Executive Summary

The Report of

The President's Task Force on

Post-Employment Benefits

July 2010

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

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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
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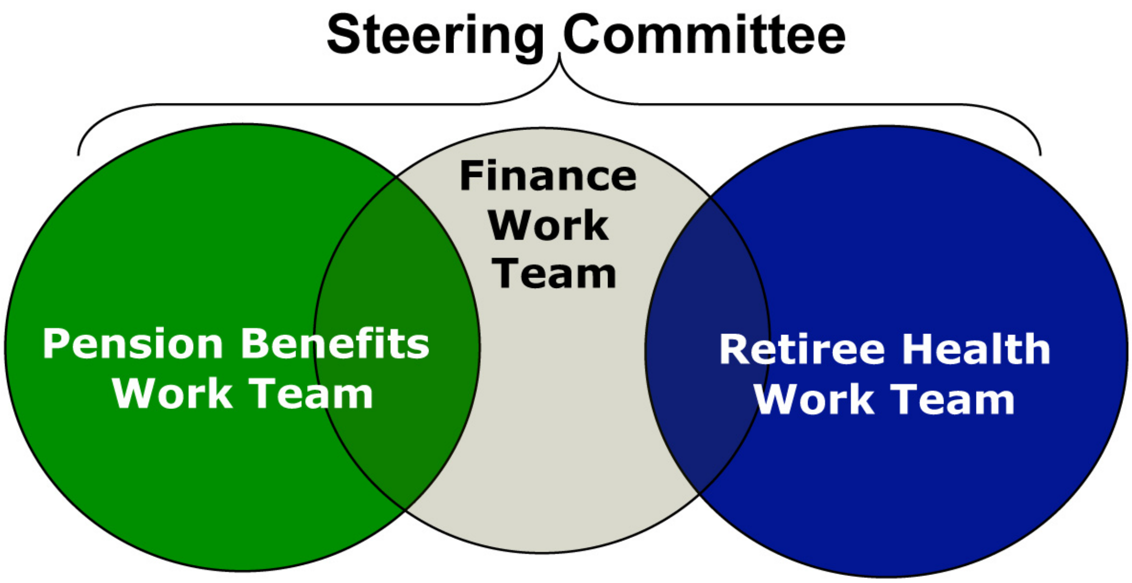
UC's Post-Employment Benefits Task Force

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 March 2009, the President of the University commissioned a Task Force on Post-Employment Benefits (PEB) to develop a comprehensive approach and related recommendations to 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 the final 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



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, work force development and renewal, work force 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.

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."

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 content expertise throughout this process and helped shaped the final recommendations.

PEB Background on Defined Benefit and Retiree Health Programs

The University of California has long provided valuable Post-Employment Benefits, principally a Defined Benefit[1] (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. Further confirmation of the importance of PEB to UC faculty and Staff can be found in the results of the PEB Survey which that Task Force authorized during the course of it deliberations. The full PEB Survey report findings and the survey questions can be found in the Final Report of the Task Force. 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 (pension income for all future services and Retiree Health) 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

[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.

time is right, it provides little incentive for retirement. 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. 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.

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 the plan for nearly twenty years.

On an annual basis, UCRP was funded since its establishment in 1961 until 1990. University and member contributions 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 contributions to UCRP due to the Plan's overfunded status at that time.

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 compensation[3] would have been required in 2009-10 fiscal year[4]. 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 factor[5], 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.

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[3] See footnote 22, page 21.

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

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

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 Cost[6] 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 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 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-value[7] 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

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

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

amortizes[8] losses over five years, the plan was 95% funded on July 1, 2009. An updated actuarial valuation[9] is presented each November to the Board of Regents. Because the 2009 actuarial funding ratio excludes 80% of the 2008-2009 losses, the funding ratio[10] will drop significantly as those losses are taken into account over the following four years.

Returning UCRP to a sound footing requires contributions equal to the "Annual Required Contribution" (ARC), 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

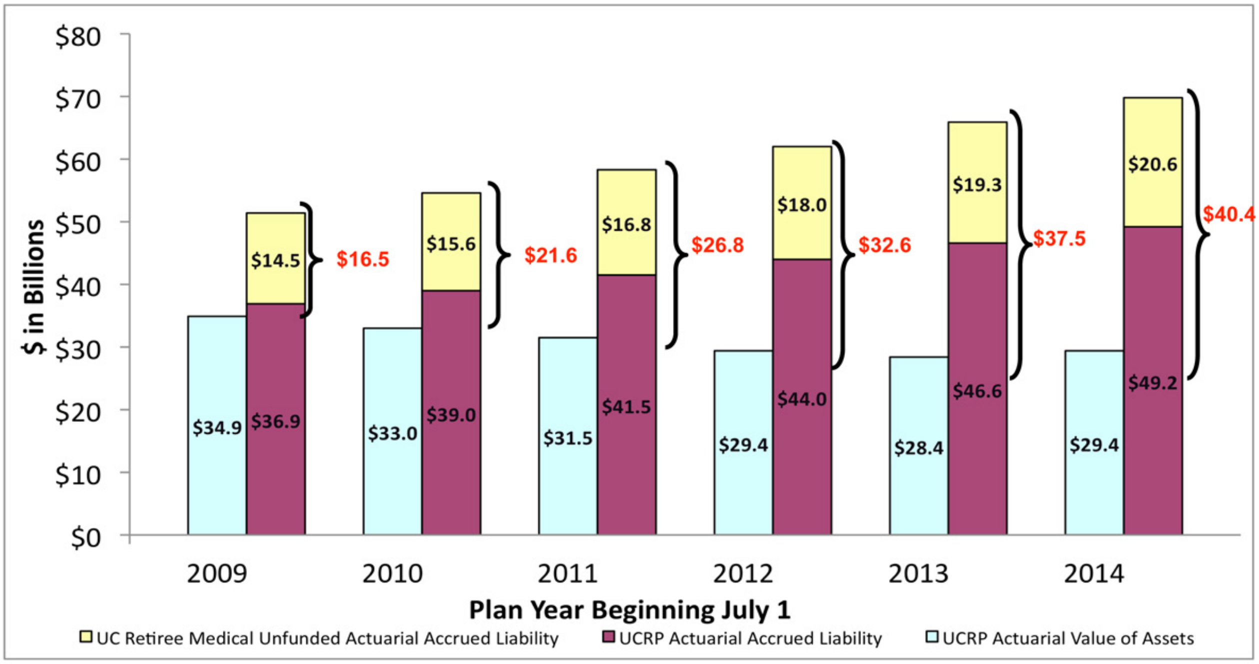
[8] Amortize: Amortize: to spread a debt in equal installments over a fixed period. Similar to a mortgage, a pension amortization period has fixed annual amounts with differing levels of principal and interest.

[9] 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

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

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:

PEB Assets and Liabilities for Campuses and Medical Centers



Calculations assume a 7.5% return on UCRP investments but do not include 2009-2010 returns above this amount.

The University must show the cumulative unfunded Annual Required Contribution or ARC[11] 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 nearly twenty years 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.

[11] ARC: A measure of needed plan funding used by GASB (Governmental Accounting Standards Board). The ARC has two parts: the Normal Cost (see footnote 6, p. 10) and the Amortization, which is the annual amount needed to eliminate the unfunded liability over the plan's amortization period, which is currently 15 years under the Regents' targeted funding level.

Not collecting money from the State also means we 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. 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 reform[12] 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.

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.[13]

[12] 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

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

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.

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 All Task Force Recommendations

Note that the numbering in the summary matches the full PEB Report. Not all of the recommendations appear in the Executive Summary.

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: ▪ 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.		

Selected 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, 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.

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	Members
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 member[14] 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[15].) However, a more rapid increase in member contributions represents a substantial impact on the Total Remuneration[16] of current employees, varying by workforce segment. It also is problematic for the University, raising employer contributions to 23% by 2018-19.

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.

[14] Safety Members: UCRP members appointed to eligible police or firefighter positions.

[15] See footnote 20, page 20.

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

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 will fall short over time. To protect pension purchasing power, the current UCRP 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.

Implement a UCRP 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 14, page 17 for definition of Safety member.)
Reduction for early retirement	5.6% per year; same as current UCRP reduction
HAPC[17]	36 consecutive months; same as current UCRP
Maximum Benefit	100%, same as current UCRP
Vesting[18]	5 years; same as current UCRP
Post-Retirement COLA	Cost-of-Living Increase 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[19]	Included; same as current UCRP
Choice[20]	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	▪ Lump sum cash out ▪ Inactive member cost-of-living increase ▪ Subsidized survivor benefits ▪ Social Security supplement[21] ▪ $133 offset to HAPC ▪ $19 offset to member contributions.

[17] 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.

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

[19] Reciprocity: Agreements between pension plans to coordinate benefit calculations.

[20] The University is working with the Internal Revenue Service (IRS) 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.

[21] 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 the current UCRP formula, the New Tier would:

- Multiply an age factor times the years of service credit times Highest Average Plan Compensation (HAPC), the highest average covered compensation[22] 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.

A 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;

[22] 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) Restoration benefits raises or eliminates those limits.

- No temporary Social Security supplement for retirees under 65 to replace the $133 offset to HAPC; no $19 offset to member contributions. This is a modest increase in benefits and member contributions.

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 Member contribution	1.5% of HAPC below Social Security Covered Compensation[23], 3.5% 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 Member contribution	2.0% of HAPC below SS Covered Compensation; 4% contribution 3.0% of HAPC above SS Covered Compensation; 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.

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.

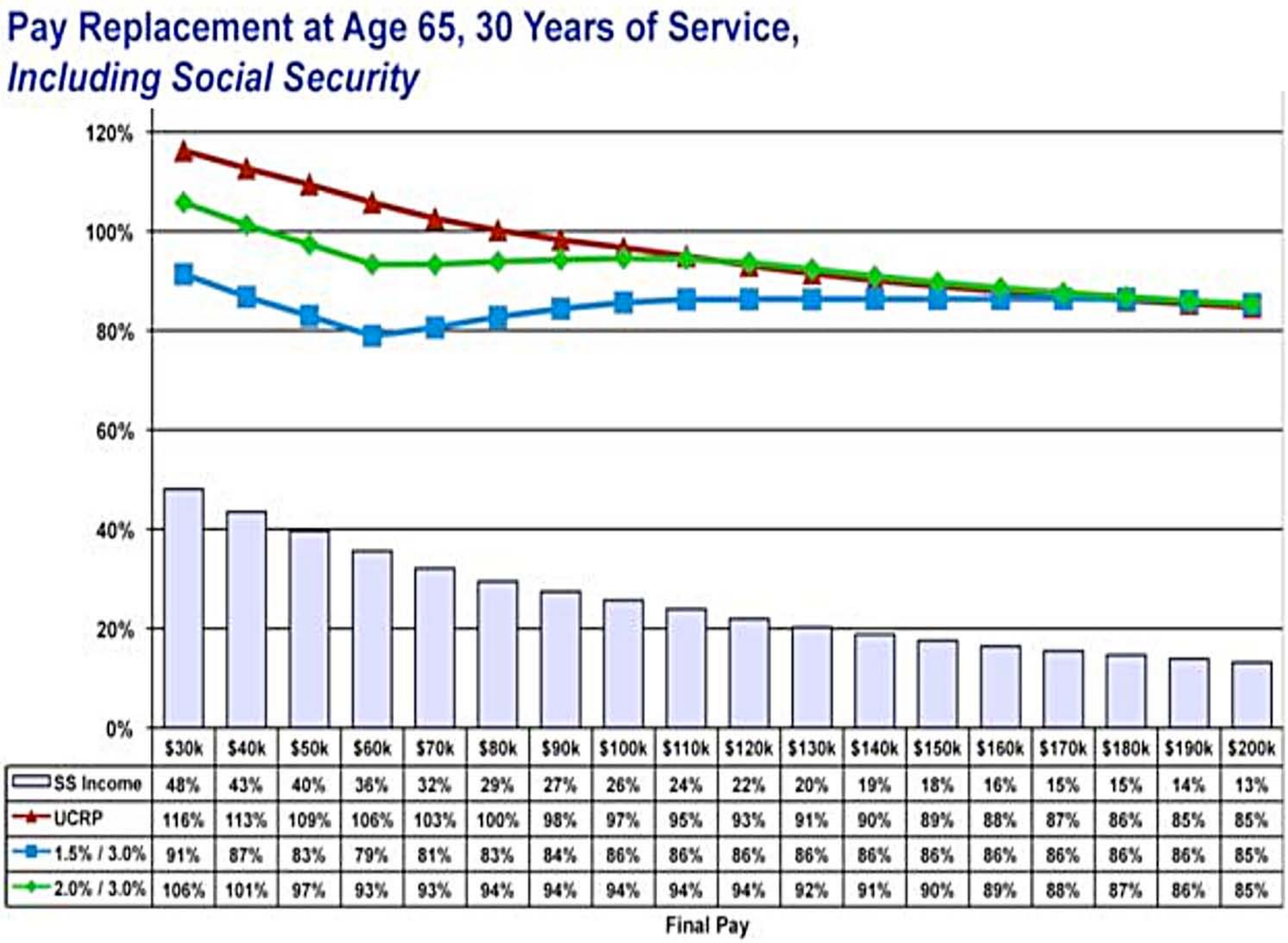
At age 65, Pension design B would provide a benefit of 2.0% of HAPC up to the Social Security covered compensation and 3.0% above that amount. Plan design B reduces the dip in income replacement at around $60,000 salary present in Plan design A. For example, for an employee at age 65 with 30 years of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

[23] Social Security Covered Compensation: For each year, the average Social Security wage base for the 35 years ending in that year. The amount is adjusted annually for inflation.

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 Levels[24] – Social Security plus Current UCRP, Proposed New Tier Designs



	$30k	$40k	$50k	$60k	$70k	$80k	$90k	$100k	$110k	$120k	$130k	$140k	$150k	$160k	$170k	$180k	$190k	$200k
SS Income	48%	43%	40%	36%	32%	29%	27%	26%	24%	22%	20%	19%	18%	16%	15%	15%	14%	13%
UCRP	116%	113%	109%	106%	103%	100%	98%	97%	95%	93%	91%	90%	89%	88%	87%	86%	85%	85%
1.5% / 3.0%	91%	87%	83%	79%	81%	83%	84%	86%	86%	86%	86%	86%	86%	86%	86%	86%	86%	85%
2.0% / 3.0%	106%	101%	97%	93%	93%	94%	94%	94%	94%	94%	92%	91%	90%	89%	88%	87%	86%	85%

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.

[24] 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

- 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 Plan design A.
- The green line with diamonds shows the percent of total replacement income from Social Security plus the New Tier Plan design B.
- Further study is needed to determine whether a refinement in the design could result in a more level amount of total replacement income across all income groups.

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 options that were accepted for inclusion in this section can be found in Appendix G of the full 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 G of the Final Report, "Update to 2009 Total Remuneration Study," under the title "Risk Valuation Analysis". 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 work force segment based on their mission-critical status or another work force 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.

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 (IRS) 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.

Explore a Defined Contribution Plan 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 plan (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, such a program's full 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

Safety Members[25]**:** 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.

UC PERS Plus 5 Plan[26]: 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.

However, the Internal Revenue Code also expressly authorizes public employers, such as UC, 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. About $17 million of the general assets of the University have been

[25] See footnote 14, page 17.

[26] 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.

earmarked for the 415(m) Restoration Plan; the Plan's projected liabilities are $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 recommends that:

1. The 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.

2. 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 Faculty[27], 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:

1. 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.

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

2. 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 severance issues for senior managers. An immediate and comprehensive assessment should be undertaken by UC administration to resolve this issue.

UC'S Retiree Health Program

Addressing the Fiscal Challenge in Retiree Health:

This separate Post-Employment Benefit began in 1962 with a $5 per month University contribution. Based on a Regents' delegation, 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 vested[28] 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 F of the full report, "UC Emeriti Bibliographic Survey 2007-2009".) Therefore, the Task Force strongly recommends that the University continue to provide Retiree Health benefits.

The program now covers over 35,000 UC retirees and 18,000 family members. The 2009/2010 annual cost is around $250 million. Another 27,000 active 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

[28] See footnote 18, page 20.

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.

Selected 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, 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.

The Task Force recommendations reduce 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% through the following steps:

Change Retiree Health Eligibility

In recognition of the intent to encourage retirement at a later age, implement a new graduated eligibility formula[29] 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 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%.

[29] Retiree Health program eligibility was last changed January 1, 1990 for new hires.

The following 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%	50.0%
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%	28.0%	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.

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.

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 active employees 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.

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.

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 actives; thus, this group would not fall under the graduated eligibility schedule proposed above. The proposed scale *would* apply to faculty and staff who retire before age 65 and do not qualify for the 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.

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.

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.

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. UC should carefully monitor national health care reform, 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**.**

The Financial Issues

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.

Addressing the Fiscal Challenge in UCRP

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, some recommendations were made by both Teams. 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.

Specifically, the Finance Team recommended the following immediate finance strategies:

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. To establish a policy contribution rate more closely aligned with a realistically attainable actual contribution rate for UCRP, the Task Force 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 level[30]. This change more closely aligns UCRP with other government pension plans. Increasing the amortization period for the unfunded liability provides the University with $4.5 billion of cash flow relief over the next ten years.

Increase University and Member Contributions to UCRP More Rapidly[31]

The increase in contributions would apply to the University as well as 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:

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

[31] *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.*

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[32] member rate: July 1, 2011: 4.5% (less $19); July 1, 2012: 6% (less $19)

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.

1. 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.

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

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

4. Borrow from STIP to fund the full UCRP ARC 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

[32] See footnote 14, page 17.

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). The Finance Team explored the possibility of issuing Pension Obligation Bonds 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 Health unfunded liability. The University essentially would exchange one liability, the unfunded liability, for another liability, the POB 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.[33] Since most of these POBs are still outstanding, the final return on them is unknown.

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

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

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).

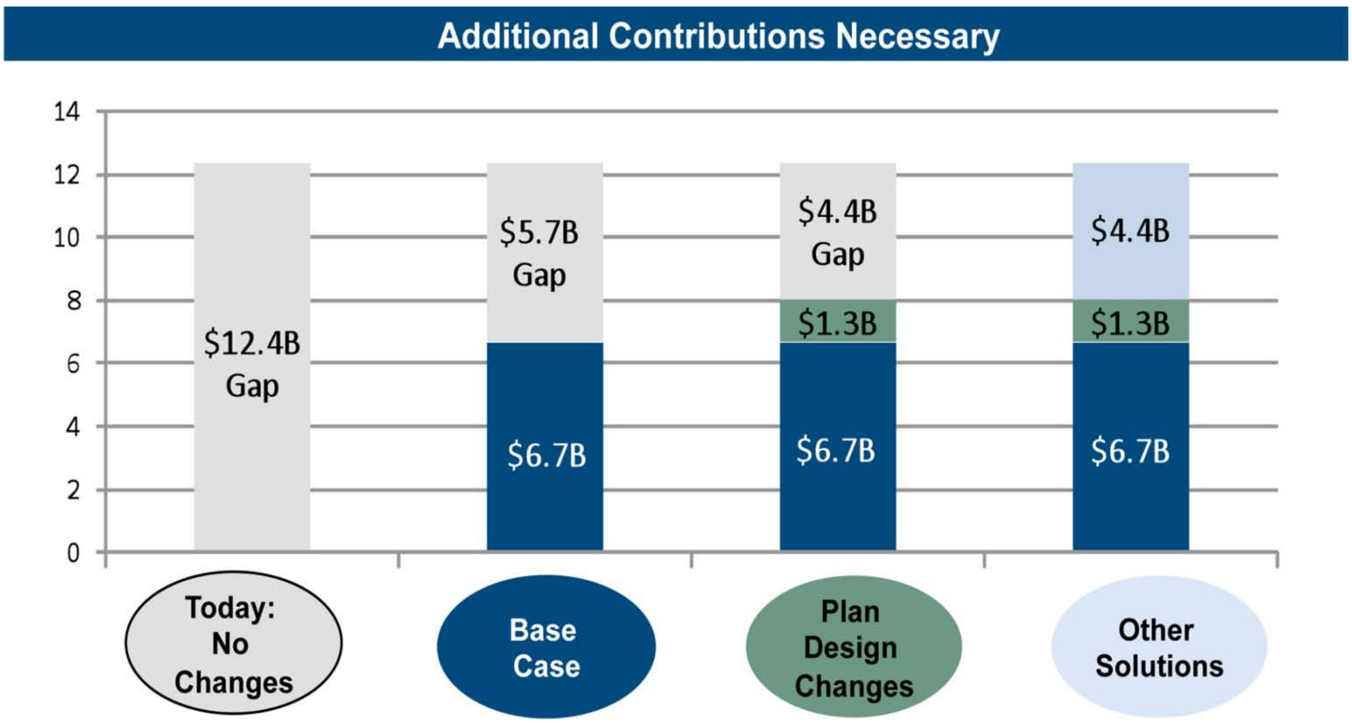
  Over a thirty-year period, each 1% in added contributions would total $2.4 billion.

  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.

Addressing the Fiscal Challenge in Retiree Health

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.

In Summation and Next Steps

This Executive Summary contains the majority of the Task Force Recommendations. The full report includes all of the recommendations with details of the discussions and related analyses. The Final 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."*