UCRS Advisory Board

MINUTES
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)
ADVISORY BOARD MEETING
FRIDAY, FEBRUARY 22, 2013
10:00 AM – 2:00 PM

BOARD MEMBERS PRESENT: Chair Ross Starr, Vice Chair Shane White, Chief Investment Officer (CIO) Marie Berggren, Vice President (VP) Dwaine Duckett, CUCRA Chair Lee Duffus, CUCEA Chair W. Douglas Morgan, Vice Chancellor Meredith Michaels (via telephone), Associate Vice Chancellor Angela Hawkins, Assistant Researcher Catherine Brennan, Spectroscopist Paul Brooks.

BOARD MEMBERS ABSENT: Executive Vice President (EVP) Nathan Brostrom

STAFF PRESENT: Associate Vice President (AVP) Debora Obley, Principal Legal Counsel Barbara Clark, Managing Legal Counsel Margaret Wu, Executive Director Gary Schlimgen, Managing Director Jesse Phillips, Director Maria Anguiano, Director Kris Lange, Director Joe Lewis, Director Ellen Lorenz, Director David Olson, Associate Director Tony DiGrazia, Manager Adam Chen-Ok, Business Controls Leader Anne St. George, Coordinator Anne Wolf, Media Specialist Dianne Klein, Principal Analyst Robert Semple.

OTHERS PRESENT: CUCRA/CUCEA Representative Adrian Harris (via telephone), UCB Retiree Association representative Antonia Sweet, UCB Emeriti Association representative George Goldman, CUCFA representative Eric Hays, AFSCME representative Maricruz Manzanarez, AFSCME representative Claudia Preparata, AFSCME representative Liz Perlman, UPTE representative Wendi Felson, UPTE representative Karen Galbreath, UPTE representative Michael Dupray, UPTE representative Michael Fehr, UPTE representative Erik Lawrence, Actuary William Fornia (Pension Trustee Advisors), Actuary Paul Angelo (The Segal Company), Actuary John Monroe (The Segal Company).

The meeting officially began at 10:03 a.m.

PUBLIC COMMENT PERIOD: UCB Emeriti Association representative Goldman mentioned that public pension plans could face another market downturn and questioned if UC had a contingency plan in place. Chair Starr said he believes that if UC were to face dire financial troubles, it is obligated to pay off creditors and pensioners first. Speaking as Plan Administrator, VP Duckett indicated that the President's Post-Employment Benefits (PEB) Task Force was created, and actions were undertaken, to ensure that UCRP and other post-employment benefits remain viable. Should future events present additional financial problems for UCRP, another group would be formed to analyze the situation and additional actions would be taken. UPTE representative and bargaining team member Mike Fehr noted that UC is increasing UCRP contributions in 2013-2014. He also noted that Governor Brown's budget proposal provides a funding increase for UC in 2013-2014, but does not specifically earmark funds for

UCRP. He questioned if UC would be diverting any of Governor Brown's increased funding to UCRP. Chair Starr said that AVP Obley would respond when she presents the budget update.

APPROVAL OF THE MINUTES: Chair Starr called for approval of the minutes from the Board meeting of November 16, 2012. The minutes were approved by acclamation.

COMMENTS FROM CHAIR STARR: Chair Starr welcomed the Board's newest member, Lee Duffus, who is the new Chair of CUCRA, replacing Marian Gade. He noted that Lee's term on the Board coincides with his term as chair of CUCRA, which is expected to last two years.

UCRP – INVESTMENT RISK MANAGEMENT UPDATE: As the basis for his discussion**,** Jesse Phillips, the Senior Managing Director of Investment Risk Management for the UC Treasurer's Office, distributed a slide presentation entitled UCRP – Investment Risk Management Update. He indicated that the Risk Management team is not specifically focused on daily "normal volatility" of equities, bonds and other investments, but rather on material losses. He noted that Risk Management attempts to identify potential risks, determine the likely range of returns that investments will provide under different scenarios, and quantify the risk for such investments. The goal is to incorporate risk in determining asset allocation and diversification in order to build portfolios with investments that provide returns appropriate for their risk level. Since risks can change, he stressed that risk management is a continuous process and forecasts are shared with the Regents to help determine appropriate asset allocation policies.

SUMMARY OF REUTERS LEGAL CASE AGAINST UC: At the request of the Chair, an update was provided by UC Counsel Margaret Wu on a legal case brought against UC by the Reuters news organization to require UC to release fund-specific returns from its investments with two venture capital investment firms, Kleiner Perkins and Sequoia Capital. Although UC provided Reuters with the little information it had available, Reuters pursued legal action under the California Public Records Act (CPRA). Counsel Wu indicated that the California Superior Court had issued a ruling requiring UC to make an "objectively reasonable" effort to disclose the fund-specific information requested by Reuters, despite the fact that Kleiner Perkins and Sequoia Capital did not provide such fund specific information to UC. Counsel Wu indicated that UC believes the California Supreme Court is misreading the law and can't force UC to disclose information it does not have. UC will be appealing the court's decision.

CHIEF INVESTMENT OFFICER – REPORT: CIO Berggren indicated that all UC plans delivered robust absolute and relative gains for 2012, primarily driven by security selection. For the fourth quarter of 2012, U.S. equities were a bit flat due to concerns over the fiscal cliff and the presidential election, but non-US equities performed well**.** Fixed income investments world-wide also did well due to monetary injections by governments. CIO Berggren indicated that it was rare to see such simultaneous positive returns in equities and fixed income investments. UCRP had a positive return of 2.52% for the fourth quarter of 2012, exceeding its benchmark by 16 basis points, and a positive return of 13.68% for the 2012 calendar year, exceeding its benchmark by 99 basis points. She attributed UCRP's returns to investment selection and asset allocation; being slightly overweight in stronger performing investments, such as emerging market equities, and underweight in weaker performing ones, such as TIPS.

ITEM A. UCRP – INTERNAL AND EXTERNAL COMMUNICATIONS: At the request of the Vice Chair, Media Specialist Klein provided an overview on UC's approach to negative media articles on UCRP. She stated that media stories concerning public pensions generally arise when there is a perceived problem and the media will often ignore or spin information provided by public institutions. Consequently, UC does not vigorously respond to each and every negative article related to UCRP. In response to a suggestion that UC and/or its members proactively submit positive op-ed pieces about UCRP, she indicated that such op-ed pieces must be topical or they wouldn't be published. Moreover, she noted that many people feel that public pensions are generous and would be skeptical of such proactive op-ed pieces. A brief discussion ensued on the availability of Senate leadership to assist in responding to and/or mitigating the impact of misleading articles concerning UCRP.

ITEM B. UCRP – FUNDING POLICY – BACKGROUND: As background for the discussion on Items C and D, Executive Director Schlimgen provided an overview on UCRP's current funding policy and cited attached Regents items from September 2008 and September 2010 as references. Noting that UCRP was fully funded in 2008, he stated that in September 2008 the Regents approved, with the support of the Academic Senate, a revised UCRP funding policy under which payments toward a future unfunded actuarial accrued liability (UAAL) would be based on a "level dollar" amount over an amortization period of 15 years. The 2008 Regents' item acknowledged that level-dollar amortization is more conservative than level-percentage of pay amortization because it funds UCRP's UAAL faster in early years, which results in less interest over the amortization period. The 2008 Regents' item also indicated that, unlike level-percent of pay amortization, level-dollar amortization avoids the possibility of "negative amortization," which occurs when early amortization payments are less than the interest on a plan's outstanding balance. Finally, he noted that the 2008 Regents' item made a clear distinction between the funding policy calculation and how the actual University and member contributions are separately established based the availability of funding and the impact on members' total remuneration. Following the re-start of UCRP contributions in May 2010, Executive Director Schlimgen stated that the Regents revised UCRP's funding policy again in September 2010. Due to the market downturn and the corresponding impact on UCRP's funded status, coupled with a lack of state funding, The Regents extended UCRP's amortization of gains/losses from 15 to 30 years so that the policy rate will more closely align with a realistically attainable actual contribution rate.

ITEM C. UCRP – ACTUARIAL BRIEFING FOR COALITION OF UC UNIONS: Actuary Fornia of Pension Trustee Advisors, an actuarial firm engaged by a coalition of UC unions (UPTE, AFSCME and CNA), led a discussion suggesting the use of alternative actuarial assumptions and methodology for UCRP. Referencing a briefing he had prepared, he stated that UCRP has a better funded status and than most public pension plans. He also noted that current contributions to UCRP are less than its policy amount and do not currently cover its Normal Cost. He indicated that UC overstates UCRP costs by using level-dollar amortization and a conservative rate of return of 7.5%, both uncommon among public pension plans. Speaking on behalf of the union coalition, he stated that it appears UC is overstating UCRP costs as a justification to implement the new tier. He stressed that the union coalition is interested in maintaining the pay of its current members and preserving pension benefits for future members. He indicated that both could be accomplished, and UCRP's UAAL could still be eliminated over a 30-year period, if level percent of pay amortization and a less conservative assumed rate of return were applied to UCRP.

A discussion ensued, including comments on the appropriateness of UCRP's amortization methodology and assumed rate of return and the types of public institutions included in Actuary Fornia's report. • Actuary Fornia clarified that he was not necessarily recommending that UCRP use a less conservative approach. However, since contributions to UCRP are not being made in accordance with its funding policy, he failed to see the usefulness of UC's conservative approach, which is an outlier among public pension plans. In response, it was noted that UCRP's assumed rate of return has been in place for 20 years and is based on UC investment policies, risk tolerance, etc., so a comparison with the rates used by other plans is irrelevant. The Chair also noted that, unlike most public institutions, UC is a research institution which derives 2/3 of its funding, including UCRP contributions, from sources other than the state. He stressed that under level percent of pay amortization, lower initial UCRP contributions could result in negative amortization. If this occurred, UC would not be able to subsequently recoup money from federal contracts and grants and other non-state sources by claiming that they had previously under-contributed to UCRP. • The Vice Chair requested that Actuary Fornia further explain his comment that UCRP's rate of return and amortization policy are used to justify the 2013 Tier. Actuary Fornia explained that if UCRP's costs were projected to increase indefinitely, then a conservative funding policy and/or a new tier with lower benefits might be justified. However, since UCRP actuarial projections show that UCRP's costs start high but lower over time, UCRP's conservative methodology is being used arbitrarily to justify benefit reductions with a new tier. • In closing, a member noted that he feels the 2013 Tier disproportionately impacts lower paid workers in manual labor positions, who generally retire prior to age 65, frequently due to the physical demands of their work. They would therefore not benefit from the highest age factor under the 2013 Tier.

EXECUTIVE VICE PRESIDENT, BUSINESS OPERATIONS – BUDGET UPDATE: In EVP Brostrom's absence, the update was provided by AVP Obley. She advised that UC had submitted a budget request for increased revenue. She indicated that the governor's budget proposal did not provide all the funds UC requested, but that Governor Brown appears to be committed to higher education based on very positive statements from him. The governor's budget proposal provides UC with $125 million for a 5% UC base budget adjustment. The governor's budget proposal also transfers some of the state's bond debt service to UC, which UC can refinance at better rates for a financial gain. However, it appears that UC may not be able to generate the $126.5 million it had hoped to receive from tuition increases, as Governor Brown does not want any tuition increase for at least four years. In response to UPTE representative Fehr's question from the public comment period, she indicated that UC will direct funds towards UCRP even though no funds were earmarked as such in the Governor's budget proposal. The Vice Chair noted that the Regents had previously approved measures to fund UCRP, such as transfers from STIP and external borrowing, and asked if similar measures to fund UCRP were likely in the near future. AVP Obley indicated that it was unlikely, since Chief Financial Officer Taylor had recently discussed such UCRP funding measures with the executive vice chancellors (EVCs) and they were against additional borrowing at this time. She closed by stating that the location budgets are under considerable strain coming off the fiscal crisis and the locations do not presently wish to commit to additional borrowing.

ITEM D. UCRP – ANNUAL REQUIRED CONTRIBUTION – PROJECTIONS AND PROGRESS: This item was presented by Actuary Angelo of the Segal Company at the request of the Vice Chair. Actuary Angelo began by referencing a chart showing UCRP's annual required contribution (ARC), modified ARC (i.e., Normal Cost plus interest on UCRP's UAAL), and Normal Cost through 2014-2015 (projected). He indicated that contributions were currently below UCRP's Normal Cost of 18% of payroll, so UCRP's UAAL is currently growing by both the 3% shortfall to Normal Cost and unpaid the interest on the UAAL. Beginning in 2013-2014, UCRP contributions will cover Normal Cost, but UCRP's UAAL will continue to increase based on the unpaid interest. Despite projected total UCRP contributions of 22% in 2014-2015, UCRP's UAAL will continue to increase since the projected UCRP contributions are less than the 2014-2015 projected modified ARC of 28.5% of payroll (ARC is projected to be 30.6% of payroll).

A discussion ensued. The Chair and Vice Chair stated that all the alternative contribution scenarios show that UCRP is getting further behind and that UC would not be complying with the UCRP contribution timeline and the additional UCRP borrowing measures approved by the Regents. Executive Director Schlimgen clarified that the Regents approved additional borrowing measures at the President's discretion. In defense of the EVCs' position, two Board members noted that UCRP employer contributions will have increased from zero to 12% of payroll in the space of four years, which is placing a significant financial strain on locations. Additionally, if tuition can't be increased for at least four years, as Governor Brown proposes, the locations will face even more financial uncertainty. Since UCRP is better funded than most public pension plans, they questioned the urgency to increase UCRP contributions over the next few years.

Responding to questions posed by Board members prior to the meeting, Actuary Monroe noted that if UCRP did not earn 7.5% every year, its UAAL would continue to increase. Actuary Monroe also indicated that if an inactive cost of living allowance (COLA) were added to the 2013 Tier, its Normal Cost would increase by 1/2 percent; approximately $5 billion over 30 years. With respect to adding a Lump Sum Cashout (LSC) option to the 2013 Tier, he stated that it would not add to the 2013 Tier's Normal Cost. However, he clarified that the President's PEB Task Force determined that an LSC option is a non-standard pension benefit and chose not to offer it in the 2013 Tier. Finally, in response to a question on intergenerational equity as to whether younger workers are unfairly bearing the brunt of UCRP's pension holiday, Actuary Angelo indicated that they were not. He explained that UCRP's Normal Cost for each year is the cost allocated for the benefits earned by eligible employees during the year. The fact that some employees didn't have to make UCRP contributions in the past does not increase UCRP's current Normal Cost for younger employees.

ITEM E. PROPOSED DEFINED CONTRIBUTION PLAN OPTION FOR UC HEALTH POLICY-COVERED STAFF NEW HIRES – FEASIBILITY STUDY – UPDATE: At the request of the Chair**,** Executive Director Schlimgen provided a brief update on this topic, which was discussed at several previous Board meetings. He noted that UC Health continues to express interest in offering newly hired, non-represented staff the option of participating in a defined contribution Plan (DC Plan) in lieu of UCRP and that the Academic Senate and some unions have expressed opposition to such a DC Plan. In response to a question posed by the Chair, Actuary Angelo clarified that it was permissible to base UCRP contributions on the institutional pay of all UC employees, even those not covered under UCRP, such as employees who might participate in an optional DC Plan. As stated in previous Board meetings, the feasibility study noted that under the proposal, UC Health would still be responsible for paying assessments on UCRP's legacy liability. The Chair questioned the financial impact to UCRP if employees who normally separate prior to vesting in UCRP (leaving their employer contributions in UCRP) chose to participate in an optional DC Plan instead. Actuary Angelo indicated that there is a termination assumption built in the valuation methodology for UCRP and it is assumed that the employment length and retirement behavior of those who may choose to participate in the proposed DC Plan would be similar to those in UCRP. However, he noted that UCRP's Normal Cost could increase if membership consisted primarily of vested, long-term members.

ITEM F. RETIREMENT SAVINGS PROGRAM – MINIMUM REQUIRED DISTRIBUTION – PROCESS AND OPTIONS: This item was revisited at the request of the Chair, since there was some confusion over the minimum required distribution (MRD) processes that were discussed at the Board's November 2012 meeting. Executive Director Schlimgen and Director Lange informed the Board that two conference calls had been held between UCOP staff and the Chairs of CUCRA and CUCEA, the joint CUCRA/CUCEA Benefits Chair, and a representative from Fidelity to discuss the MRD processes. As a result of these calls, a chart (which was attached to Item F) was developed to better explain the MRD processes. They reported that the chart was well received and addressed the outstanding questions that arose at the Board's November meeting. The CUCRA and CUCEA Chairs in attendance, and the CUCRA/CUCEA Joint benefits Committee Chair participating via teleconference, agreed that the their questions had been addressed and that the chart was helpful.

ITEM G. RETIREMENT ADMINISTRATION SERVICE CENTER ANNUAL REPORT: Director Lewis began by providing a brief history of the RASC and indicated that he would be entering phased retirement in July 2013, transferring management of daily RASC operations on an interim basis to Director Lorenz. Director Lorenz then provided a summary of the RASC accomplishments for the past year; expansion of the Customer Relation Management tool, enhanced reporting and payment/ distribution capabilities, and the processing of 15% more telephone inquiries without adding staff. She also highlighted the drive to encourage retirees to initiate direct deposit of their UCRP monthly benefit payments, which resulted in a 36% reduction of paper checks. She concluded by indicating that she would be happy to provide any interested members of the Board with a tour of RASC.

ITEM H. LUMP SUM CASHOUT REPORT AND UCRS STATISTICS: Business Control Leader St. George provided some LSC statistics for the past year, noting that there was a slight decline in both the number of LSC elections (-11.%) and amount of LSC payments (-7.4%). Approximately 54% of LSCs were elected by inactive members. Director Olson then briefly provided some UCRS statistics, noting that UCRP benefit recipients had increased by 5% during the past year while the number of UC Retirement Savings Program (RSP) participants had decreased by 7%.

ITEM I. RETIREMENT SAVINGS PROGRAM – FUND MENU MANAGEMENT: Director Lange provided a summary of the second phase of the fund menu management project, which had been described at previous meetings. She indicated that in January 2013 all RSP participants with funds in non-Core, non-institutionally priced funds had received a general notification that such funds would be removed from the main fund menu and closed to new contributions or incoming transfers as of late March 2013. As suggested by the Board, approximately 43,000 affected participants will also be provided with a personalized announcement and a decision guide in late February 2013 to assist them in transferring their existing RSP monies and redirecting their future RSP contributions. The decision guide will provide information on all fund options, including the brokerage link option. She indicated that Fidelity will also be providing workshops at the UC locations and on-line workshops to help affected participants. Finally, she noted that a reminder postcard will be sent out in June 2013 to affected participants who have not yet taken action. The postcard explains that each member's existing monies in the frozen funds will be mapped to an age-appropriate UC Pathway fund, absent participant direction.

ITEM J. RETIREMENT SAVINGS PROGRAM – VENDOR RELATIONS MANAGEMENT REPORT: Due to time constraints**,** Director Lange had little time to summarize the report but encouraged members to review it at their leisure. She informed the Board that the UC financial education program was selected as a "Plan Sponsor of the Year" finalist by PlanSponsor Magazine.

At the close of the meeting, a member requested that a discussion on UC's retirement calculators be included as an agenda item for the June meeting.