COMMITTEE ON FACULTY WELFARE
Report on the New Third Tier of Retirement

To: Academic Senate, Santa Cruz Division

As part of the 2015-2016 Budget agreement between the University, the Governor, and the Legislature, the State will provide a total of $436 million for the University of California Retirement Plan (UCRP) over the next three years. In return, the University must implement a new pension tier within UCRP for employees hired on or after July 1, 2016 with a limit or cap on the amount of covered compensation (CCL) that can be used in calculating retirement income that matches the State retirement plans Public Employees' Pension Reform Act (PEPRA) legislation ($117,020). The University has the option of creating a supplemental Defined Contribution (DC) plan to accompany the Defined Benefit (DB) plan with this cap.

The impact of the new retirement plan will be significant for those future employees whose salaries rise above this cap, most of which will be faculty. To address this problem, President Napolitano appointed a task force to develop options for new plans or supplemental plans that would support the University in remaining competitive enough to recruit and retain high quality employees and ensure the financial stability of UCRP. The report of this task force was released to campuses on January 15, 2016 with a response/comment deadline of February 15, 2016.[1] The president intends to make a final recommendation to the regents on March 23, 2016. A report guide was also supplied by Academic Senate Chair and Vice Chair Dan Hare and Jim Chalfant.[2] CFW's response to this report and analysis of the options explored are described herein.

Analysis of the Options Being Considered

The Committee on Faculty Welfare (CFW) reviewed the Retirement Options Task Force (ROTF) Report recommendations for two plans. As represented by "income replaced," both plans will provide significantly lower benefits than existing Defined Benefit plans. Given these limited options, CFW favors Plan A: UCRP 2016 Tier Plus DC, a hybrid with a Defined Benefit up to the CCL ($117K) supplemented with a Defined Contribution Plan up to the Internal Revenue Code (IRC) limit of $265K. The committee does not support Plan B: DC Choice Plan for reasons discussed below, and recommends that UC continue to contribute 14% to employee retirement to the IRC limit. The committee further recommends that UCRP reconsider the 7.25% rate of return on investments.

The hybrid plan A replicates a key feature of the current DB plans, providing a fixed retirement income with minimal risk. This one feature provides a sense of security that arguably keeps top faculty from seeking employment elsewhere despite the promise of higher salaries, but with the uncertainty of DC retirement plans. Even with the PEPRA cap, it is possible that the DB component will still be attractive, assuming the supplemental DC can cover much of the reduction

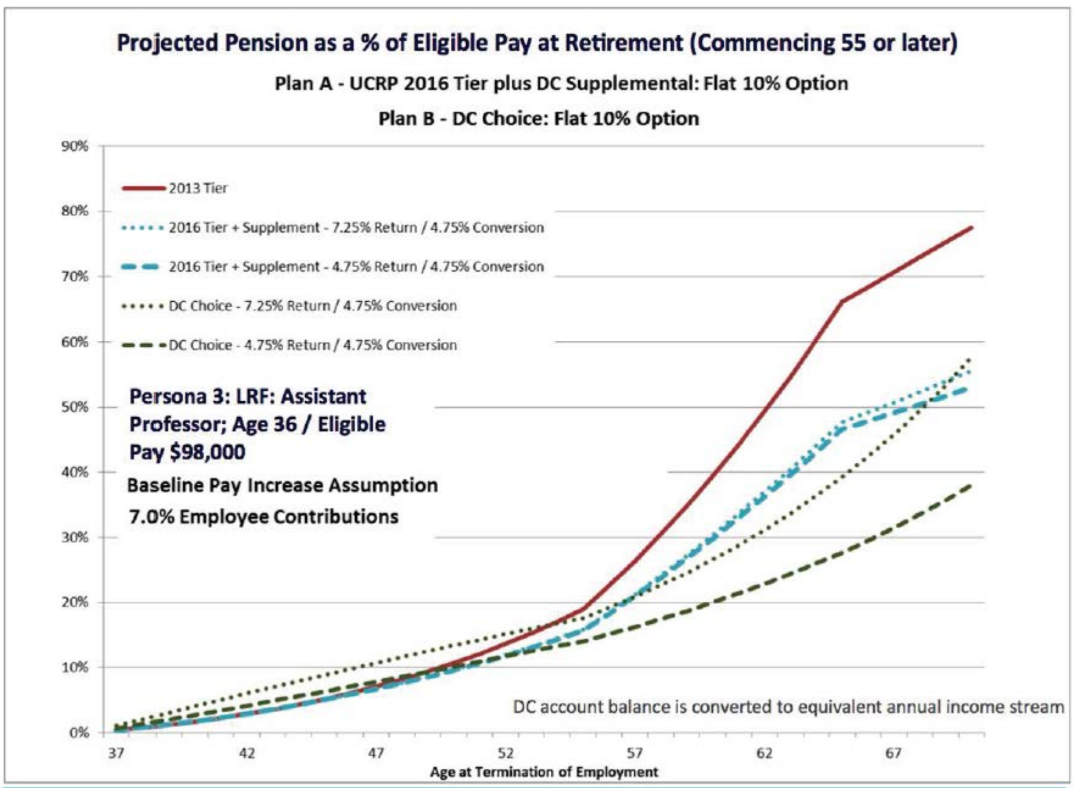
[1] The report, "University of California Retirement Options Task Force Report to the President (January 15, 2016)" may be viewed at - http://ucnet.universityofcalifornia.edu/compensation-and-benefits/2016-retirement-benefits/rotf-report.pdf

[2] The guide, "*A Guide to Reviewing the Recommendations of the Retirement Options Task Force Report* (January 15, 2016)" may be viewed at - http://senate.ucsc.edu/committees/cfw-committee-on-faculty-welfare/post-retirement-benefits/3ROTF%20Report%20Guide.pdf.pdf

in covered comp above the cap. Based on the data provided in the report, however, it is clear that the supplemental DC as proposed will be inadequate to achieve this (see figure 1). The combination of late initiation (at the PEPRA CAP) and % of employer/employee contributions at modest rates of return yield amounts that fall far short of matching the shortfall in income replaced that is provided by current DB plans (see figure 1). Closing the gap would require larger employer contributions to the benefit (~10%) above the CCL to the IRC cap, and/or initiating the DC plan and supplemental contributions well before the CCL is reached, for example, at the time of employment. With compounding interest, the latter would have the greatest potential impact assuming modest rates of return.

The full defined contribution (DC) plan considered in Plan B, is viewed by CFW as least desirable for both employees and the University. As articulated in the report, the full DC plan shifts the entire investment risk to the employee, and assuming less than optimal rates of return (i.e., <7.25%), will produce a lower level of "income replaced" over the long-term, thus encouraging many faculty to hold off retirement well beyond normal retirement age, while delaying the hiring of junior faculty. While certain employment situations might benefit from a DC option (e.g., short-term), these are uncommon and the added benefit small.

Figure 1. Modeled pension (% of eligible pay) at age of retirement for the 2016 Tier and DC choice plan options assuming employment at age 36, starting salary of $98K (for rates of return of 7.25 and 4.75%). The 2013 Tier is included for comparison (source: ROTC Report 2016).



CFW also questions whether the assumed 7.25% rate of return, as used for UCRP investments, is realistic given the transformation of the global economic landscape over the last decade. Such an assumption for either the supplemental or full DC plans will encourage an insufficient level of employer/employee investment. Standard industry projections for long-term returns on investments (i.e., next 30 years) are far less optimistic.

As for the Unfunded Accrued Actuarial Liability (UAAL) of UCRP, the impacts of the various options considered, either Plan A or B, appears to be relatively minor (assuming a continued surcharge (~6%) to pay down the unfunded liability up to the CCL). The report shows how the overall normal costs declines as 2016 Tier plan employees replace 2013 and 1976 Tier employees. Assuming the University holds the employer and employee contributions to UCRP constant, the amount not required to fund normal costs of UCRP would then go toward reducing the UAAL. Modeling by the task force (within a range of modest assumptions) suggests that even without the added UAAL contributions above the CCL for the 2016 Tier, the timing of return to full funding of UCRP is little changed. For the DC choice plan (B), however, there is a small trade off in the funding of the employee benefit and residual contribution to the UAAL. The greater the percentage toward the benefit, the lower the UAAL contribution. For example, the majority report recommended 10% to benefit, leaving 4% to UAAL. The lower UAAL contribution could be compensated for by continuing payments up to the IRC limit. In any case, the worse scenario is one with the DC choice (plan B) as default with a 4% surcharge, which CFW does not recommend. As a reminder, regardless of outcomes, the State is legally obligated to cover pension benefits to current employees. The current funded state of UCRP is a consequence of poor management with reallocation of pension funding over 20 years to support university operations and infrastructure, and to keep tuition down.

The Third Tier and Inequities between UC Campuses

CFW is operating under the assumption that the Tier III retirement is a "fait accompli" due to the May 2015 agreement between President Napolitano and Governor Brown. The committee, however, must state its opposition to an agreement that will further erode the total remuneration of UC faculty, weaken the University's ability to recruit and retain top faculty, and will likely increase total remuneration inequities between the UC campuses while potentially doing little to reduce the unfunded liability of UCRP. The campus breakdown of the 2014 Faculty Total Remuneration Study showed that UC systemwide lags comparison universities by 12%, with UCSC near the bottom relative to our sister campuses (-20%). For this reason, CFW supports the ROTF Report recommendation that the Tier III reduction in retirement benefits be compensated for with an increase in starting salaries. However, the committee notes that without significant adjustments in the on-scales systemwide, this would require additional increases in off-scales at the time of hiring. Some campuses, UC Los Angeles and UC Berkeley for example, might have sufficient resources (i.e. large endowments) to offer competitive salaries with larger off scales, whereas campuses such as UC Santa Cruz will be limited. Without the resources to provide a substantial boost in base salaries, it is likely that UCSC's ability to competitively hire and retain faculty will be disproportionately compromised by the reduction in retirement benefits.

Finally, the turn-around time (~30 days) for review and assessing the full impacts of the these proposed retirement options is grossly inadequate, particularly given the importance of retirement benefits to the welfare, recruitment and retention of faculty, and overall excellence of UC. The short turnaround time also undermines opportunities to fully vet the proposed options as the best course of action in terms of overall financial impacts on the University. For example, in the long run any savings gained from the retirement programs could be offset or exceeded by the cost of higher salaries to retain top faculty, and to continue paying high salaried senior faculty well beyond optimal retirement age.

Respectfully submitted;
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