plan design A. For example, for an employee at age 65 with 30 years of service, Plan design B provides after-tax income replacement (when combined with Social Security) greater than 90% of pre-retirement income to employees with a final salary of \$60,000. For employees with a final salary under \$40,000, the combined benefit exceeds 100%.

The following chart shows income replacement at various levels of pre-retirement income under the current UCRP plan and for the proposed New Tier options.

Income Replacement Levels³² – Social Security plus Current UCRP, Proposed New Tier Designs

Pay Replacement at Age 65, 30 Years of Service, Including Social Security



Example by Segal Consulting, actuary to The Regents

NOTE: Calculations assume retirement in 2010 and past salary increases of 4% per year. There is a slight reduction in Social Security benefits for early retirement under the program. Since the Social Security Covered Compensation is adjusted for inflation each year, results would change in future years.

- The blue columns show the percent of Social Security replacement income.
- The red line with triangles shows the percent of total replacement income from Social Security plus the current UCRP.
- The blue line with squares shows the percent of total replacement income from Social Security plus the New Tier design option A.
- The green line with diamonds shows the percent of total replacement income from Social Security plus the New Tier design option B.

³² Aon Consulting also did an income replacement analysis. Their 2008 Replacement Ratio Study is available at: <http://www.aon.com/about-aon/intellectual-capital/attachments/human-capital-consulting/RRStudy070308.pdf>

Examples of Retirement Income under New Tier Integrated Designs

At age 65 with 30 years UCRP service credit and an HAPC of \$60,000.

Design	Age factor	Years of service	HAPC (annual)	HAPC (monthly)	Monthly pension	% of Monthly HAPC
A	1.5% of HAPC \leq \$60,000* 3.0% of HAPC > \$60,000	30	\$60,000	\$5,000	(1.5% x 30 x \$5,000) \$2,250	45%
B	2.0% of HAPC \leq \$60,000* 3.0% of HAPC > \$60,000	30	\$60,000	\$5,000	(2% x 30 x \$5,000) \$3,000	60%

At age 65 with 30 years UCRP service credit and an HAPC of \$100,000.

Design	Age factor	Years of service	HAPC (annual)	HAPC (monthly)	Monthly pension	% of Monthly HAPC
A	1.5% of HAPC \leq \$60,000* + 3.0% of HAPC > \$60,000	30	\$100,000	\$8,333	(1.5% x 30 x \$5,000) + (3% x 30 x \$3,333) \$5,250	63% (2.1% overall factor)
B	2.0% of HAPC \leq \$60,000* + 3.0% of HAPC > \$60,000	30	\$100,000	\$8,333	(2% x 30 x \$5,000) + (3% x 30 x \$3,333) \$6,000	72% (2.4% overall factor)

*First factor is applied to HAPC up to Social Security Covered Compensation (~\$60,000); second factor is applied to HAPC above it. Illustration assumes level salary over a three-year period.

Implementing a New Tier does not change UCRP's current unfunded liability, but because these recommendations fully fund Normal Cost for new hires, they do limit its growth and help stabilize the UCRP funding status so that future contributions and investment returns will help return the plan to a fully funded status over the long term. Implementing the New Tier Plan Design A with a 7.3% employer long-term Normal Cost reduces UCRP's costs by an estimated \$20 billion between 2013 and 2038; Plan Design B, with a 9% employer long-term Normal Cost, reduces plan costs by around \$13 billion. The lower employer Normal Cost for new hires saves money that will reduce pressure on operating budgets as the University seeks to amortize the unfunded liability. These new designs increase retention in some workforce segments (since they encourage later retirement and better

coordinate with Social Security and Medicare eligibility ages). Other employees in other workforce segments may consider leaving the University because of a reduction in the value of these benefits. Following the initial total remuneration analysis of Plan design A, the Steering Committee discussed the merits of other design variations with different long-term employer Normal Costs.

These discussions sharply focused some of the critical path issues – namely, **Market Competitiveness** and **Employer Cost** – issues the Task Force has sought to address since its inception. As the Steering Committee completed the final phases of these deliberations, the issue of **Risk Valuation** also required additional discussion and delineation perspectives.

Market Competitiveness

The Finance Team asked the Pension Team to develop a plan for new hires with an employer Normal Cost of 7%. After additional analysis by the Pension Team, some of the participating Academic Senate members of the Steering Committee and Pension Team believed that the 7% employer contribution level produced retirement benefits too far below competitor employers and that the employee contributions needed to achieve a 7% employer long-term Normal Cost were uncomfortably high. As a result, the Pension Team recommended analyzing the market competitiveness of a plan with a 7.3% employer Normal Cost (Plan design A).

In 2005 The Regents committed to a goal of market-competitive total remuneration for faculty and staff and adopted the goals of obtaining, prioritizing, and directing funds, to the extent available, to increase salaries to achieve market comparability for all groups of employees over the ten-year period from 2006-2007 through 2015- 2016. In 2005, UC retained Mercer and since 2007, both Hewitt Consulting and Mercer, to do periodic Total Remuneration studies. Hewitt and Mercer applied the same industry-standard methodology used in their previous work for the University to assess the market-competitiveness of Plan design A, and found that it is non-competitive across virtually all employee groups which was an unanticipated set of results in the Task Force deliberations.

The non-competitiveness of the plan designs, as depicted by the total remuneration studies, caused some members of the Steering Committee and Pension Team to reassess Plan Designs A and B in favor of plans that more closely resemble the current UCRP design with uniform age factors across all salary levels. Some Steering Committee members expressed doubt about the total remuneration results, noting that the market comparator benefit information is two years old and that there is a clear national trend in reduction in retirement benefits. Current lagging UC salaries also adversely lower the value of any pension plan since the benefit calculation in part depends on the employee's pre-

retirement salary, although Options A and B still were below competitor plans when lower salaries were taken into account. A number of Steering Committee members felt that there was some economic value of a defined benefit plan compared with a defined contribution plan as a result of the employer's assuming the risk of market fluctuations and continuing to pay an earned pension benefit in up or down markets. Other Steering Committee members felt this risk-assumption was contained in the total remuneration calculations. No agreement could be reached on this important issue.

Based on Steering Committee discussions of the total remuneration analysis, the Chair of the Steering Committee asked a small group of Senate and administration members of the Task Force to develop additional plan designs that would be more competitive and closer to market under current salary levels. This small work group considered two options that have uniform age factors of 2.0% and 2.5%, respectively. Ultimately, the Steering Committee did not recommend these uniform age factor designs because they did not reduce the total long-term Normal Cost significantly below the current level.

For our purposes, the total remuneration analysis of the integrated Plan designs A and B underscore one well-known and long-standing fact: – that cash compensation lags for almost all workforce segments of the University, and for the Faculty in particular, make these two integrated designs less competitive – also true for the two other plans that more closely resembled the current UCRP that were considered. The impact of the recommended increases in member contribution rates on the market-competitiveness of UC total remuneration needs to be considered as well. If during the next two years, the recommended increases in member contribution rates are implemented and no salary increases are provided, the market competitive position of total remuneration for faculty and staff will continue to deteriorate. These historic and systemic salary lags have had and will continue to have a substantial negative impact on the competitiveness of any pension design. Addressing the issue of cash compensation is critical. There are a number of existing policies and approaches that could respond to the salary lags, if they are adopted and adhered to without interruption or deferral. To accomplish this, targeting cash compensation at the 50th percentile of comparator markets, performance-based pay and predictable salary range adjustments will need to be reinstated as our practice and commitment. While not part of the Task Force Charge, the Steering Committee strongly believes that the cash compensation lags must be addressed as a matter of great urgency for the future excellence of the University. The steady reductions in State funding for UC have prevented market-competitive salary increases for all groups, but the Steering Committee recommends that the Regents reconfirm that higher salaries are a priority as soon as funds are available. (A full

description of the results of the Total Remuneration Study for the designs that were accepted for inclusion in this section can be found in Appendix H of this report.)

Employer Cost

This issue has been a central consideration in the Steering Committee discussions and the Task Force Work Teams. Specific and detailed financing strategies are described in the Finance section of the full report.

The question addressed is what the University can afford to support the long-term cost of the pension options. The Steering Committee recommends that long-term employer Normal Cost should be within a range of 7.3% and 9%, as reflected in Plan designs A and B. The Steering Committee reached consensus on the parameters of the cost range, but did not reach consensus on which end of the range it preferred. These parameters are the upper and lower employer cost limits that the Steering Committee forwarded to frame future consultation and discussion of the integrated Plan designs A and B with the President.

Risk Valuation Analysis

Following the total remuneration analysis, the Steering Committee discussed the merits of various plan designs, and discussed quantifying the risks and institutional benefits presented to an employer offering a Defined Benefit plan. Several members of the Steering Committee believe that the Total Remuneration methodology does not adequately value the investment risk assumed by the employer in a DB plan. Other Steering Committee members noted that investment risk is explicitly recognized by a risk adjustment in determining the actuarial assumed 7.5% rate of return, and suggested a specific methodology for determining the risk-adjusted value of the benefits to employees that also supports the 7.5% assumption.

At the request of the Steering Committee Chair, two small groups from the Task Force – faculty and administration members – met separately to draft descriptions of the two differing views on this topic, and attempted to determine a methodology for valuing UC's assuming the risk (either positive or negative) inherent in a Defined Benefits plan that guarantees a pension payment regardless of market performance). These narratives can be found in Appendix S. These concepts have not been discussed or analyzed by the Steering Committee or the Work Teams of the Task Force. They are included in the Final Report as a starting point for discussions during the next phases of review, discussion and decision-making in the PEB work.

As Post-Employment Benefits Steering Committee discussions revealed, there is an interdependency of these issues since they influence other questions such as workforce behavior or workforce

segmentation of benefits. For instance, some Steering Committee members expressed the view that more employer pension contributions could be provided to one workforce segment based on their mission-critical status or another workforce segment might prefer “salary dollars” now vs. “benefit dollars” later. The issues of **Market Competitiveness**, **Employer Cost** and **Risk Valuation** have occupied considerable time and attention during the final phases of the Task Force process and will be the starting point for future consultation and discussions among the President, the University community and The Regents.

4. Offer Current UCRP Members Choice

For all service after June 30, 2013, UCRP members as of that date could choose either the current UCRP plan design at a higher member contribution rate or the New Tier for future service (accrued UCRP benefits for past service cannot be reduced).

The Pension Team suggested a 7% member contribution rate to remain in the current UCRP plan design; subsequently, some members of the Steering Committee proposed higher contribution levels. The current UCRP plan design, at a higher contribution rate, would be the default option for those who made no choice.

The University is working with the Internal Revenue Service to determine whether offering employees a choice between the two options will result in inclusion of employee contributions in gross income. The Office of the General Counsel believes it is possible that the IRS will provide assurance that the employee contributions will retain their pretax status but if the IRS does not, current UCRP members will stay in UCRP under the current terms with a higher employee contribution rate. Employees newly hired on or after the recommended effective date of the New Tier, 7/1/13, will be placed in the New Tier option.

5. Explore a Defined Contribution Option for the Clinical Enterprises

At the request of the Clinical Enterprise leadership, the Task Force recommends a study of the feasibility of also offering a Defined Contribution option (in addition to the New Tier) for the Clinical Enterprises since market studies show this plan type as the norm for their comparator groups. Such a plan also might assist in recruiting key workforce segments. As with the recommended New Tier, the program’s total employer cost would be fully funded from the beginning and would not impact UCRP’s unfunded liability.

Any new plan for the Clinical Enterprises will need to recognize their appropriate share of the existing unfunded pension liability and include a payroll assessment for the amortized amount. The ability of the Clinical Enterprises to fund a market-competitive plan, in addition to an assessment for their existing unfunded liability, would be part of the analysis.

Other Pension Considerations and Recommendations

6. **Safety Members**³³. Within the context of collective bargaining and total remuneration strategy for University Safety personnel, monitor competitive Safety member contribution rate and retirement age ranges with appropriate market competitors; in the future, review possible changes to the 3% at age 50 formula.

7. **UC PERS Plus 5 Plan**³⁴: For these annuitants, an ad hoc COLA should be implemented to bring them to their UCRP peer equivalent. In addition, an annual COLA provision should be implemented using the equivalent UCRP COLA formula, and paid annually, as long as PERS plus 5 funds are available. **The PERS plus 5 Plan is not part of UCRP and the PERS plus 5 Plan assets cannot be used for any purpose other than paying PERS Plus 5 benefits and administrative expenses.** (These recommendations reduce the current PERS plus 5 funded status to approximately 129%).

Steering Committee Pension Considerations and Recommendations

The Steering Committee reviewed and discussed other Post-Employment Benefit program issues that apply specifically to highly compensated University faculty, senior managers and executives.

The 415(m) Restoration Plan

This plan has been in effect since January 1, 2000. Recipients are primarily long-service faculty and senior managers. Internal Revenue Code §415(b) limits the dollar value of the annual benefit that can be paid from a tax-qualified Defined Benefit plan such as UCRP. The current limit is \$195,000 for individuals who retire at age 62 or later and is adjusted for inflation. The annual limit is lower for retirement at younger ages.

³³ See footnote 24, page 31.

³⁴ Retired members of the University of California Voluntary Early Retirement Incentive Program (the PERS Plus 5 Plan or Plan) were members of PERS while employed at UC who elected concurrent early retirement under PERS and the PERS Plus 5 Plan effective October 1, 1991, who now receive lifetime supplemental retirement income and survivor benefits from the Plan.

However, the Internal Revenue Code also expressly authorizes public pension plans, such as UCRP, to establish an excess benefit plan such as the UC 415(m) Restoration Plan that provides the difference between the UCRP benefit paid at the Section 415 limit and the benefit that would be paid if the limit did not apply. The University's 415(m) Restoration Plan primarily benefits employees who have long service in addition to high income. Without the University 415(m) Restoration Plan, some long-service faculty and administrators would reach the maximum pension benefit in their 50s, creating potential retention problems.

415(m) Restoration Plan benefits are not paid from UCRP or funded through a separate trust. Instead, employing departments pay a quarterly assessment. The 415(m) Restoration Plan benefit generally is paid as a supplemental monthly retirement income. If a member chooses a lump-sum cashout under UCRP, the restoration benefit is paid as a 10-year annuity. (If this benefit has a present value of \$35,000 or less, it is paid as a lump sum.) About \$17 million of the University's general assets are earmarked for the 415(m) Restoration Plan; projected liabilities are about \$90 million. About 200 retirees now receive 415(m) benefits of about \$5 million/year. In the next ten years, up to 1,000 members are projected to be eligible.

The Steering Committee discussed eliminating restoration of the limited amount of the lump sum option effective July 1, 2013 for all new hires and UCRP members who are not eligible to retire as of the effective date of the change. The group also discussed alternatives for managing the unfunded liability. The Steering Committee recommends that:

8. The UC 415(m) Restoration Plan be continued, but providing restoration benefits when the lump sum cashout option is chosen under UCRP be discontinued for new hires and for those not eligible to retire as of the effective date of the change.
9. Strategies should be developed to address the unfunded liability of employing departments for future payments under the 415(m) Restoration Plan, with some flexibility based on the current funding methods used by campuses. Campuses should pay both the Normal Cost and an amortization payment on the unfunded liability for the 415(m) Restoration plan.

UCRP 401(a)(17) Restoration Benefits

The Internal Revenue Code Section 401(a) (17) limits the amount of covered compensation that can be included in calculating a UCRP member's benefits. Currently, the limits are \$360,000 for grandfathered employees hired before July 1, 1994 and \$245,000 for all others; the limits are adjusted annually for inflation. The limits affect highly compensated individuals, regardless of length

of service. About 250 current UCRP members have covered compensation over the applicable limits.

The President's charge to the Task Force was to consider whether it would be appropriate to implement a program under UCRP to restore some part or all of the benefits lost by the application of the 401(a)(17) limit. It would apply primarily to Health Science Faculty³⁵, the Senior Management group and other executives. Recognizing that deferred compensation benefits are critical to attracting the most highly qualified executive staff, the Steering Committee (with dissenting opinions from the Academic Senate members) recommends:

10. Establish a benefit restoration formula under UCRP that applies a uniform compensation cap set at the grandfathered employee level for all faculty and staff to be effective as of the prospective effective date established for plan changes.
11. Develop non-pension options for local use to address the impact on benefits attributable to salary above the uniform compensation limit.

Senior Management Supplemental Benefit Program

This program for the Senior Management Group has been in the University community dialogue on Post-Employment Benefits mistakenly linked to UCRP. This benefit is not funded by UCRP in any way. This Post-Employment Benefit is a retirement savings vehicle. It was instituted to address issues of non-competitive compensation and the at-will employment status of senior managers. There are about 200 participants with an annual cost of \$2.5 million. The Steering Committee concludes that this program should be eliminated and that other compensation solutions should be developed and adopted to address these issues for senior managers. An immediate and comprehensive assessment should be undertaken by UC administration to resolve severance issues.

³⁵ Health Science faculty have academic appointments in a health science school which include such departments as Medicine, Nursing, Dentistry, Pharmacy.

Retiree Health Work Team

Retiree Health Background

This separate Post-Employment Benefit began in 1962 with a \$5 per month University contribution. Based on a Regents' delegation to the President, University administration designs and annually negotiates plan and rate changes in close consultation with the Academic Senate. Plan options, benefits and rates are subject to change each year and are not a vested³⁶ benefit such as accrued pension benefits. Periodically, the University has changed the Retiree Health benefit and eligibility for it. The University believes that providing Retiree Health benefits is critical to the long-term recruitment and retention of quality faculty and staff, in addition to sustaining its commitment to current retirees. The value of these programs is also underscored by the roles and contribution that emeriti and staff retirees continue to provide to the University mission long after they have left active UC service and appointments. A report detailing the contributions of emeriti can be found in Appendix G of the full report, "UC Emeriti Bibliographic Survey 2007-2009". The Task Force strongly recommends that the University continue to provide Retiree Health benefits in support of the recruitment, retention and continued service aims of the University.

The program now covers over 35,000 UC retirees and 18,000 family members. The 2009/2010 annual cost is around \$250 million. Another active 27,000 faculty and staff have earned eligibility for Retiree Health benefits under the current program (at least age 50 with 10 or more years of UCRP service credit). Eligible individuals who retire from UC with a monthly pension have the same coverage options as active members. If a retiree or family member is eligible for Medicare, Medicare is the primary coverage and the University plan is secondary. University policy requires eligible retirees to enroll in Medicare.

Eligible faculty and staff who retire receive a University contribution amount based on their date of hire, age and years of UCRP service credit.

- Those hired after 1990 are eligible for a University contribution to health premiums on a sliding scale based on years of service.
 - The minimum requirement for 50% of the maximum University contribution is age 50 with 10 years of UCRP service credit. Each additional year of service adds 5% to the University contribution.
 - At age 50 or older with 20 or more years of UCRP service credit, a retiree receives 100% of the maximum University contribution.

³⁶ See footnote 19, page 24.

- Those hired before 1990 who are at least age 50 with 10 years of UCRP service credit or age 55 with 5 years of UCRP service credit receive 100% of the maximum University contribution.

In 2003, the University began to examine the implications of the Government Accounting Standards Board Statement (GASB 45) that, beginning in 2005, required public employers to include their retiree health plan unfunded liability in their annual accounting as they do for unfunded pension liability. The University has been calculating this liability since 2003. In 2007, the liability was included in a footnote on the financials and in 2008 and it was fully reported and accounted for as a balance sheet obligation in accordance with the GASB 45 requirement. As part of a longer-term strategy, The Regents created a trust under IRC §115 in November 2007 that could be used to pre-fund the Retiree Health program at a future date. Currently, pay-as-you-go contributions flow through the trust. Effective January 2010, the University also began implementing a strategy for equivalent premium contributions for faculty, staff and retirees with and without Medicare. In 2010, this resulted in an average University contribution of 89% of the total premium cost for retirees.

Process, Other Considerations and Conclusions

The Work Team began with a review of current policies and benefits, as well as changes that had been considered earlier by other University committees – some of which folded into the ongoing discussions. They considered changes in minimum eligibility, a revised graduated eligibility schedule, the University's group premium rate and contribution strategies, what groups should be protected from future contribution policy changes and the impact of changes on workforce behavior. Options were developed based on a Finance Team request to target a long-term Retiree Health Normal Cost in the 3% - 4% range.

Current Financing

Retiree Health program cost is included in the University's operating budget on a pay-as-you-go basis. Retiree health benefits are ***not*** paid from the UCRP trust. For 2010, campuses and medical centers are assessed \$3.12 per \$100 of covered payroll, covering only the pay-as-you-go cost (the University's annual share of premiums). This cost will increase to \$3.31 in 2011. No contributions are being made towards the unfunded liability.

Benchmarking

To help frame discussions, the Team looked at other States' responses to retiree health program liabilities. The Deloitte consulting firm summarized an early 2008 study, showing that many states

had made recent changes and others planned to do so. Their findings are summarized in the following chart.

Retiree Health Benefits at the States – 2008*

Medical Plan Premium-Sharing & Benefit Design Changes	Changes Made in the Past Five Years	Likely to change over the Next Five Years
Increase Retiree Share of Premiums	66%	76%
Increase Deductible	50%	64%
Increase Co-pay (non-Rx)	56%	68%
Increase Co-pay (Rx)	66%	70%
Increase Coinsurance	26%	50%
Increase Out-of-Pocket Maximum (Limit on total benefits plan pays)	34%	38%

Retiree Health Program Changes	Changes Made in the Past Five Years	Likely to change over the Next Five Years
Catastrophic Plan Plus an Individual Account	8%	14%
Eliminate Prescription Drug Coverage	4%	0%
Increase Age Requirement for Eligibility	6%	20%
Increase Service Requirement for Eligibility	14%	32%

*Results from *Retiree Health Care in the American States* produced by the Center for State and Local Government Excellence.

Deloitte Consulting LLP

Conclusion: Changes in the amount of premium sharing and the age and service requirements for eligibility are consistent with trends in the marketplace.

Graduated Eligibility

The Team considered various options for modifying the sliding scale of eligibility for Retiree Health, looking at multiple combinations of age and service as well as increasing the minimum age for eligibility. The impact of changes on retirement behavior and recruitment and retention also were modeled. The Work Team adopted the view that any eligibility changes should encourage later retirements while remaining competitive and should allow faculty and staff adequate time to prepare for the program change.

Conclusion: Eligibility for Retiree Health should recognize longer University service while still providing access to coverage for early retirees. The benefit also should coordinate with the Medicare eligibility age and the proposed UCRP New Tier implementation. Eligibility changes should be mitigated for certain groups.

UCRP Members Nearing or Eligible for Retirement

This is a large group, roughly 25% of the existing active population; an additional 30% of faculty and staff have age plus UCRP service credit greater than 50. The Team felt that faculty and staff with longer service should be protected. There also were concerns about the ability of those between age 50 and 56 to obtain coverage outside the University and concerns about their ability to readjust retirement planning for large medical premium costs.

Conclusion: There should be some protection for longer-service faculty and staff close to retirement.

Contributions

Changes in premium sharing between the University and its retirees would apply to current and future retirees, thus impacting the program's unfunded liability in the near term. Consequently, this was an area of concentration for the Work Team. The Mercer and Hewitt 2009 Total Remuneration³⁷ study shows that the University's contribution for Retiree Health is substantially above market. Various levels of contribution were modeled, ranging from the current level of 89% down to 58%. The effect on current retirees was discussed in depth, particularly the need to give them adequate planning time for any changes in their cost.

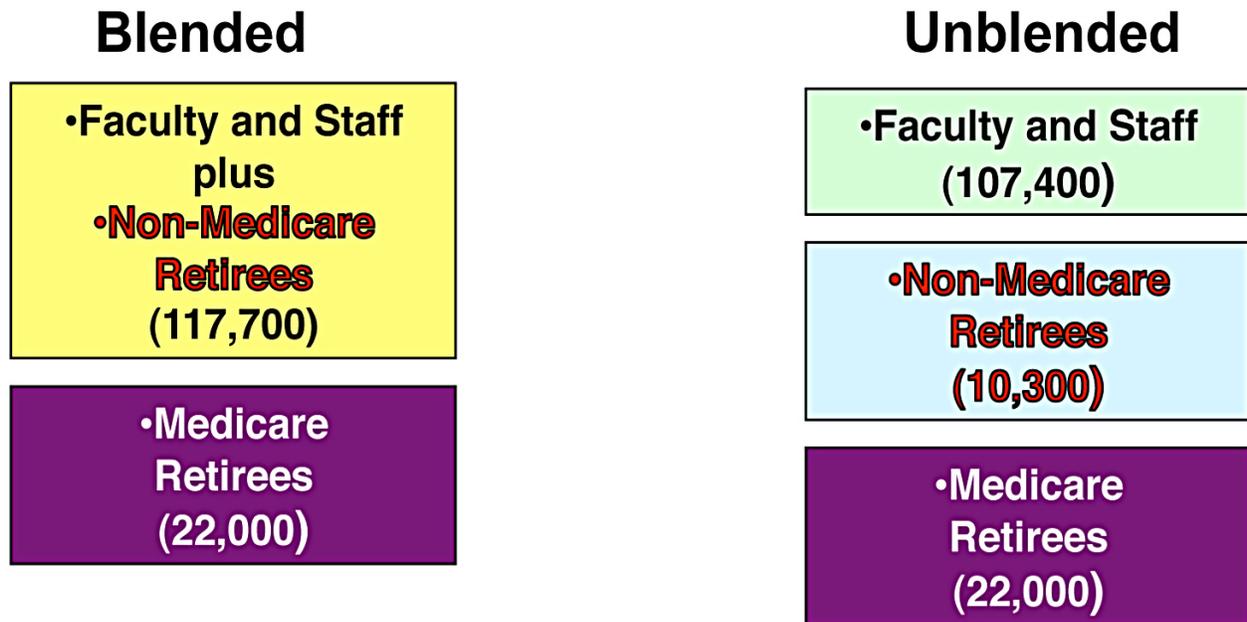
Conclusion: Reduce the unfunded liability by moving the University's contribution towards market norms.

Blended Premiums

A key discussion addressed the current practice of blending faculty and staff premiums with non-Medicare retiree premiums. There are two rating groups for retirees, as shown in the left of the following chart: one for retirees with Medicare, and one that includes faculty, staff and retirees without Medicare.

³⁷ 2009 Update of Total Remuneration Study for Campus and UCOP and Medical Centers, October 2009 – http://www.universityofcalifornia.edu/news/compensation/total_rem_report_nov2009.pdf

Medical Plan Rating Groups



Blending rates creates an implicit subsidy for non-Medicare retirees, costing the University \$50 million in fiscal year 2010. Using unblended rates would create three rating groups shown in the right of the above chart: faculty and staff, retirees with Medicare and retirees without Medicare. Using unblended rates would substantially increase the premiums for retirees without Medicare since their claims costs are approximately 40% higher than faculty and staff and they are a proportionally small group. These retirees also need predictable costs, something hard to achieve if they are moved into a separate rate category given the small size of the group and their higher claims cost. Though changing the current practice by shifting to unblended rates reduces the premiums slightly for actives and minimally reduces the University's cost for its share of their premiums, it creates very limited savings to the unfunded liability and severely impacts retirees who are not eligible for Medicare.

Conclusion: Given the small savings generating by changing the blended premium rating process, the University should consider other options to reduce program costs.

Retirees Age 65 and Older not Eligible for Medicare

In revising eligibility, the Team looked at what categories of members, if any, should be treated differently. The University requires retirees eligible for Medicare to enroll in the program. However, there is a cohort who will not qualify for Medicare since they do not participate in Social Security

through their University employment and will not qualify through other employment or a spouse's eligibility. These are UCRP members who did not choose Social Security when they had the option in the mid-1970's, thus saving themselves and the University money throughout their careers since there were no employer/employee Social Security contributions made for them. Presumably, their only medical plan coverage is through the University. Non-Medicare retirees age 65 and older are a much more expensive group since their medical claims are 40% higher than claims for actives and there is no Medicare subsidy to offset their cost. There are 1,600 retirees over 65 who do not have Medicare and an estimated 8,700 retirees under 65. Of that number, it is estimated that around 15%, or around 1,300 will not be eligible for Medicare through their own outside employment or a spouse's. Another 2,400 faculty and staff do not have Social Security through their University appointments and it is estimated that 50% of that group, 1,200, will not be eligible for Medicare in the future. So, in the group without Medicare there are 1,600 current retirees and, potentially, another 2,500 future retirees.

Conclusion: Because of the substantial financial burden and the fact that this group is diminishing in size over time, the Team supported mitigating the impact of proposed University contribution changes for them.

Members Receiving UCRP Disability Income

These members had their retirement planning interrupted by illness or accident. Because their University careers were cut short, they may be receiving a lower UCRP income than they would have with a normal career path. They also are a relatively small group: 2,157 beneficiaries as of 2009. Currently, a disabled member with at least 5 years or up to 10 years UCRP service credit is eligible for 50% of the University's maximum contribution. Each added year of UCRP service credit adds 5% to the University contribution and, with 20 years of UCRP service credit, the member receives 100% of the maximum available amount³⁸.

The Team noted that there are multiple sources of disability protection – a benefit from UCRP and others within the insurance plans offered in the Health and Welfare programs; and work-related disabilities are covered through the University's Workers' Compensation program. These benefits are complicated and do not always coordinate well.

Conclusion: The administration should undertake a review of all University-provided disability benefits.

³⁸ This is the current graduated eligibility scale used for UCRP members hired after January 1, 1990.

Longer-Service Retirees with Small Pensions

The Task Force considered this issue at the request of the Joint Benefits Committee of the Council of University of California Emeriti Associations (CUCEA) and the Council of University of California Retiree Associations (CUCRA), but found it very difficult to properly define the parameters for determining those to be included in this group because of the inability to assess total household income. One of the questions in the PEB on-line survey of retirees on health care issues asked whether they would be willing to disclose this information and the large majority indicated that they would not wish to provide income information to the University.

Conclusion: The Task Force asked the administration to be aware of this issue as recommendations for the Retiree Health program are implemented.

Retiree Health Recommendations

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 for represented employees.

Benefit levels and the member contribution rates modeled in this report are dependent on the specified implementation dates, as approved by The Regents. Variations in the implementation date of the recommendations for a group may impact that group's benefit levels and member contribution rates.

The Team made a series of recommendations to reduce unfunded liability and long-term Normal Cost for the Retiree Health program. In contrast to the UCRP recommendations, these changes have an immediate impact on both costs, reducing the unfunded liability for Retiree Health from \$14.5 Billion to \$11.8 Billion and the long-term Normal Cost from 7.9% of covered compensation to 4.1%. However, they also have a long phase-in period for current faculty, staff and retirees to allow them to make plans for adjusting to the proposed changes.

12. Change Retiree Health Eligibility.

In recognition of the intent to encourage retirement at a later age, implement a new graduated eligibility formula³⁹ based on age at retirement and years of service that is aligned with the later retirement changes proposed in the New Tier pension design. This formula would multiply an age factor times UCRP service credit to determine the percentage of the University contribution towards health premiums available to a retiree. The formula increases the minimum age for the University contribution and provides a lower contribution for shorter University service.

- Age 50-55 – access to coverage with no University contribution; retirees would pay the full cost of their coverage. Requires at least 10 years of UCRP service credit.
- Age 56 to 65 – graduated contributions based on years of UCRP service credit and age. There are two separate factors and sliding scales in this formula one for age and one for service credit. Multiplying the two factors together determines the level of the University contribution to health premiums:

For example:

- At age 56 and 10 years of service, the UC contribution is 5%.
- At age 65 and 20 years of service, the UC contribution is 100%.

³⁹ Retiree Health program eligibility was last changed January 1, 1990 for new hires.

This chart shows the eligibility factors derived by multiplying the age factor times the service credit factor:

**Recommended Graduated Eligibility Based on Age and Service
Age at Retirement**

Years of Service at Retirement	Current Minimum Age 50	50-55	56	57	58	59	60	61	62	63	64	65
	10	50%	0%	5.0%	10.0%	15.0%	20.0%	25.0%	30.0%	35.0%	40.0%	45.0%
11	55%	0%	5.5%	11.0%	16.5%	22.0%	27.5%	33.0%	35.0%	44.0%	49.5%	55.0%
12	60%	0%	6.0%	12.0%	18.0%	24.0%	30.0%	36.0%	38.5%	48.0%	54.0%	60.0%
13	65%	0%	6.5%	13.0%	19.5%	26.0%	32.5%	39.0%	42.0%	52.0%	58.5%	65.0%
14	70%	0%	7.0%	14.0%	21.0%	28.0%	35.0%	42.0%	49.0%	56.0%	63.0%	70.0%
15	75%	0%	7.5%	15.0%	22.5%	30.0%	37.5%	45.0%	52.5%	60.0%	67.5%	75.0%
16	80%	0%	8.0%	16.0%	24.0%	32.0%	40.0%	48.0%	56.0%	64.0%	72.0%	80.0%
17	85%	0%	8.5%	17.0%	25.5%	34.0%	42.7%	51.0%	59.5%	68.0%	76.5%	85.0%
18	90%	0%	9.0%	18.0%	27.0%	36.0%	45.0%	54.0%	63.0%	72.0%	81.0%	90.0%
19	95%	0%	9.5%	19.0%	28.5%	38.0%	47.5%	57.0%	66.5%	76.0%	85.5%	95.0%
20	100%	0%	10.0%	20.0%	30.0%	40.0%	50.0%	60.0%	70.0%	80.0%	90.0%	100.0%

To find the University contribution for a particular age and number of years UCRP service credit, look down the far left column for the number of years UCRP service credit. Then look across that row to the appropriate age. That will show the amount of the University contribution. Example: with 15 years of UCRP service credit at age 60, the retiree receives 37.5% of the University contribution.

13. Grandfather Some Faculty and Staff under Current Eligibility Rules.

Faculty and staff with age plus UCRP service credit greater than or equal to 50 and at least 5 years UCRP service credit as of July 1, 2013 will remain under the current graduated eligibility rules. The grandfather provision is intended to avoid the unintended consequences of workforce behavior such as creating a wave of retirements by individuals seeking to lock in the current rules. However, changes in the University’s maximum contribution for health coverage would apply to the faculty and staff covered by the grandfather provision.

14. Reduce the University Maximum Contribution to Retiree Health Premiums.

Between 2011 and 2018, reduce the percent of the maximum UC contribution to Retiree Health from about 90% of the premium to a floor of 70% of the premium; retirees would pay the rest. This would apply to all current retirees, as well as to current and newly hired

employees when they retire. The long phase-in period gives retirees, and those nearing retirement, time to plan for the additional cost.

Each year, during the annual health plan renewal process and in the context of overall budget resources, salary adjustments for actives and COLAs for retirees, the administration should reassess the level of the University contribution, the appropriateness of an additional 3% reduction in the contribution and whether the floor should be 70% or a higher amount.

This chart illustrates the proposed changes in University contributions:

Illustration of Gradual Reduction in Maximum UC Contribution towards Retiree Health Plan Premiums

Calendar Year	<i>Maximum University contribution as a % of:</i>	
	Non-Medicare Premiums (blended)	Medicare Premiums
2010	84%	92%
2011	81%	89%
2012	78%	86%
2013	75%	83%
2014	72%	80%
2015	70%	77%
2016	70%	74%
2017	70%	71%
2018	70%	70%

The following table provides a comparative illustration of the premiums retirees may be expected to pay in 2011 under the current contribution policy compared to what retirees would pay in 2011 if the recommended contribution policy were implemented (3% reduction in the University's contribution percentage):

A Comparative Illustration of Retiree 2011 Medical Plan Premiums Using Proposed UC Contribution Changes

Plan	<u>Non-Medicare</u>			
	Single		Two Adults	
	Current Contribution Policy	3% Reduction in Contribution Policy	Current Contribution Policy	3% Reduction in Contribution Policy
Health Net	\$ 76	\$ 95	\$ 210	\$ 249
Kaiser	\$ 62	\$ 71	\$ 135	\$ 156
ABC PPO	\$ 107	\$ 127	\$ 277	\$ 316

Plan	<u>Medicare - Including Part B</u>			
	Single		Two Adults	
	Current Contribution Policy	3% Reduction in Contribution Policy	Current Contribution Policy	3% Reduction in Contribution Policy
Health Net	\$ 3	\$ 21	\$ 6	\$ 42
Kaiser	\$ 0	\$ 0	\$ 0	\$ 0
ABC PPO	\$ 15	\$ 34	\$ 30	\$ 67

These values are based on a projection of the 2010 premiums. The actual 2011 premiums have not yet been determined and may differ substantially from the values shown above. The University's current contribution policy covers approximately 84% of total Non-Medicare retiree premiums (across all plans) and 92% of total Medicare retiree premiums (including Part B). In 2011, the recommended contribution policy would reduce the University's contribution to 81% of total Non-Medicare retiree premiums and 89% of total Medicare retiree premiums.

15. Continue Blended Premiums for Retirees not Eligible for Medicare.

Rates for retirees without Medicare are blended with rates for all actives, continuing an implicit subsidy since claims costs for these retirees are higher. However, they are a relatively small group and rating them as a separate group would dramatically increase the cost and volatility of their health plan premiums. Given this, and the very limited savings from unblended rates, the Task Force recommended continuing the current rating strategy.

16. Protect Retirees Age 65 and Older Who Are Not Eligible for Medicare

As of benefit plan year 2011, provide University contributions for this group at the same level as active employees; thus, this group would not fall under the graduated eligibility schedule proposed in Recommendation #12. The proposed scale *would* apply to faculty and staff who retire before age 65 and do not qualify for Recommendation #13's grandfathering provision.

This is a small, diminishing cohort for whom savings from applying the proposed University contribution scale are minimal. Additionally, they will have a hardship not facing Medicare-eligible retirees because their premiums will not decrease when they reach age 65. Lastly, over many years, this cohort created savings for the University since UC did not have to match Social Security taxes for them during their working career.

17. Continue the Status Quo Eligibility and Contribution Policies for Members Receiving UCRP Disability Income,

The Pension Team recommendation was made subject to a broader review by the administration of all disability benefits.

18. Fund Retiree Health Benefits.

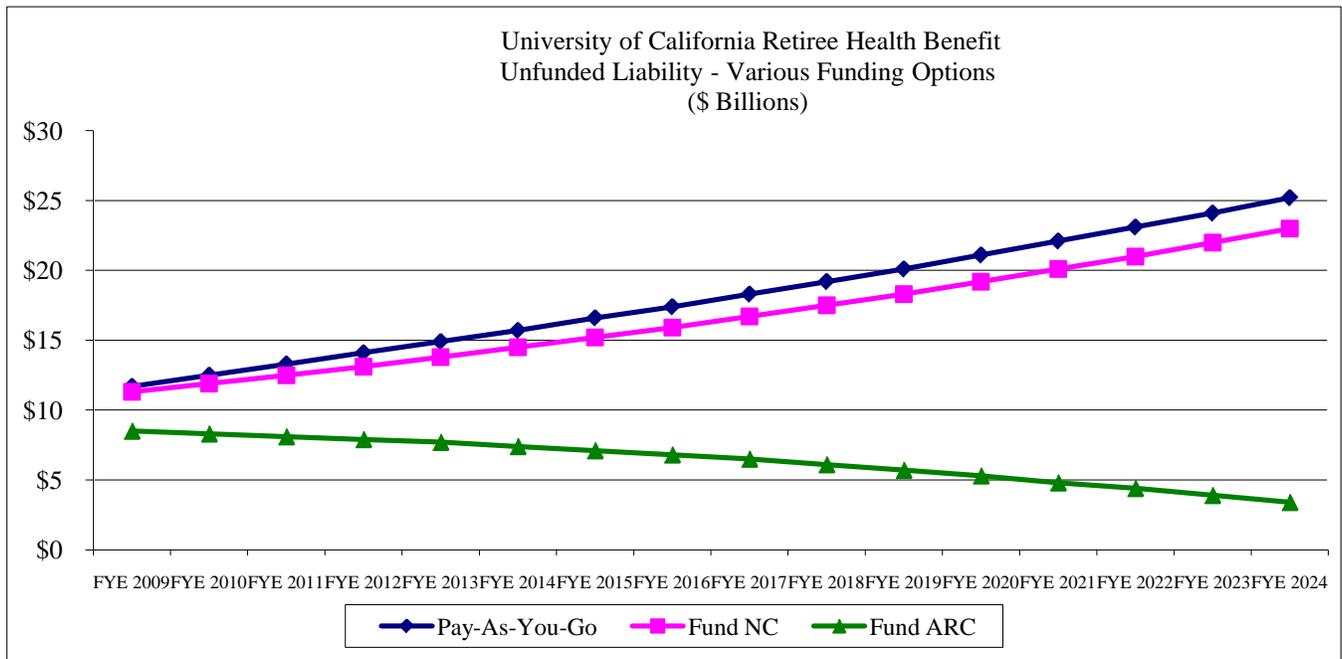
Steps to funding the Retiree Health program were identified: first, fund the Normal Cost; and, long-term, fully fund the program liability by financing the ARC. As an interim funding measure, increase the Retiree Health assessment fee by an amount to be determined by the UCOP Budget Office during a budget planning cycle beginning in FY 2011/2012. The increased fee amount is to be dedicated to funding the Retiree Health program through the Retiree Health Trust.

Fund the Annual Required Contribution (ARC) for Retiree Health once full funding is achieved for UCRP's unfunded liability.

Funding Impact of Retiree Health Recommendations

The effects of continuing the Retiree Health pay-as-you-go-policy, funding Normal Cost or funding ARC are shown in this chart developed by Deloitte (assuming all recommended Retiree Health plan changes are adopted):

Options for Retiree Health Unfunded Liability



Funding only the Normal Cost has minimal impact on the unfunded liability. Paying the full ARC will almost fully fund the Retiree Health program in fifteen years.

- The blue line shows the growth of unfunded Retiree Health liability if the current “pay-as-you-go” strategy is continued. By 2024, the unfunded liability is over \$25 billion.
- The pink line shows that there is a very small impact if the annual Normal Cost is funded but no contribution is made to the unfunded liability. The unfunded liability continues to grow because of interest on the unfunded amount.
- The green line shows that paying the ARC, the Normal Cost plus the amortized cost of the current unfunded liability, results in almost fully funding the program by 2024 (assuming contributions to ARC begin immediately).

The decision to prefund would also have the immediate effect of reducing the liability. This is because investment earnings on those contributions would be assumed to fund a portion of future Retiree Health costs.

The Finance Work Team considered prefunding Retiree Health in the larger context of the UCRP unfunded liability needs and overall University budget planning and made recommendations in this area. (See Finance recommendation #25.) The Retiree Health Work Team concurred with the

recommendation.

Deloitte consultants modeled the impact of the Work Team’s recommended changes using moderate workforce behavior impact assumptions about changes in the ages⁴⁰ at which faculty and staff would retire. The total financial impact is shown in this chart:

Financial Impact of Retiree Health Recommendations

	Actuarial Accrued Liability (% change)	Normal Cost as a % of Pay (% change)	Annual Required Contribution (ARC) (% change)
Baseline	\$14.5 billion	7.9%	\$1.75 billion
Graduated Eligibility	-\$2.7 billion (-18.3%)	-2.4% (-30.1%)	-\$0.37 billion (-21.4%)
Contribution Policy	-\$2.4 billion (-16.6%)	-1.4% (-17.7%)	-\$0.28 billion (-15.9%)
Subtotal A: Savings (graduated eligibility plus contribution policy)	-\$5.1 billion (-34.9%)	-3.8% (-47.8%)	-\$0.65 billion (-37.3%)
Grandfathering	\$2.1 billion (14.2%)	0.9% (11.5%)	\$0.22 billion (12.3%)
Non-Medicare Retiree Over 65	\$0.3 billion (2%)	0.0% (0.3%)	\$0.02 billion (1.3%)
Subtotal B: Reductions in Savings (costs for grandfathering plus protecting non-Medicare retirees over 65)	\$2.4 billion (16.2%)	.9% (11.8%)	\$0.24 billion (13.6%)
Total Net (Subtotal A + B)	\$11.8 billion (-18.7%)	5%* (-36.0%)	\$1.34 billion (-23.7%)

*The short-term Normal Cost impact (a blend of grandfathered retirees, non-Medicare retirees over 65 and all others; long-term Normal Cost is estimated to be 4.1% as the protected groups diminish.

As shown in the baseline, the current unfunded liability for Retiree Health is \$14.5 billion, with a Normal Cost of 7.9% of covered pay and an Annual Required Contribution (ARC) of \$1.75 billion. Implementing the proposed changes in graduated eligibility and the employer contribution policy reduces the unfunded actuarial accrued liability by over \$5 billion or a combined 34.9%. The annual required contribution reduces by 37% to \$0.65 billion. Grandfathering faculty and staff with 5 or more years of service and age plus service equal to or greater than 50 adds \$2.1 billion back into the

⁴⁰ UCRP’s current average staff retirement age is 59.6; the faculty average is 63. The moderate behavioral assumption developed by Deloitte and Segal for purposes of this modeling assumed an average age of 61.8.

unfunded liability, reducing the savings to Normal Cost and ARC. However, the Team believes that providing enough time for those near retirement to plan for these changes outweighs the cost of grandfathering them. The cost impact of providing a different contribution policy for non-Medicare retirees over 65 is small enough, adding \$0.3 billion back into the unfunded liability, that the Team did not feel reduced University contributions was worth the hardship for this group.

Even with these changes, UC's Retiree Health benefit remains more than competitive and some might argue for further reductions in the value of Retiree Health benefits. However, these reductions were reviewed by the Task Force in the context of all the other changes and reduction in the PEB designs. The Task Force also considered the current lack of prefunding for Retiree Health; the only way to relieve pressure on the current operating budget would be to make further and immediate reductions in the maximum UC contribution. This would have an immediate adverse effect on current retirees and would free up only a modest amount of money in the operating budget.

19. Continue Monitoring National Health Care Reform's Impact on University programs, including the Early Retiree Reinsurance Program during the annual health plan renewal cycle to determine what future changes should be made in the provision of Retiree Health Benefits.

Finance Work Team

Finance Background

The Finance Team reviewed UCRP and Retiree Health programs from a long-term financial planning perspective. The goal was a fiscally sustainable benefits structure that would contribute to the University's financial well being for the next thirty years and thereafter. Left unchanged, PEB costs will lead to fiscal insolvency. Maintaining the status quo means that within four years, the University will be paying more for pension and retiree healthcare than for instruction at the ten campuses. The University's current annual PEB payments are only one third of the actual costs. The other two-thirds deferred costs are being deferred and are building a large unfunded liability that is expected to reach \$37.5 billion by 2013.

The financial issues surrounding UCRP and Retiree Health are similar, but UCRP's underfunding resulted from almost twenty years of zero funding for Normal Cost while the Retiree Health underfunding is a result of a pay-as-you-go strategy. Since the circumstances surrounding both UCRP and Retiree Health are quite different, the constraints around their potential funding solutions are quite different. So, while a holistic budgetary perspective was taken, the Finance Team analyzed the two issues separately and developed a different set of recommendations for each.

Various options were considered for financing and funding existing and projected shortfalls, along with the issues of appropriate cost-sharing ratios between the University and plan members. The magnitude of the issue means there is no single answer or single "silver-bullet" solution; rather, the Team explored a series of initiatives with shared responsibility throughout the University community.

Process, Other Considerations and Conclusions

Due to the scope of the funding challenge and multifaceted nature of PEB, the Team identified major areas for exploration:

- UCRP funding components
- Impact of PEB costs on budget planning,
- Consequences of delayed funding strategies,
- Fund sources,
- Risk valuation analysis,
- Changing UCRP's actuarial methods,
- Other financing alternatives and
- Appropriate level of replacement income from UCRP plus Social Security for a full University career⁴¹,

⁴¹ A fuller discussion of income replacement occurred in the Pension Work Team but also helped frame Finance Team discussions.

Analyzing each of these areas helped in formulating overall financial goals and, combined with the Task Force guiding principles, were the foundation for recommendations. The core of the recommendations centers on paying the full UCRP Annual Required Contribution for PEB as soon as practical. (ARC is defined in footnote 12, page 13.)

Though simple in theory, paying the ARC requires that all stakeholders commit to change. The funding gap does not have a single solution. A variety of measures are needed: increasing annual University and member contributions, increasing revenue sources, and reducing/reshaping annual expenses to better conform to projected future cash flow. Only combined efforts will ensure the University's future financial health. The major areas of exploration are outlined below:

UCRP Funding Components

The three major parts to pension funding are:

- Actuarial cost method or a calculation that assigns part of the present value of future benefits to each year. The calculation makes assumptions about such things as pay increases and when members will retire. From this, the actuary estimates how much is needed to fund the benefit.
- Amortization period for plan gains and losses over a number of years for a more stable estimate of the value of the plan assets over the long term.
- Contribution policy defines the total amount to be paid annually by the member and the employer and is set by the plan sponsor.

Since UCRP's actuarial cost method is long established and consistent with industry standards, the Work Team did not focus on it. UCRP's amortization period also is within industry standards. But, there is more variation within this metric and, because of the recent recession, many plan sponsors are revisiting the time period used to spread out gains/losses.

The contribution policy has two parts: an amount based on The Regents' targeted funding level and the University's actual contribution. Each year, the total policy contribution⁴² is calculated and projected as though it will be made in each future year. In that calculation, the policy contribution amount as a percent of payroll decreases as the unfunded liability is paid down. When actual

⁴² For this report, policy contribution is the total of Normal Cost plus an amount payable towards the unfunded liability.

contributions are less than policy amounts, the unfunded liability increases by the amount of the shortfall and also increases future policy contributions.

Impact of PEB Costs on Budget Planning

Currently, 10.7% of the University's total budget (~\$20 billion) goes directly to benefit costs for faculty, staff and retirees. As a percent of covered payroll⁴³, these costs are

- 13% for Health and Welfare benefits of faculty and staff,
- 8% for other costs (Social Security, Medicare, Workers' Compensation, Unemployment and Employee Support Programs).

Another 7% of payroll is spent on PEB benefits:

- 4% for UCRP and
- 3% for Retiree Health.

However, neither UCRP nor Retiree Health is being funded at its full cost. The University's full annual cost of providing PEB benefits is actually 25% of covered payroll (17% Pension Normal Cost and 8% Retiree Health Normal Cost). The total actual benefits cost is 44% of covered payroll. If you add in the annual cost of amortizing the unfunded liability for both UCRP and Retiree Health, this would add an additional cost of 19% of payroll a year (8% UCRP unfunded liability amortization, and 11% Retiree Health unfunded liability amortization).

While current financing for Post-Employment Benefits (PEB) is a critical issue any solutions must meet both long-term and short-term University needs. It is important to keep in mind that for purposes of pension planning and accounting for retiree health liabilities, short-term means 10 years; long-term means 20 to 30 years. These time horizons are very consistent with the investment perspectives for PEB.

Conclusion: If no changes are made to reduce the University's annual PEB costs, they will overwhelm the operating budget in the near future.

⁴³ Covered Payroll: eligible earnings for UCRP.

Consequences of Delayed UCRP Contributions

Not restarting contributions to UCRP over the last five or six years, has exacerbated the UCRP funding problem. The unfunded liability of UCRP, on a market-value basis, was \$12.9 billion as of July 1, 2009; the plan was 71.4% funded using a market valuation. On an actuarial basis, which amortizes losses over five years, the plan was 95% funded on July 1, 2009.

Because the 2009 actuarial funding ratio excludes 80% of the 2008-2009 losses, the funding ratio will drop significantly as those losses are taken into account over the following four years. The pension plan pays out over \$1.6 billion annually in benefits. UCRP's unfunded or "legacy" liability was \$2 billion in 2009 (much larger on a market value basis). For the campus and medical center segment of UCRP, the unfunded liability is projected to be \$19.8 billion by 2014, if no changes to funding or design are made. The positive investment returns in 2009-10 have reduced the unfunded liability in UCRP somewhat. However, they have had no effect on the Retiree Health unfunded liability, since Retiree Health is not prefunded or funded through UCRP.

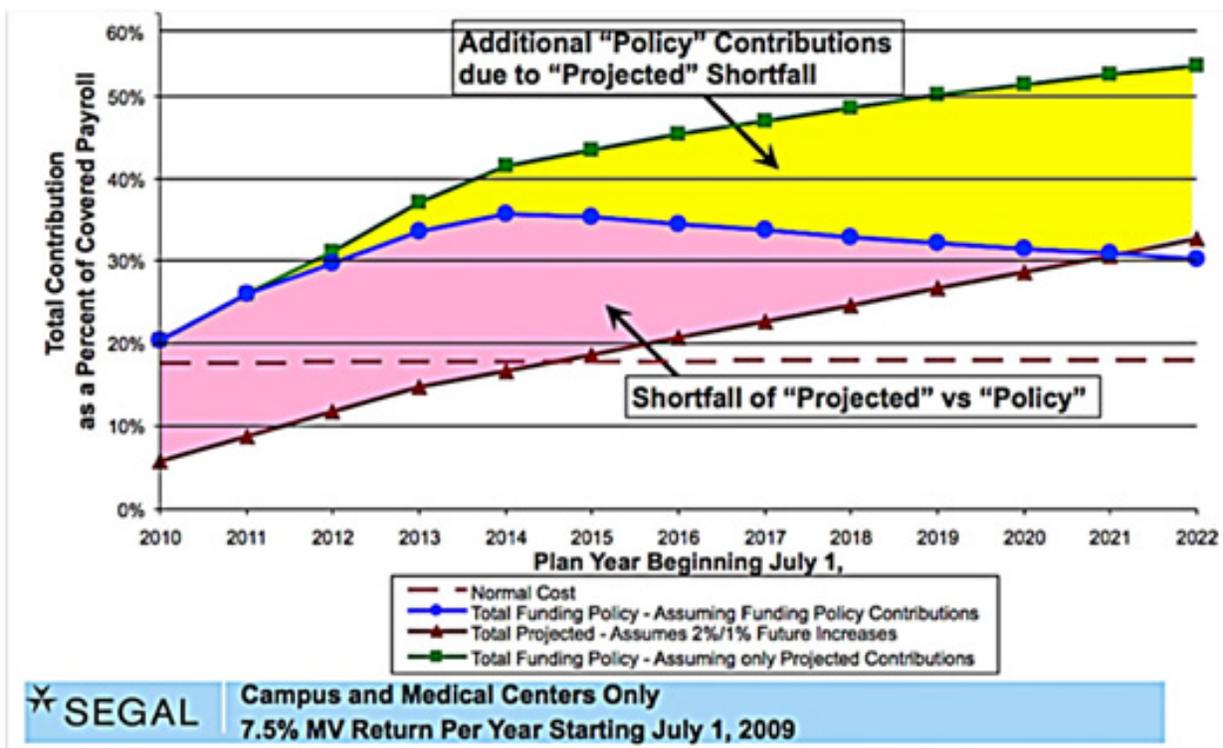
Returning UCRP to a sound footing requires contributions equal to the "Annual Required Contribution" (ARC), consisting of Normal Cost, plus a charge for amortizing the unfunded liability. The Regents' actuary, The Segal Company, prepared estimates of ARC under the Regents' Targeted funding level, based on the July 1, 2009, actuarial valuation. The estimated ARC rises to over 20% in 2010-11, and to approximately 37% of covered compensation in 2014-15, as the losses incurred in 2008-09 are fully taken into account. After 2015, the ARC declines slowly. However, if the University were to follow its previous plan of slowly ramping up contributions, ARC would eventually rise well above 50% of covered compensation since the slow ramp-up creates a shortfall each year that adds to the unfunded liability. Contributing the full ARC in the short-run out of the current operating budget would be devastating, but delay makes the problem much, much worse. Current University projections are to gradually increase UCRP contributions until they reach the level in The Regents' targeted funding level adopted in September of 2008. Gradual increases leave contributions below the targeted funding level for many years. The Finance Team explored the long-term cost and budgetary implications, along with the cost of other alternatives such as adopting the funding policy by 2011. Each deferred dollar of contributions increases future required contributions by substantially more than a dollar. This is because every deferred dollar grows at an annual interest rate of 7.5% (UCRP's assumed rate of earnings). As a result, contributions below the targeted funding level are projected to rise above 50% of covered pay by 2022 for UCRP alone, increasing the University's cost by \$17.5 billion from now until 2022. To quantify the scope of the University's total pension costs, the

Finance Team modeled a projected “funding gap” over the next 10 years based on the assumptions that follow.

The funding gap for the campus and medical center segment of UCRP was estimated based on the difference between ARC and projected UCRP contributions and totaled over \$12.4 billion from fiscal years 2011/2012 to 2021/2022. Projected contributions were calculated using the current UCRP funding strategy starting in April 2010: employee contributions of 2%, increasing by 1% per year up to 5%; University contributions of 4%, increasing by 2% per year. Not only did the current plan create a \$12.4 billion funding gap, but for every year that the University does not pay ARC, the unfunded liability increases another 7.5%. Adopting the full funding policy immediately without any changes to the plan cost structure or reductions in benefits, however, would irreparably damage the University. In the present budget climate of substantially reduced State funding, tuition increases and employee layoffs, finding money for the full cost of PEB is nearly impossible, requiring the University to take severe measures. The 2011/2012 Annual Required Contribution (ARC) for UCRP alone is the equivalent of salary and benefits for 17,000 staff employees or 7,300 faculty systemwide.

The following graphically depicts UCRP’s current Projected vs. Actual contribution plan:

Projected UCRP Contributions: Actual vs. “Policy”



- Horizontal dotted red line is UCRP’s Normal Cost (17.6% as of July 1, 2009).

- Red line with triangles shows contributions approved by The Regents for April 2010 starting at 4% for UC and 2% for members. The projection assumes the University rate increases 2% per year and the member rate increases 1% per year up to 5%.
- Blue line with dots is what policy contributions would be if these amounts were fully paid each year (the Normal Cost plus an amount that would pay the unfunded liability over 15 years).
- Pink area between the red and blue lines shows the shortfall between actual and policy contributions that is added to the unfunded liability each year.
- Green line with squares is the higher policy contribution needed each year because of the unfunded liability created by earlier contribution shortfalls (pink area).
- Yellow area between the blue and green lines is the amount of increase in policy contributions needed to amortize the increased unfunded liability over 15 years.

The approved gradual phase-in of contributions (red line with triangles) rapidly approaches 30% of payroll but the shortfall increases the unfunded liability and policy contributions (green line with squares). Fully funding the policy contribution eliminates unfunded liability in around fifteen years but requires rates as high as 35% of payroll before beginning to decline (blue line with dots⁴⁴). The Academic Senate recommended the University use savings from reductions of non-personnel costs first and issue Pension Obligation Bonds for the balance of the unfunded liability and any part of the Normal Cost not paid by the State in the short-term (see discussion below). Faculty representatives to the Task Force recommend borrowing from the University's STIP fund since the interest rate is more favorable.

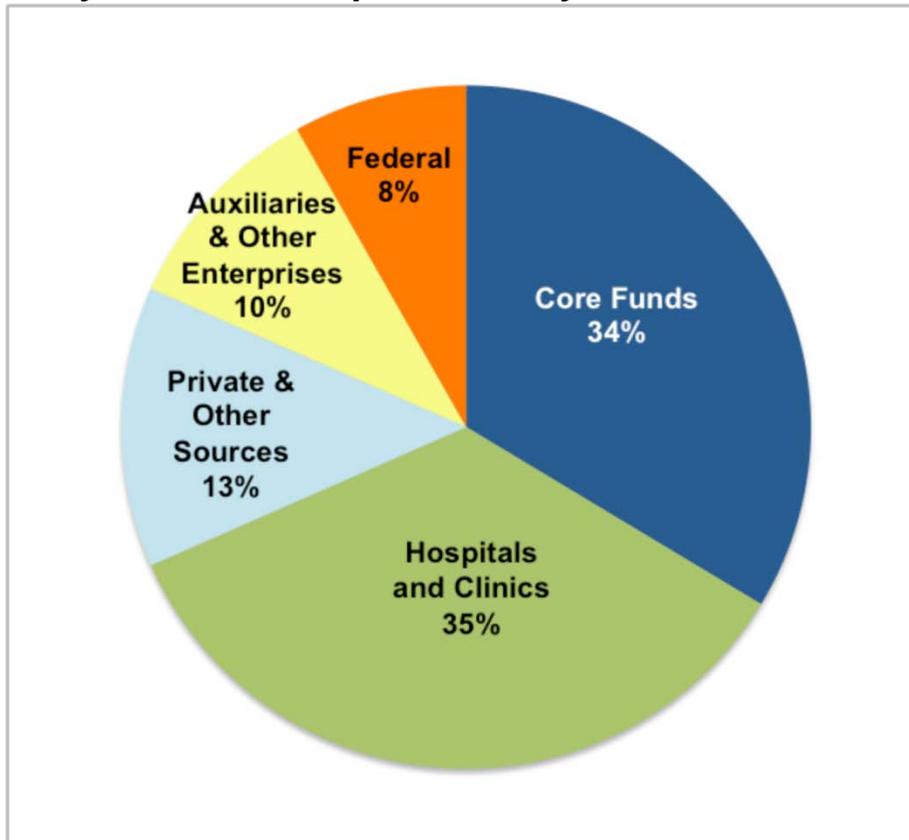
Conclusion: Develop short and long-term solutions. Quickly funding UCRP Normal Cost and amortizing the unfunded liability is desirable, but immediately funding the full policy contribution is not feasible.

⁴⁴ The ARC increases between 2010 and 2014 because the investment losses of 2008 are being "smoothed" or recognized in calculations of UCRP's assets.

Fund Sources

The University has several internal and external payroll fund sources as shown in the following graph. State and University general funds make up 36% of the University's budget, while other sources, such as medical centers, auxiliaries, federal funds and private funds make up the rest of the 64%.

University Covered Compensation by Fund Source 2009-2010



Core funds include State and University General Funds, as well as student fees.

Medical Centers, Clinics, Auxiliaries, Extension and Extramural Activities are University entities, but they must be self-supporting. Additional benefits costs substantially impact their operating margins and could force them to shut down, causing the loss of essential University services for both the public and the University community.

As noted earlier, because benefits charges must be the same across all fund sources and more than two-thirds of University funding is non-State based, for each dollar the State fails to pay, the University loses more than two dollars. Alternatively, for every dollar that is contributed for the State share of benefits, other University sources must find two matching dollars. Additionally, deferring full contributions means that the University is not capturing monies from fund sources incurring the

liability. For example, 8% of the University's covered compensation comes from federal sources, and since the University cannot charge the federal government for retirement benefit-related costs unless its other sources are also contributing, the University loses federal reimbursement dollars in every year it does not fully fund its retirement benefits. The lack of State PEB contributions however, will make it difficult for the University to fund its PEB costs. With no State support, the University's General Fund would have to cover these costs. In FY2009-10, to fully cover the cost of its PEB costs, the General Fund would have to pay \$1.7 billion for PEB benefits, a severe financial burden for campuses already faced with funding challenges caused by the recent State budget cuts. Unless the State provides substantial additional funding, the University will have to make major, painful changes in its size and shape. To put it into context, the \$1.7 billion General Fund share of total PEB costs equals more than all the financial aid given to students by the University, or approximately the entire operating budget of two medium-sized campuses.

Conclusion: Even if the University could fund the State's share of PEB costs immediately, it cannot be assumed that other fund sources will be able to afford their full share of ARC without being given time to revise their operating models and assessing the impact on students, staff and faculty.

Changing UCRP's Actuarial Methods

Amortizing UCRP's unfunded accrued actuarial liability – the difference between the actuarial value of assets and the amount needed to pay the total accrued benefits over the current members' lifetimes – is projected to cost 8% of payroll starting in FY 2011-12 and rise to a maximum of 19% of payroll by FY 2015-16. This annual cost is in addition to our current Normal Cost of 17.6% of payroll.

Smoothing out PEB costs was a key concern for the Finance Team. That is, if paying ARC funding was the lowest long-term cost alternative, could ARC be lowered? UCRP's current actuarial policies set a 15-year level dollar amortization of unfunded liability. This severely strains University cash flow as it increases the short-term payment needed for full ARC funding.

Using a longer amortization time period that still meets accepted accounting standards lowers ARC substantially in the first ten years, making funding ARC more manageable in the short term. However, any time period above fifteen years also increases interest on the unfunded liability since it accrues over twenty or thirty years instead of fifteen. So the Team sought a balance between short-term cash flow relief and increased long-term costs.

Conclusion: Extending the University unfunded liability amortization period could provide near-term cash flow but, if the University funds the State share of PEB costs immediately, it cannot be assumed that other fund sources will be able to afford their share without some time to revise their operating models and assess the impact of faculty, students and staff.

Debt Financing Capacity and Pension Obligation Bonds

The Finance Team also explored the possibility of issuing Pension Obligation Bonds (POBs) to help pay for the required contributions. These are taxable bonds issued by states and local municipalities to pay all or part of their pension or retiree healthcare benefits unfunded liability. The University essentially would be exchanging one liability, the unfunded liability, for another liability, the Pension Obligation Bonds. Bond proceeds would be used to retire part or all of the unfunded liability – or to pay for the ARC.

Bonds could be issued for just the State share of the expense or for the entire system cost. Issuing bonds does not solve the University's funding problem; it just defers the payments into the future. However, bonds might reduce the size of the University's future payments if investment returns are strong. Reducing or eliminating the unfunded liability through bonds means it is no longer increasing at the UCRP assumed 7.5% growth rate, but at a potentially lower debt service cost. While POBs can be a constructive element in a comprehensive funding strategy, there are substantial risks. If the return on investments is less than the debt interest over the life of the bonds, the University's PEB costs will be even higher than if no bonds had been issued. Currently 90% of POBs issued since 1992 have negative rates of return.⁴⁵ Since most of these POBs are still outstanding, the final return on them is unknown.

Besides market and investment risks of POBs, there are several other factors to consider. The University's total debt capacity is around \$6 to \$8 billion over the next five years. Projected capital financing needs for the next five years are approximately \$8 billion, not including \$1.5 billion in deferred maintenance and another \$1.9 billion that is due from the State. Any debt issuance for PEB bonds would have to be balanced with the University's strategic plan and future capital needs.

⁴⁵ Source: Center for State and Local Government Excellence; Issue Brief, Pension Obligation Bonds: Financial Crisis Exposes Risks; January 2010.

Pros and Cons of Pension Obligation Bonds

Pros	Cons
Interest Rate Savings	Investment Risk
<ul style="list-style-type: none"> Any UAAL balance incurs an implicit annual interest rate charge (UC – 7.5%) If current taxable market borrowing costs are lower than the actuarial earnings rate charged on the unfunded liabilities, savings can be achieved 	<ul style="list-style-type: none"> Actual return on the purchased investments is less than the cost of the debt over the life of the bonds. Bonding rates are at 6.5-7.5% right now and investment return might fall below this rate
Investment Earnings	Loss of Financial Flexibility
<ul style="list-style-type: none"> Pre-funding reduces total liability When bond proceeds are invested, they could earn a higher interest rate than expected, thereby reducing the liability 	<ul style="list-style-type: none"> Converts “soft liability” to a bonded debt (“hard liability”), reducing budget flexibility in times of economic downturn Takes up valuable debt capacity that might otherwise be used for capital projects
Budget Relief	Market Risk
<ul style="list-style-type: none"> POB/OPEBs with longer terms than the UAAL amortization period can lower the annual cost for UC Short-term issue could cover funding the for next few years allowing other fund sources to contribute and allow UC time to ramp up its contributions 	<ul style="list-style-type: none"> Takes several months to implement during which bond rates could turn unfavorable

In addition to drastically reducing debt capacity and limiting the ability to carry out the University’s current capital plan, no clear repayment source has been identified for POBs. State funds cannot be used for paying debt service on bonds, leaving only student fees as a revenue source to repay the State portion of the liability.

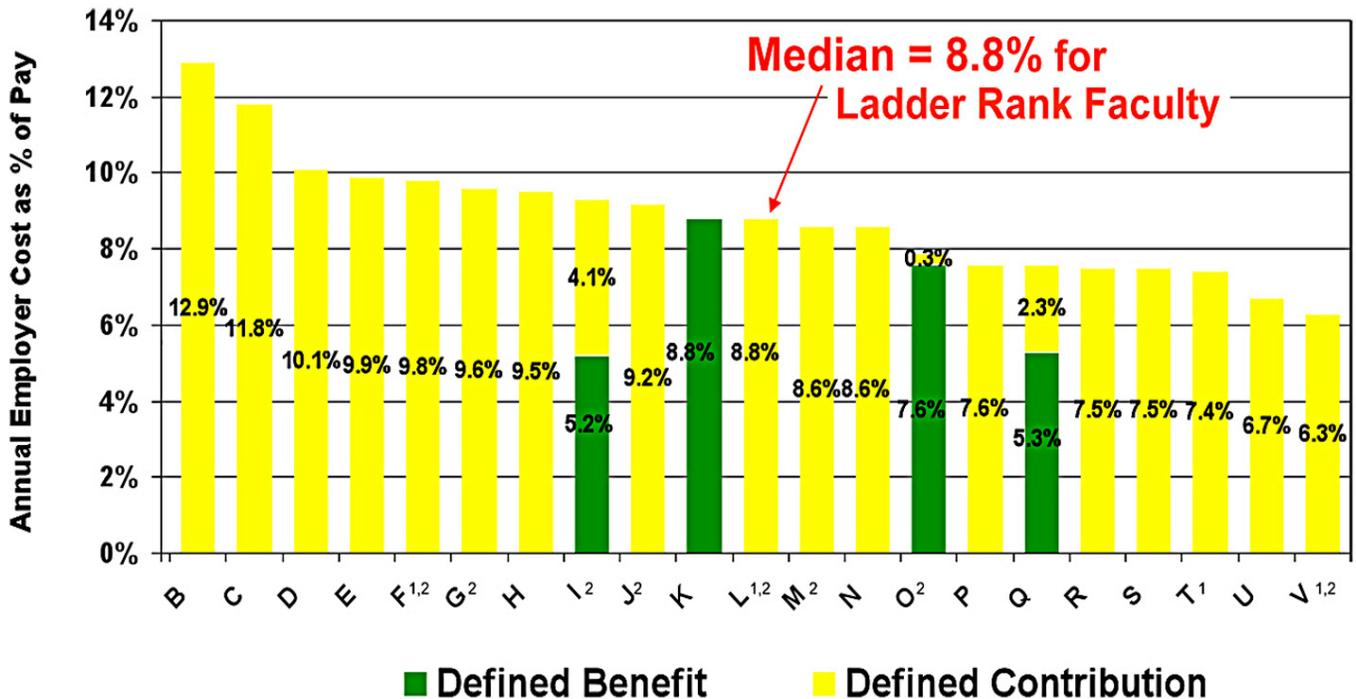
The Academic Senate and their Task Force representatives favored issuing POBs or using some other debt financing method to accelerate paying down UCRP’s unfunded liability.

Conclusion: While POBs can provide cash relief, the risks must be carefully evaluated against other alternative financing mechanisms.

Benchmarking and Competitive Analysis

Benchmarking against other public retirement systems and the University’s Comparison 26 was an important part of the process, particularly as the Finance Work Team developed Normal Cost target ranges for the other two Teams. The following chart illustrates the employer contributions for 21 of the University’s 26 academic comparison institutions. The green bars show the contributions for Defined Benefit Plans and the yellow bars, for Defined Contribution plans.

**Employer Costs as % of Pay – Ladder Rank Faculty
Based on 2008 data* from 2009 Total Remuneration Study**



***2008 information for 21 Comparator 26 institutions in Hewitt benefits database.**

¹ Choice between DB and DC offered. Plan participants assumed to elect DC plan.

² Also a Comparator 8 institution. Comparator 8 institutions include Harvard, MIT, Stanford, SUNY, University of Illinois, University of Michigan, University of Virginia and Yale.

As a percent of payroll, seven of the University’s comparator 8 institutions contributions for ladder rank faculty range from 6.3% to 9.8% for their pension plans and five of those are paying over 8.5% per year. Two of the institutions have Defined Benefit and Defined Contribution plans; the other five provide Defined Contribution Plans. Of the twenty-one institutions in this survey of benefits for Ladder Rank Faculty, four provide a Defined Benefit plan. The median employer contribution is 8.8% of covered payroll.

Conclusion: The effects of reductions in Post-Employment Benefits on total remuneration will be examined closely.

Finance Recommendations

The Finance Work Team made several recommendations related to funding and financing PEB. They also supported the Pension Work Team’s recommendation of a UCRP New Tier for new hires and, provided a technical tax issue can be resolved, recommended offering that New Tier as a choice to current members. The pension and finance recommendations are interdependent, not stand-alone strategies – thus, both Teams made some recommendations. The Finance Work Team also concurred with recommendations of the Retiree Health Work Team regarding program changes that would reduce the unfunded liability for Retiree Health. Given the severe financial consequences of not fully funding the ARC, the Finance Team focused on achieving ARC funding as quickly as possible through a four-pronged approach: implementing actuarial changes to the plan policy, ramping up the annual contributions to the plan, reducing the total annual cost of providing retirement benefits and filling in any remaining gaps through various financing methods. Implementing a suite of changes to UCRP’s funding model and cost structure allows effective management of the funding gap between ARC and the approved UCRP contributions.

1. Effective July 1, 2010, Amortize UCRP’s Gains and Losses over 30 Years.

Historically, the University’s targeted funding level resulted in an annual required contribution (ARC) that matched the annual contribution level to UCRP. For many years before 2009, the University had no unfunded liability so short periods were used to amortize the gains consistent with the policy of making no contributions to the plan. But, as of July 1, 2009, UCRP developed an unfunded liability. In September 2008, The Regents adopted a new targeted funding level that included the following parameters:

Regents’ UCRP Targeted funding level Parameters – September 2008

Parameter	UCRP Policy
Actuarial Cost Method	Entry Age Normal
Asset Smoothing	5 Year Asset Smoothing
Amortization Method	Level Dollar
Current Surplus Amortization Period	3 Years
Gain/Loss Amortization Period	15 Years, separate layers, fixed periods
Assumption, Method, Benefit Change Amortization Period	15 Years
Future Surplus Amortization Period	30 Years

Shortly after adopting this policy, the investment market declined 20% and the State of California cut the University’s appropriation by \$637 million, including all funds earmarked for UCRP contributions. While both events are rare, their occurrence at the same time to this degree was unprecedented. In this economic environment, the University cannot make contributions to UCRP consistent with the targeted funding level adopted in 2008.

To establish a policy contribution rate more closely aligned with a realistically attainable actual contribution rate for UCRP, the Finance Team recommended a 30-year period for amortizing gains/losses instead of the current 15-year policy. All other assumptions would remain the same as adopted in the 2008 Regents’ Targeted funding level⁴⁶. This change more closely aligns UCRP with other government pension plans. Increasing the amortization period for the unfunded liability provides the University with \$4 billion of cash flow relief over the next ten years.

2. Increase University and Member Contributions to UCRP More Rapidly.⁴⁷

The increase in contributions would apply to the University, current faculty and staff, and new hires, capturing dollars from all fund sources and reducing growth of the unfunded liability.

The table below shows the proposed schedule:

Recommended University and Member Contributions

Effective Date	University	Member
July 1, 2011	7%	3.5% (less \$19)
July 1, 2012	10%	5.0% (less \$19)
July 1, 2013	2% additional per year	Choice

Safety member⁴⁸ rate: July 1, 2011: 4.5% (less \$19); July 1, 2012: 6% (less \$19)

The UCRP contribution strategy approved for April 1, 2010 restarted University and member contributions and included a gradual increase in amount over time. This plan leaves a \$12.4 billion funding gap over the next ten years. Balancing the need to close the funding gap with the University’s budgetary realities, the Team recommended allowing a ramp-up period, but

⁴⁶ The 2009-2010 positive investment returns will be included in the 2010 valuation and, if this recommendation is implemented, amortized over 30 years.

⁴⁷ *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 for represented employees. Benefit levels and the member contribution rates modeled in this report are dependent on the specified implementation dates, as approved by The Regents. Variations in the implementation date of the recommendations for a group may impact that group’s benefit levels and member contribution rates.*

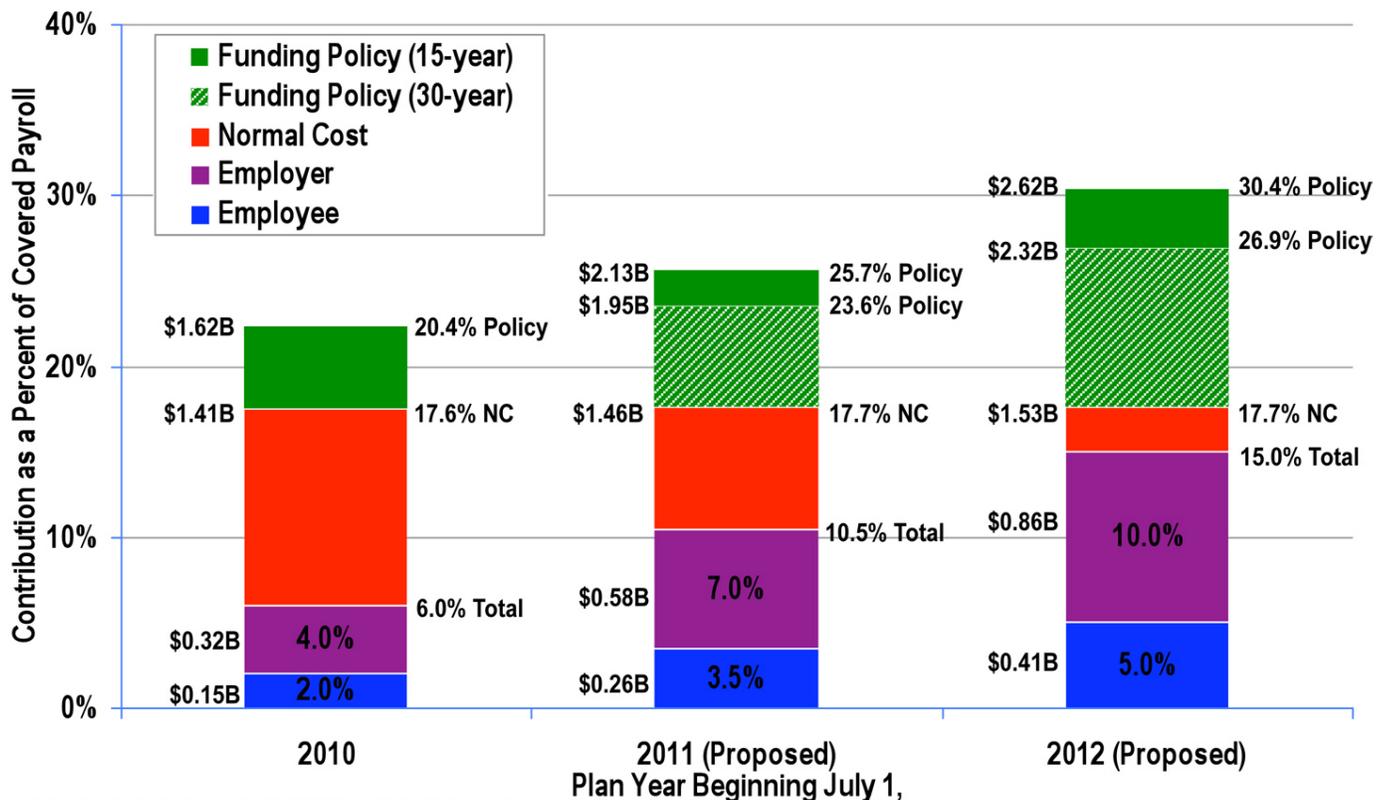
⁴⁸ See footnote 24, page 31.

increasing contributions more quickly. This schedule helps the University return to full funding of ARC sooner and make contributions towards UCRP unfunded liability earlier. Increasing contributions also adds an additional \$1.8 billion to UCRP over the next ten years.

Starting in 2013, member contributions would be based on their choice between the current UCRP plan and the New Tier⁴⁹ (provided the University is successful in its discussions with the Internal Revenue service concerning the tax issue.) However, this proposal represents a substantial impact on the Total Remuneration of current employees. It also is problematic for the University, raising employer contributions to 22% by 2018-19.

The Regents' actuary, Segal, provided the following chart showing the effect of accelerated University and member UCRP contributions:

Projected and Targeted funding level Contributions



Estimated 12.7% MV Return for 2009/2010 and 7.5% MV Return Per Year Starting July 1, 2010
 Campus and Medical Centers Only
 Member Contributions are Reduced by \$19 Per Month

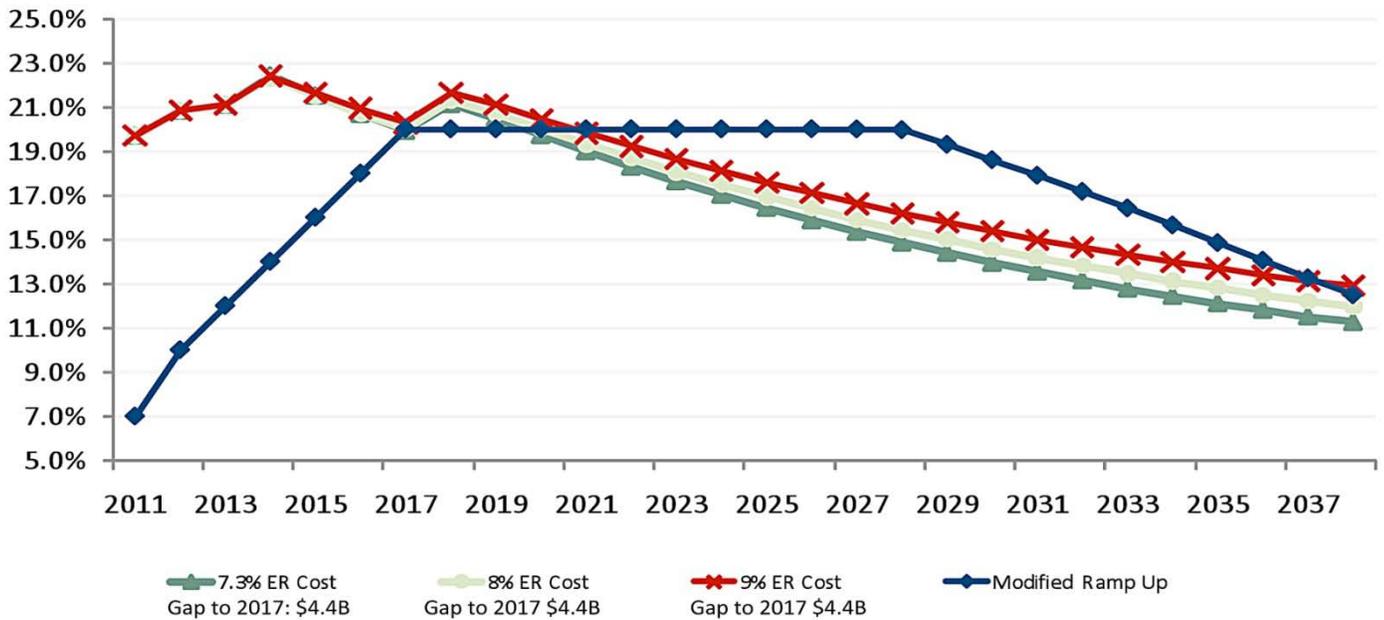


⁴⁹ See recommendations #4, Pension, and #23, Finance.

3. Implement a UCRP New Tier Defined Benefit Plan for Faculty and Staff Hired on or after July 1, 2013⁵⁰. (See Pension Recommendation #3.)

Implementing a New Tier with a lower Normal Cost than the current pension plan does not change UCRP’s current unfunded liability, but it does help stabilize the University’s funding status. Because it lowers the Normal Cost for new hires, it lowers the University’s ARC payment. The New Tier lowers the funding gap by approximately \$1.3 billion. Long term, the impact will be even larger. New Tier implementation under Plan design A is projected to lower the Normal Cost by over \$20 billion in the next thirty years; Plan design B lowers by around \$13 billion. The following chart compares projections of the current UCRP contributions to a range of University contributions for the New Tier from 7% to 9%.

**UCRP New Tier Cost Comparison
7%, 8% and 9% University Contribution**



- Over the next 30 years, an 9% employer normal cost for a New Hire Tier is ~\$6 billion more costly than a 7.3% normal cost.

Calculations in this chart assumes a New DB Tier is implemented by FY 2013 with a 7% employee contribution for employees who choose to remain in the current UCRP plan

- The blue line with diamonds shows the impact of the current gradual increase in University contributions to the current UCRP plan. Contributions as a percent of covered payroll rise to over 20% by 2017 and remain at that general level until 2029, before tapering off.

⁵⁰ See footnote 47, page 75.

- The dark green line with triangles shows the University contributions for New Tier design Option A. Contributions reach 23% in 2014, dip to 20% by 2017, and rise briefly to 22% in 2019 before declining sharply. (The 2017 dip is the result of paying interest only on the UCRP unfunded liability per recommendation #24; the 2019 rise occurs when the amortized principal amount is added to the contributions.)
- The dark red line with “X’s” shows the 9% University contribution for the New Tier design Option B; the lighter green line with diamonds shows a mid-range, 8% contribution. Both follow the pattern of the green line.
- All three contribution levels project UCRP as fully funded sometime after 2037.

20. Offer Current UCRP Members Choice⁵¹ Effective July 1, 2013.

To further lower the University’s annual cost while providing faculty and staff with an appropriate level of post-retirement benefits, the Team recommended allowing current UCRP members a choice between pension plans in 2013: remain in the current UCRP plan and pay a higher member contribution rate or move to the New Tier with a lower contribution rate (as outlined in Pension Recommendation #4). Faculty and staff who choose the New Tier for future service will create a lower average aggregate Normal Cost and, thus, employer savings through lower required contributions. On the other hand, assuming that all current employees stay in the current plan and pay an additional 2% of pay reduces the University’s pension costs by approximately \$1.3 billion over the next 30 years.

The Pension Team suggested a 7% member contribution rate to remain in the current UCRP plan design; subsequently, some members of the Steering Committee proposed higher contribution levels. The current UCRP plan design, at a higher contribution rate, would be the default option for those who made no choice.

The University is working with the Internal Revenue Service to determine whether offering employees a choice between the two options will result in inclusion of employee contributions in gross income. The Office of the General Counsel believes it is possible that the IRS will provide assurance that the employee contributions will retain their pretax status but if the IRS does not, current UCRP members will stay in UCRP under the current terms with a higher employee

⁵¹ See footnote 28, page 33 and footnote 47, page 75.

contribution rate. Employees newly hired on or after the recommended effective date of the New Tier, 7/1/13, will be placed in the New Tier option.

21. Achieve ARC Funding as Soon as Possible by Using Other Financing Solutions

Even with the faster ramp-up in the UCRP contribution schedule and the Normal Cost reductions introduced by the new plan design, there remains a gap between the projected ARC and contributions to UCRP until 2017-18.

To manage this gap, the Finance Team approached the funding recommendations in terms of discrete steps: first, pay UCRP Normal Cost; second, pay Normal Cost plus interest only on the unfunded liability; and, third, pay the full UCRP ARC. The Team chose four solutions to address the remaining funding gap between the modified ramp-up plan and ARC funding. The goal is to achieve ARC funding as soon as practical, possibly by next fiscal year 2011/2012, if the recommendations below can be implemented.

- As an interim financing strategy, pay UCRP Normal Cost plus interest only on the UCRP unfunded liability until 2018 and then pay ARC (Normal Cost with full amortization of unfunded liability) thereafter.

A traditional ARC calculation includes amortizing both principal and interest on the unfunded liability, but delaying inclusion of the principal in the ARC calculation provides time for operating units to absorb the costs into their budgets. The Finance Team wanted to balance reduced costs with a prudent contribution policy. Contributing anything less than the interest on the unfunded liability increases its balance going forward. While paying both the principal and interest is the recommended long-term plan, an interest-only payment on UCRP's unfunded liability through June 2018 provides the University with approximately \$900 million cash flow relief from July 2011 to June 2018. This interim financing strategy stops UCRP's unfunded liability from growing, achieves temporary budgetary relief and moves closer to fully funding ARC.

- Restructure debt and use the cash flow savings to pay part of the annual pension expenses.

The University currently has \$8.3 billion of outstanding debt, 99% in fixed rate mode. UC could restructure 20-25% of its existing fixed-rate debt with lower cost floating-rate variable rate demand bonds (VRDBs). Campuses would continue to pay a fixed rate, while bondholders

would receive the lower VRDB rate. The spread between campus payments and bondholder payments could be directed towards strategic initiatives, such as paying for part of the UCRP ARC. Cash flow savings on this restructuring is projected to be approximately \$40 million a year.

- Use incremental Short Term Investment Pool (STIP) interest to cover part of the cost of UCRP.

Currently the University has over \$8 billion invested in its Short Term Investment Portfolio (STIP). STIP now earns an interest rate of approximately 2.5%. The Team recommended the University redirect any investment earnings above 2.5% but below 4% to help defray the University's annual pension expenses. This plan limits any impact on the current operating budgets of campuses and medical centers with a STIP balance since only interest earnings above the current 2.5% rate would be redirected. Campuses could keep their current projected earnings while adding an additional annual contribution of \$120 million to UCRP.

- Borrow from STIP to fund UCRP contributions until the University can meet its obligation through the annual budget process.

The University also could leverage its large STIP balance by borrowing the annual funding gap amount from STIP at an agreed upon interest rate for a 20-30 year period. The borrowed funds would be used to pay the full ARC in any given fiscal year. The amount borrowed would be limited to the annual funding gap between ARC and the scheduled pension contribution percentage. The University's STIP borrowing rate would be anywhere between 2-3%, much lower than the cost to issue Pension Obligation Bonds, which is currently estimated to be over 6.5%. As the unfunded liability grows at 7.5% per year, each year the University pays its full ARC with borrowed funds, it saves the difference between 7.5% and its borrowing rate, up to 5% a year if current STIP rates are used. STIP loans would be repaid over 30 years from the operating budget. While debt service repayment would have to be built in to the operating budget, the relatively low borrowing rate limits the amount to between 0.5% and 1.3% of payroll. If further borrowing is required, proceeds from debt restructuring could be used, as could Pension Obligation Bonds (POBs).

Other UCRP gap closing alternatives considered by the Finance Team included the sale of University property and the privatization/monetization of housing and parking structures and possible workforce

reductions. While this could help raise funds for UCRP contributions, the Work Team concluded that these measures should be left to the individual campuses and/or medical centers. Student fee increases dedicated to UCRP contributions also were considered; however, Finance Team members felt systemwide student fee increases should be implemented for broader operational needs than Post-Employment Benefit costs.

The following table illustrates some of the coordinated options proposed by the Finance Work Team for UCRP. The column at far left shows the unfunded liability today, with no program changes.

- The Base Case column shows the effect of increasing the period for amortizing UCRP's unfunded liability to 30 years, increasing contributions more rapidly as specified in the pension recommendations, paying interest only on the unfunded liability until fiscal year 2017-18 (assuming UCRP's portfolio earned a 12.7% return in fiscal year 2009-10). These changes reduce our funding gap by over half, or around \$6.7 billion. Because the contributions are not at the targeted funding level in the early years, the cost for both Plan designs is the same; however, between 2019 and 2038, Plan design B costs around \$6 million more than Plan Design A.
- Each additional 1% contributed to UCRP by University operating budgets is approximately \$80 million dollars (1% times \$8 billion covered compensation. This is the equivalent of
 - Over 630 new faculty (at \$126,582 per year for salary and benefits), or
 - A 5.65% increase in student fees, not including related financial aid, or
 - Instruction costs for almost 7,300 students (at \$11,000 each), or
 - Gift aid awards for almost 7,800 students (at \$10,300 average gift).

Over a thirty-year period, each 1% in added contributions would total \$2.4 billion.

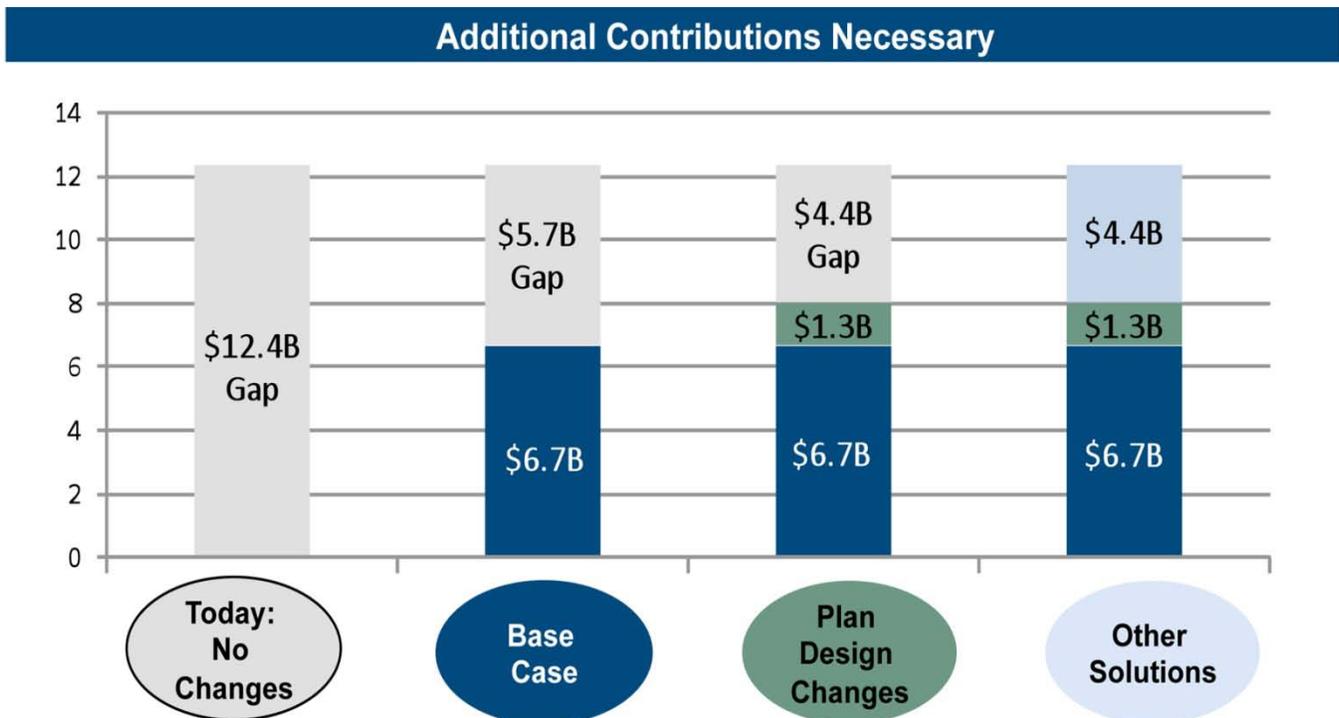
By comparison, costs for some other important University programs are \$1.2 million for UC Washington DC, \$4.7 million for MESA (Mathematics and Engineering Science Achievement Program, an academic preparation program), \$1.4 million for Puente (an academic preparation program for educationally disadvantaged students) and \$10 million for Summer Session instruction.

- The "Plan Design Changes" column quantifies the reduction in the funding gap over the next ten years due to the lower Normal Cost of either New Tier plan design A or B. Over the next thirty years, Plan design A would reduce the UCRP costs by over \$20 billion; Plan

design B, by \$13 million. But, because Plan design B, as modeled, has a higher employer Normal Cost, it imposes greater demands on UC’s operating budget. The employer contribution is 1.7% higher for Option B than Option A, about \$140 million.

- The “Other Solutions” column covers the remaining \$4.4 billion gap and encapsulates the rest of the revenue-generating solutions outlined in this recommendation: restructuring debt, using STIP interest and borrowing from STIP.

Impact of Finance Recommendations Managing the \$12.4 Billion Contribution Gap from 2011-2021



*Note these figures represent the 2011-2021 funding gap created between annual required contribution and projected UC employer/employee contributions. It does not include total cost of some of the proposed changes. For example, over the entire life of the 30 year level dollar amortization UC will pay more than if a 15 year level dollar amortization was utilized

New Tier designs A and B have approximately the same effect on the funding gap in early years, covering around \$1.3 billion. However, between 2019 and 2038, Plan design B would cost around \$6 billion more than Plan Design A. These numbers also include the effect of an assumed 7% employee contribution to UCRP for current employees.

The Task Force analyses began with an unfunded liability and UCRP benefit structure requiring total contributions at 37% of covered compensation by 2014-15. Assuming a 5% employee contribution, this would have required a 32% University contribution. The Task Force Finance recommendations reduce the University contribution to a maximum of 23% over time. While that number poses a

frightening challenge to the University operating budget, it represents the collective best efforts of the Task Force, given the legal necessity of covering the unfunded liability and the need to provide competitive retirement benefits, essential to UC's operating mission.

22. Reduce Retiree Health Normal Cost to 3-4%

After reducing the Retiree Health Normal Cost, begin funding it with an increase to the campus assessment fee. Contribute to Retiree Health unfunded liability after fully funding UCRP liability.

Total Remuneration Impact

Background and Overview

Analyzing the Task Force recommendations on pension and retiree health programs against workforce segment comparators was an important part of the process. The reason the University offers these or any other pay and benefits programs, is to attract and retain the best talent with competitive total remuneration. In September 2005, The Board of Regents' Finance Committee agenda included discussion on an action item committing to the goal of market-competitive total remuneration for faculty and staff. In November 2005, the Board of Regents took the following action:

“The Advisory Group on University Compensation recommends to the Board of Regents that the Committee on Finance recommend to the Board of Regents the adoption of the following policies and procedures, with the overall goal of aligning the compensation of University of California faculty and staff with their market comparators.

These actions shall modify current Regents policies and procedures on compensation. The specific actions are:

To adopt the goals of obtaining, prioritizing, and directing funds, to the extent they are available, to increase salaries to achieve market comparability for all groups of employees over the ten year period from 2006-2007 through 2015-2016.

The Regents committed to a goal of market-competitive total remuneration for faculty and staff and adopted the goals of obtaining, prioritizing, and directing funds, to the extent available, to increase salaries to achieve market comparability for all groups of employees over the ten year period from 2006-2007 through 2015- 2016. There has been slow progress towards this goal.

The key philosophy driving the plan's objectives is that:

‘The quality of our academic, management and staff personnel is essential to maintain the excellence of the University of California and its ability to contribute to the health and vitality of the State of California. Our strategy is to attract and retain the highest quality academic, managerial, and staff talent by offering competitive total remuneration.’ “

The Task Force Steering Committee and all three Work Teams incorporated this philosophy into their deliberations. The interplay of the overall costs for faculty, staff and retiree benefits; their impact on the University's financial position; and the effect of these recommendations on total remuneration are critical in understanding options and subsequent recommendations by the Task Force.

The purposes of the Total Remuneration Study are:

- To generate a comprehensive and valid evaluation of UC's current competitive position on total remuneration
- To facilitate a better understanding of how total remuneration competitiveness varies by UC personnel program
- To develop a basis for assessing the appropriateness of current total remuneration in supporting UC's talent management strategies
- To inform short term and longer term talent management strategies by the University

The University Medical Centers became a part of the Total Remuneration process in 2007. Another segment of the UC population has not been included to date in the Total Remuneration Study – the Health Sciences Faculty⁵². Administrative measures are currently underway to remedy this issue and a revised version of the 2009 Total Remuneration Study will be available in the spring of 2011 that will include this workforce segment.

As part of the effort of updating the Total Remuneration process after the 2005 Study, a comprehensive review was undertaken with the active engagement of selected representatives from the UC Faculty Welfare Committee of the Academic Senate. These representatives, along with staff from the UCOP HR Department and Academic Personnel, formed an Advisory Group that worked during the period from fall of 2008 to spring of 2009. The Advisory Group examined, defined and confirmed every aspect of the Total Remuneration Study including the Study methodology, assumptions and market comparators. The Faculty Advisory Group made valuable contributions to the updated Study by working extensively with the consultants, to assess, and where necessary make statistic, formulaic and methodological changes that were fully incorporated into the final Study results. It also should be noted that the market comparator organizations were selected originally and reconfirmed to reflect the full scope and scale of the academic and business operational diversity of the University of California. As a direct result of this review and the recommendation of the Advisory Group, the role of the retained consultants was changed with Hewitt assuming the lead role in the Study process for the campus and UCOP benefits portion of the Study. Mercer Consulting continued to conduct the cash compensation analysis for the full Total Remuneration Study, as well as assuming responsibility for the Medical Center compensation and benefits portion of the Study. The Advisory Group concluded its work in May 2009. The Total Remuneration Study was issued in

⁵² See footnote 35, page 45.

October 2009. The delay in the issuance of the Study was due to internal review and desire to analyze the impact of the UC furlough program on the Study results for salary comparisons.

As the detailed data results of the PEB Update to the 2009 Total Remuneration Study are reviewed, several important factors should be generally kept in mind:

- The Total Remuneration Study is a market comparator measure at one point in time and is at best only an approximation of the market at that point in time. It is primarily retrospective in nature.
- The Total Remuneration Study shows the employee value of employer provided benefits. **It does not measure the employer cost of benefits or risk for providing these benefits.** To analyze benefit costs and whether a particular program or policy is needed for strategic business or talent management reasons, other analytical methods must be used that are specifically designed for those purposes. The Total Remuneration Study measures employee value in terms of dollars, but the intangible factors other than dollars determine what will influence employee behavior.
- The cash compensation benchmarked in the Study is based on individual market comparisons of selected University positions as defined by UC using multiple surveys for staff comparisons and the Comparison 8⁵³ for ladder rank faculty. Typically, these salary studies are aged by a percentage factor where appropriate to reflect market and internal UC salary changes. The market comparator groups generally reflect the entities that compete with the University to attract and retain faculty and staff.
- The benefits comparisons are group comparisons using UC's age and service demographic data for each of the comparator organizations that neutralize variation in benefit valuations. A complete list of the comparator organizations can be found in the Study. The Study results should be viewed as if the whole UC population became the comparator's organization.
- The 2009 Total Remuneration Study was updated to reflect the recommendations of the President's Task Force on Post-Employment Benefits. For this Study, assumptions were updated to include the Post-Employment Benefit designs recommended by the Task Force for pension and Retiree Health only. All other factors (cash compensation, population, demographics, health and welfare benefits) were held constant.

⁵³ Comparison 8 institutions include Harvard, MIT, Stanford, SUNY, University of Illinois, University of Michigan, University of Virginia and Yale.

- The results show the effect of UC Post-Employment Benefit changes, but **do not** account for future changes in plan design or the value of benefits for any of the market comparators beyond the date of the Study. Additionally, the Study **does not** take into account any future salary adjustments to cash compensation for the University or the market comparators.
- **Finally and critically, there is no way to accurately account for market benefit changes in 2013 when the new UC plan designs are scheduled to be implemented. We do know however that the general market trend is to decrease the amount of employer provided value of Post-Employment Benefits.**

The Study results of the proposed PEB designs show significant variances by market comparators for different employee segments (campuses overall population, ladder rank faculty and Medical Centers). For instance, the retirement benefit market lag for ladder rank faculty is approximately -40% while the market lags for various non-faculty segments range from -6% to over -50%. The extent and level of these differences led the Task Force to recognize the likelihood that any changes to UCRP would affect different employee segments differently and that the varying competitive pressures faced by the University of California in recruiting and retaining segments of the workforce should be carefully considered before adopting changes to PEB.

A critical point of consensus for the Task Force was the lag in compensation. Although it was outside the purview of their charge, the Task Force strongly recommends that the salary lags be addressed, especially in light of the impact on total remuneration of potential changes to Post-Employment Benefits. High benefit levels have historically served to offset the focus on lower cash compensation levels. However, if during the next two years the recommended increases in member contribution rates are implemented and no salary increases are provided, the competitive position of total remuneration for faculty and staff will continue to deteriorate and at a faster rate: eroding not only the University's market position, but also potentially undermining the institution's ability to attract and retain quality faculty and staff. The Task Force recognized that the differences in cash compensation are real, are important and need to be addressed by the University⁵⁴. At the same time, the Task Force also recognized that providing benefits in excess of comparator values is not the optimal way to offset differences in cash compensation.

⁵⁴ The lag in cash compensation affects the overall total remuneration results in that it depresses the valuation of the benefits.

After initial results analyzing the proposed PEB changes were presented to the Steering Committee, that group appointed a sub-team to refine the pension plan designs since they appeared to be non-competitive for faculty in particular. That work is reflected in the Pension Work Team and Steering Committee recommendations presented earlier in this report. It is important to note that some members of the Task Force believe that, while market values of Post-Employment Benefits are likely to decline for many comparator organizations and occupations, this is unlikely to be true for ladder rank faculty. The University will need to continue searching for and retaining excellent faculty in a fiercely competitive nationwide and international market of public and private institutions.

See Appendix H for the complete PEB Design Updates to the 2009 Total Remuneration Study. Selected results are shown on the following pages.

Total Remuneration Analysis of PEB Changes Pension Design A

Campus and UCOP Detailed Results (All Population Segments)

- **Current:** With employee contributions to UCRP at 5% of pay
- **New PEB Designs:** Proposed redesign of pension (A – 1.5%/3% option) and retiree health plans

Element of Remuneration	UC Average		Market Average	Variance ¹ from Market	
	Current	New PEB Designs		Current	New PEB Designs
Total Cash Compensation	\$67,727	\$67,727	\$77,948	-13%	-13%
Health & Welfare Benefits	\$19,894	\$19,894	\$18,730	+6%	+6%
Medical & Dental	\$17,698	\$17,698	\$16,684	+6%	+6%
Life Insurance ²	\$1,452	\$1,452	\$1,362	+7%	+7%
Long-term Disability	\$743	\$743	\$564	+32%	+32%
Dependent Tuition	\$0	\$0	\$120	n/a	n/a
Total Retirement	\$15,740	\$8,333	\$10,665	+48%	-22%
Retirement (DB/DC)	\$9,570	\$4,980	\$8,729	+10%	-43%
Retiree Medical	\$6,135	\$3,313	\$1,869	+228%	+77%
Retiree Life	\$35	\$40	\$67	-47%	-40%
Total Remuneration	\$103,361	\$95,954	\$107,343	-4%	-11%



¹ All variance figures shown are rounded to the nearest whole percentage.

² Includes pre-retirement survivor benefits.



Total Remuneration Analysis of PEB Changes Pension Design A

Ladder Rank Faculty Detailed Results

- **Current:** With employee contributions to UCRP at 5% of pay
- **New PEB Designs:** Proposed redesign of pension (A – 1.5%/3% option) and retiree health plans

Element of Remuneration	UC Average		Market Average	Variance ¹ from Market	
	Current	New PEB Designs		Current	New PEB Designs
Total Cash Compensation	\$112,198	\$112,198	\$124,177	-10%	-10%
Health & Welfare Benefits	\$25,163	\$25,163	\$23,798	+6%	+6%
Medical & Dental	\$19,479	\$19,479	\$18,539	+5%	+5%
Life Insurance ²	\$4,093	\$4,093	\$3,529	+16%	+16%
Long-term Disability	\$1,591	\$1,591	\$1,288	+24%	+24%
Dependent Tuition	\$0	\$0	\$442	n/a	n/a
Total Retirement	\$20,693	\$12,842	\$19,983	+4%	-36%
Retirement (DB/DC)	\$15,662	\$10,040	\$16,993	-8%	-41%
Retiree Medical	\$4,991	\$2,757	\$2,853	+75%	-3%
Retiree Life	\$40	\$45	\$137	-71%	-67%
Total Remuneration	\$158,054	\$150,203	\$167,958	-6%	-11%



¹ All variance figures shown are rounded to the nearest whole percentage.
² Includes pre-retirement survivor benefits.
³ Please note there were differences in retirement assumptions used for LRF relative to other personnel programs. Actual retirement experience for LRF has been incorporated at the request of the Total Remuneration Advisory Group of the Faculty Welfare Committee. See Appendix A for additional information.



Total Remuneration Analysis of PEB Changes Pension Design A

Medical Centers Detailed Results (All Staff Population Segments; Does not include Health Sciences Faculty)

- **Current:** With employee contributions to UCRP at 5% of pay
- **New PEB Designs:** Proposed redesign of pension (A – 1.5%/3% option) and retiree health plans

Element of Remuneration	UC Average		Market Average	Variance ¹ from Market	
	Current	New PEB Designs		Current	New PEB Designs
Total Cash Compensation	\$71,409	\$71,409	\$72,859	-2%	-2%
Health & Welfare Benefits	\$15,503	\$15,503	\$15,429	0%	0%
Medical & Dental	\$15,268	\$15,268	\$14,837	+3%	+3%
Life Insurance ²	\$170	\$170	\$231	-26%	-26%
Long-term Disability	\$65	\$65	\$362	-82%	-82%
Total Retirement	\$18,764	\$13,148	\$12,998	+44%	+1%
Retirement (DB/DC)	\$12,112	\$8,789	\$11,462	+6%	-23%
Retiree Medical	\$6,652	\$4,359	\$1,535	+333%	+184%
Total Remuneration	\$105,676	\$100,060	\$101,286	+4%	-1%

¹ All variance figures shown are rounded to the nearest whole percentage.
² Includes pre-retirement survivor benefits.



From the July 14, 2010 update of the Total Remuneration study. For Retiree Medical, the University contribution is calculated to 2013 and does not show the full effect of the proposed 70% floor.

Since the Total Remuneration analysis of Plan Design A is reasonably competitive for Clinical Enterprises' staff, an analysis of Plan Design B was not done for this group.

Total Remuneration Analysis of PEB Changes Pension Design B

Campus and UCOP Detailed Results (All Population Segments)

- **Current:** With employee contributions to UCRP at 5% of pay
- **New PEB Designs:** Proposed redesign of pension (B – 2%/3% option) and retiree health plans

Element of Remuneration	UC Average		Market Average	Variance ¹ from Market	
	Current	New PEB Designs		Current	New PEB Designs
Total Cash Compensation	\$67,727	\$67,727	\$77,948	-13%	-13%
Health & Welfare Benefits	\$19,894	\$19,894	\$18,730	+6%	+6%
Medical & Dental	\$17,698	\$17,698	\$16,684	+6%	+6%
Life Insurance ²	\$1,452	\$1,452	\$1,362	+7%	+7%
Long-term Disability	\$743	\$743	\$564	+32%	+32%
Dependent Tuition	\$0	\$0	\$120	n/a	n/a
Total Retirement	\$15,740	\$9,715	\$10,665	+48%	-9%
Retirement (DB/DC)	\$9,570	\$6,362	\$8,729	+10%	-27%
Retiree Medical	\$6,135	\$3,313	\$1,869	+228%	+77%
Retiree Life	\$35	\$40	\$67	-47%	-40%
Total Remuneration	\$103,361	\$97,335	\$107,343	-4%	-9%



¹ All variance figures shown are rounded to the nearest whole percentage.

² Includes pre-retirement survivor benefits.



Total Remuneration Analysis of PEB Changes Pension Design B

Ladder Rank Faculty Detailed Results

- Current: With employee contributions to UCRP at 5% of pay
- New PEB Designs: Proposed redesign of pension (B – 2%/3% option) and retiree health plans

Element of Remuneration	UC Average		Market Average	Variance ¹ from Market	
	Current	New PEB Designs		Current	New PEB Designs
Total Cash Compensation	\$112,198	\$112,198	\$124,177	-10%	-10%
Health & Welfare Benefits	\$25,163	\$25,163	\$23,798	+6%	+6%
Medical & Dental	\$19,479	\$19,479	\$18,539	+5%	+5%
Life Insurance ²	\$4,093	\$4,093	\$3,529	+16%	+16%
Long-term Disability	\$1,591	\$1,591	\$1,288	+24%	+24%
Dependent Tuition	\$0	\$0	\$442	n/a	n/a
Total Retirement	\$20,693	\$14,769	\$19,983	+4%	-26%
Retirement (DB/DC)	\$15,662	\$11,967	\$16,993	-8%	-30%
Retiree Medical	\$4,991	\$2,757	\$2,853	+75%	-3%
Retiree Life	\$40	\$45	\$137	-71%	-67%
Total Remuneration	\$158,054	\$152,130	\$167,958	-6%	-9%



¹ All variance figures shown are rounded to the nearest whole percentage.

² Includes pre-retirement survivor benefits.

³ Please note there were differences in retirement assumptions used for LRF relative to other personnel programs. Actual retirement experience for LRF has been incorporated at the request of the Total Remuneration Advisory Group of the Faculty Welfare Committee. See Appendix A for additional information.



Workforce Behavior

Workforce Behavior

At the request of the University, Mercer Human Resources Consulting (Mercer) conducted a study in June 2007 on the impact of various retirement programs (Defined Benefit, Defined Contribution, and retiree health care plans) on workforce behavior at higher education and research institutions, with a particular focus on faculty. Mercer catalogued and summarized the findings of relevant publications in an effort to understand the implications of potential changes to the University's Post-Employment Benefits. They looked for research on how different pension plan designs might influence employees' decisions on when to retire, any preferences for particular designs and whether DB plans might induce earlier retirements as compared to DC plans. The influence of retiree health plans on retirement decisions also was considered, as well as the effect of government-provided benefits such as Social Security and Medicare. Since multiple factors influence decisions on retirement, Mercer particularly looked for research that had attempted to isolate the influence of retirement plans versus other factors. They reviewed available research on how pension plans influence employees' behavior before retirement: choice of an employer, decision to remain with an employer, turnover rates and whether employees tend to choose organizations sponsoring DB, rather than DC plans. Finally, they analyzed whether pension plans contribute to improved productivity and morale at higher education institutions.

The study used publicly available research materials, including academic research papers, articles and other publications that fully or partly addressed the questions around workforce behavior and benefit designs. Some research materials were juried publications presented in reputed academic journals while others merely presented the authors' views. The research was limited by the availability of demographic and other data. Mercer reviewed 48 papers in the course of the study. The full study can be found in Appendix F.

Some of the observations from Mercer's summary were that:

- Faculty at academic institutions is aging and the end of mandatory retirement may delay retirements more in the coming decade. Orderly retirement of older faculty while preserving the value of their contributions is critical to faculty renewal and the University's ability to respond to increased demands likely in a global knowledge-based economy.
- Generally, pension and retiree health plans significantly influence employees' retirement decisions and the timing of those decisions.
- DB and DC plans influence retirement decisions and rates of retirement differently.

- DB plan retirement rates tend to cluster round age-specific incentives such as early eligibility ages or the age at which the maximum benefit formula is reached.
- DB plans induce retirement at earlier ages than DC plans by about two years.
- DB plans influence longer service, while DC plans promote mobility.
- DC plans are age-neutral in terms of retirement rates at specific ages.
- There is no clear evidence showing employee preference for DB or DC plans, though recent studies of public systems indicate that public employees may have a preference for DB plans. But, based on the available information, this is not conclusive.
- Compensation, health care benefits and the tenure process influence attraction and retention of faculty more strongly than pension programs.
- Retirement rates are delayed when retirees do not have access to health coverage or the cost of the coverage increases. The degree of difference between active and retiree health care options also impacts retirement rates.

Mercer noted that they did not find research applying behavioral economics theories to understanding faculty behavior around employment and retirement. They also stated that it was not clear from the materials they reviewed whether the influence of Post-Employment Benefits would change by generational cohorts.

Implementation Issues

Implementation Issues

Collective Bargaining

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.

Benefit levels and the member contribution rates modeled in this report are dependent on the specified implementation dates, as approved by The Regents. Variations in the implementation date of the recommendations for a group may impact that group's benefit levels and member contribution rates.

Communications (for Choice models)

The Task Force has throughout its work has sought to meet the mandate the President gave at its inception, namely that it engage in a robust communication and consultation process. This mandate will be critically important as the PEB process move to its next phase implementation. Work is underway to frame a comprehensive communication plan to accompany and support each phase of the implementation (see Appendix I)

In the event the University offers UCRP members a choice between the current UCRP design and the New Tier design, extensive background material and options for personal counseling will be needed. Multiple media approaches to reach and educate members will be critical to accomplish the intended outcomes. Explaining the UCRP New Tier benefits and the Retiree Health graduated eligibility formula will present formidable challenges, given the complexity of the designs. The Regents' actuary observed during the Task Force meetings that the integrated pension concept was extremely difficult to communicate and administer. Counseling UCRP members who have one set of benefit rules for service before 2013 (proposed implementation date of New Tier) and another set of rules for service after that date will tax already depleted existing staff and operational resources. Patience and understanding will be required for all members (active and retired) and University administrators.

Systems and Operations Resources

As the Task Force moved into the later stages of its work a Technical Advisory Committee was formed to begin an early assessment of implementation issues such as systems and operations. Even as the Technical Advisory Committee reviewed the broad PEB concepts, it concluded that the

impacts to support systems and staff resources could be substantial. Staff and related resources will be needed during three distinct phases to support the goals of the PEB Task Force:

- Added resources to perform detailed analysis as the final concepts become more concrete and the functional details emerge.
- Added resources, possibly significant, to design, test and implement the changes.
- Ongoing resources to maintain the implemented changes.

Information systems that could be impacted include:

- The University Retirement System
- The University Payroll system
- The HR member service site, At Your Service
 - Enrollment and Proposed Choice Process
 - Tools supporting member decision-making
 - Human Resources administration tools
- Additional decision-support analytical and reporting tools – as the University provides new options and plan members make choices.

As proposed, administering the UCRP New Tier for current members who choose this option will require systems capability to track two types of benefit formulas (previous UCRP plus New Tier) – for example to apply two different COLA formulas, and permit lump-sum cashout options for only part of such a member's service. The early assessment of the Technical Advisory Committee is that it may or may not be possible to support implementation of the PEB recommendations within the current and existing systems framework and capacity of the University.

Communication and Consultation

Communication and Consultation

In support of the robust communication and consultation process requested by The Regents and the President, the Task Force used several methods to assure it met this aspect of its charge.

Website

Shortly after its formation, the Task Force established a Website for interaction with the University community – one that would serve as an ongoing source of information on the Task Force and its work. The site has had an open Q&A function with a high level of activity and effectiveness in reaching the University community; over 100,000 individuals used it between February and June 2010.

The site is “The Future of UC Retirement Benefits” at:
<http://www.universityofcalifornia.edu/news/ucrpfuture/>

Location Forums

The Task Force conducted open forums in Fall 2009 and Spring 2010 at every location within the University. They used a panel format and twenty-seven Task Force members participated in one or more forums. These presentations were designed to educate the University community, update them on the process and obtain their feedback and comments. There were sixty-five presentations reaching over 12,000 faculty, staff and retirees with many location having webcasts. These meetings were successful and well received, with strong, open exchanges during the question and answer periods. Union representatives attended most sessions. The University also met with union coalition leaders at the very beginning of each set of location forums to share the presentation, answer questions and solicit feedback, which was incorporated into the presentations. The fall and spring final presentations with audio tracks are posted on the University website: “The Future of UC Retirement Benefits.”

Going forward, the University’s communication around the PEB process is described in a proposed draft attachment for a September Regents’ item (see Appendix I).

Consultation

As the range of potential options and recommendations were narrowed, a wider consultation process began in March 2010. Consistent with practice and principles of shared governance, Task Force representatives met with Academic Senate committees on Planning and Budget and on Faculty Welfare. Based on their guidance, information also was shared with Academic Senate Division

Executive Councils. A University Budget Summit with the Academic Council and University leadership provided another opportunity for discussion of PEB and the Task Force's work to date. Academic Senate representatives were members of all three PEB Work Teams and have made significant contributions throughout the process.

The Chair, Vice Chair and Vice Chair-elect of the Academic Senate are members of the Task Force. In April and May, the Academic Senate Chair and Vice-Chair began informational meetings with the Academic Senate Divisions about the Task Force's work, soliciting their comments and views. Extensive consultation was undertaken with administration and leadership peer groups within the University, including the Executive Vice Chancellors, Vice Chancellors for Administration and Vice Chancellors for Planning and Budget. Broad consultation will continue on the final Task Force recommendations and through all phases of implementation. The University also will meet its obligations under HEERA as it engages in the collective bargaining process.

Surveys

Early in 2010, the University conducted a targeted online survey of PEB preferences. The questions were modeled on Towers Watson's 2009 national survey: *Effect of the Economic Crisis on Employee Attitudes Toward Retirement* and 17,700 UC faculty and policy-covered staff were randomly selected to participate⁵⁵.

At the same time, an open on-line random survey with six questions (in English and Spanish) was posted on the Future of UC Retirement Benefits web site. A separate survey was posted for retirees to respond to questions about Retiree Health Benefits. Both surveys were voluntary and confidential and designed to help University management and the Task Force understand:

- Faculty, employee and retiree PEB preferences
- How changes could impact workforce behavior
- Areas of needed education and additional communication

The targeted survey had a 23% response rate; 9,000 faculty and policy-covered staff and 3,000 retirees responded to the open survey.

The results confirmed that the Post-Employment Benefit package is a key motivator for talented faculty and staff coming to the University and staying, regardless of the demographics. Retiree

⁵⁵ An invitation to the union coalition for represented employee participation was declined.

responses expressed overwhelming satisfaction with the Retiree Health program. Towers Watson's analysis of the survey results included these key observations:

- UC has a very high satisfaction rate with the retirement program reporting an 81% favorable rating.
 - 82% of respondents indicated the retirement program as an important reason they stay at the University. Results did not vary appreciably by group (faculty vs. staff, campus vs. medical).
- The high value that employees place on the retirement program persists regardless of age.
 - Over 70% of workers under age 50 are satisfied with the Retirement Program.
 - Well over 50% of employees under age 40 would be willing to pay more to retain the DB plan.
 - Results for younger employees at UC far exceed what is typically seen among younger employees elsewhere.
 - Widespread and uniformly high value placed on Retirement Benefits suggest that cost shifting alternatives (in addition to benefit changes) be considered.
- There is broad-based interest among UC employees in paying more (5%-7% of their pay each month) to retain a lifetime monthly pension benefit.
 - Only 13 percent of respondents responded favorably to receiving higher cash pay today for a lower retirement benefit. In fact, 69 percent of respondents disagreed with this statement.
- Support remains high among retirees
 - Among retirees the UCRP was ranked as the most important source of retirement security; 80% of respondents ranked it as number 1.
 - Regarding retiree medical, 58% of retirees indicated they would be willing to pay a higher amount each month in order to keep lower, predictable health care costs.

Overall, the survey results showed that the workforce is committed to the University. Most employees plan to stay twenty or more years. High satisfaction among plan members gives the University a competitive edge in recruiting and retaining top quality faculty and staff so changes need to be carefully viewed for potential disruption in the existing relationship between key elements of the workforce and the University.

Towers Watson's analysis of the results is in the *Report of Findings*, March 2001:
<http://www.universityofcalifornia.edu/news/ucrpfuture/survey.html>

Retirees – a Vital Part of the University Community

The relationship to UC as both a member and contributor continues into retirement, with many emeriti and retirees providing valuable service to the University, much of it voluntary. The Council of UC Emeriti Association report, “UC Emeriti Bibliographic Survey 2007-2009, ” provides ample evidence of this. They surveyed over 3,600 emeriti and 33% with a median age of about 76 responded. Of these, more than 350 contributed funds to the University through extramural grants supporting over 1,350 staff as well as providing liberal sums for University overhead. Over half of the survey’s respondents taught, as well as teaching and advising graduate and undergraduate students at various University campuses. Emeriti frequently serve on many committees throughout the University and are a strong part of fund-raising entities. Additional data on the contributions of Emeriti can be found in Appendix G, “UC Emeriti Bibliographic Survey 2007-2009”.

Retired University managers and staff also contribute heavily to the University, often being recalled to service because of their expertise and knowledge of the University community. This has been particularly valuable to the University in recent years as “baby-boomers” begin to retire and budgets have been cut. University retirees continue to be a vital and valuable resource to the University. This fact provides additional support to the Task Force’s view that making an ongoing commitment to sustainable Post-Employment Benefits is a major part of an effective talent management strategy for the University.

In Summation and Next Steps

This full report includes all of the recommendations with details of the discussions and related analyses. The separate Executive Summary contains the majority of the Task Force Recommendations. The full Report Appendices are intended to serve as a compendium and reference library for others, as they continue the next phases of the PEB work. In these documents can be found the history of UC pension and retiree health benefit programs, Regents actions on these programs, and responses to such issues as the University's current position in Total Remuneration, a review of research on workforce behavior and retirement programs, comparator information on Task Force program design proposals and funding analyses of PEB, the results of the PEB employee survey, and a wide range of background materials.

In closing, this work has been long, contentious and difficult. It has been so because of the vital issues and questions involved. The members of the Task Force Steering Committee and its Work Teams have shown through their diligence and passion a commitment to UC and its long-term future that was only a much-desired aspiration at the outset of this effort. Though much has been accomplished to date, the greater work is ahead of us in the processes of consultation, communication, decision-making, implementation planning and execution of the recommendations for Post-Employment Benefits at the University of California.

To those who now take on the next phases of this work, from those who have participated and completed this phase of it, remember these watch words from Winston Churchill - *"Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning."*