UCRS Advisory Board

MINUTES
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)
ADVISORY BOARD MEETING
FEBRUARY 24, 2017
10:00 AM – 2:00 PM

BOARD MEMBERS PRESENT: Chair Meredith Michaels, Vice Chair David Brownstone, Chief Operating Officer (COO) Rachael Nava, Associate Vice Chancellor David Odato (via telephone), Professor Henning Bohn, Pharmacy Technician Naomi Nakamura, Computer Resource Specialist Michael Fehr, CUCRA Chair Marianne Schnaubelt, and CUCEA Chair Richard Attiyeh (via telephone).

BOARD MEMBERS ABSENT: Chief Investment Officer (CIO) Jagdeep Singh Bachher, Vice President (VP) Dwaine Duckett.

UCOP STAFF PRESENT: Associate Chief Investment Officer (CIO) Arthur Guimaraes, Director Marco Merz, Director Sam Kunz, Executive Director Gary Schlimgen, Director David Alcocer, Director Ellen Lorenz, Associate Director Tony DiGrazia, Communications Strategist Wendy Welsh, Manager Ken Reicher, Manager Hyun Swanson, Principal Analyst Kendra Eaglin and Principal Analyst Robert Semple.

OTHERS PRESENT: CUCRA Chair elect Joe Lewis, UCBEA representative Amy Joy, UCBEA representative Caroline Kane, UCRAB representative Antonia Sweet, UPTE representative Paul Brooks, AFSCME representative Own Li, SETC representative Andy Taff, Teamsters representative Mary Higgins, Academic Senate representative Ken Feer (via telephone), Actuary John Monroe (Segal Consulting) and Actuary Paul Angelo (Segal Consulting, via telephone).

The meeting officially began at 10:06 a.m.

PUBLIC COMMENT PERIOD: No public comments were made.

APPROVAL OF THE MINUTES: Chair Michaels called for approval of the minutes from the Board meeting of November 18, 2016. The minutes were approved by acclamation.

COMMENTS FROM THE CHAIR: Chair Michaels formally welcomed Marianne Schnuabelt, who became the new CUCRA Chair and ex-officio Board member effective January 1, 2017. She then announce that Principal Legal Counsel Barbara Clark was retiring and thanked Barbara (who was unable to attend) for her dedication to UC, and the Board in particular, for the last 13 years.

OFFICE OF THE CHIEF FINANCIAL OFFICER – BUDGET UPDATE: Director Alcocer began by noting that, in January, the Regents approved a 2.5% tuition increase and a 5% student services fee increase. He noted that there was broad agreement for the tuition increase, since a substantial portion of the increase would be dedicated to financial aid. He noted that the Governor's proposed budget included a 4% base budget adjustment, funding for undergraduate enrollment growth in 2017-18 and the final installment of $169 million in Proposition 2 monies dedicated to addressing UCRP's unfunded liability. He noted that there was an unresolved issue with respect to $50 million in Proposition 56 monies (cigarette tax) in lieu of state general funds for funding medical residents. He also noted that UC has requested an additional $35 million for deferred maintenance, approximately $9 million for graduate enrollment growth in 2017-18 and additional funding for undergraduate enrollment growth for the 2018-19 year. In closing, he noted that the Governor is proposing defunding the middle-class scholarship program.

CHIEF INVESTMENT OFFICER – REPORT: The CIO report was provided by Associate CIO Guimaraes, Director Sam Kunz, and Director Marco Merz. Director Kunz provided the overview of UCRP, noting that UCRP had $54 billion in assets as of June 30, 2016 compared with $57 billion as of December 31, 2016; a gain of slightly over $3 billion. He noted that $2.42 billion of the increase was due to market gains and $0.57 billion was attributable to valued added (i.e., returns exceeding benchmarks). He noted that UCRP was still slightly overweight in public equity, which had the most significant impact on UCRP's performance since roughly 55% of UCRP's assets were allocated to public equity. Director Kunz noted that while returns on public equity were a sore point during the last fiscal year, the returns have been very good for the first half of the current fiscal year. In closing, he noted that the Office of the CIO may pull back a bit on public equity investments and invest a bit more conservatively, despite the recent upturn in public equity returns.

Associate CIO Guimaraes and Director Merz provided an overview of the Retirement Savings Program (RSP), which has assets in excess of $20 billion, making it the second largest defined contribution program in the nation. They noted that the target date funds (i.e., Pathway Funds) were the cornerstone of the RSP and currently held $5.8 billion, followed by the Savings Fund and the UC Global Fund (100% equity fund) with $4.2 billion each. CIO Guimaraes reiterated that the Office of the CIO is looking to merge the UC Global Fund and the UC Balanced Growth Fund (blend of equity and fixed income) into the Pathway Funds later this year following a multi-tiered communications approach, which ideally would start in May 2017 with a description of the line-up changes. He also reiterated that the Office of the CIO is looking for a third-party manager for the Pathway Funds by the end of the calendar year in an effort to improve returns and fees for these funds.

ITEM A. UCRP – POTENIAL ADDITIONAL FUTURE BORROWING: Manager Reicher began by noting that over the last few years, the employer contribution to UCRP (14% of covered payroll) and the employee contribution (7-8% of covered payroll depending upon tier) have been sufficient to cover UCRP's Normal Cost (roughly 18% of covered payroll), but fell short of the Total Funding Policy (i.e., the Normal Cost plus an amortized amount to pay off the unfunded liability over time). He mentioned that in November 2015, the Regents authorized the President to make transfers from the Short Term Investment Pool (STIP) to UCRP to bring its contribution level up to the Total Funding Policy level for fiscal year (FY) 2015-16 through FY 2017-18. Due to the enduring underfunded status of UCRP, the uncertainty of additional state funding and ongoing budgetary challenges, he noted that a proposal for additional borrowing beyond FY 2017-18 is being considered for presentation at a future Regents meeting. Actuary Monroe from Segal then walked the Board through a chart illustrating the estimated and hypothetical dollar amounts, in addition to employer and employee contributions, that would need to be borrowed each FY from 2018-19 through 2022-23 to meet UCRP's Total Funding

Policy for each of those years. He noted that the amount needed each year was based on several assumptions, including that UCRP would meet its annual 7.25% investment earnings assumption.

ITEM B. UCRP – REVIEW OF INVESTMENT EARNINGS (RETURN) ASSUMPTION: As part of the Board's ongoing discussion of the appropriateness of the UCRP investment earnings assumption and in the context of CalPERS and CalSTRS each lowering its investment earnings assumption, an item was presented on the impact to UCRP of hypothetical reductions in its investment earnings assumption. Manager Reicher provided some background, noting that that UCRP's investment earnings assumption had been reduced from 7.5% to 7.25% affective July 1, 2015. He also noted that a component of the investment earnings assumption was the rate of future assumed increases in the Consumer Price Index (CPI), or more commonly referred to as the inflation rate assumption. The inflation rate assumption was also reduced from 3.5% to 3% effective July 1, 2015. Finally, he noted that CalPERS had recently approved lowering its investment earnings assumption from 7.5% to 7% in stages over the next three years and that CalSTRS was lowering both its investment earnings assumption and inflation rate from 7.5% to 7% and from 3% to 2.75%, respectively, by 2018. Actuary Monroe from Segal Consulting then summarized a handout with scenarios in which UCRP's investment earnings assumption and inflation rate were lowered. In each scenario, lowering UCRP's investment earnings assumption and its inflation rate had a corresponding impact of increasing its unfunded ratio and its Total Funding Policy contribution.

ITEM C. UCRS – 2016 RETIREMENT CHOICE PROGRAM STATISTICS – UPDATE: Principal Analyst Eaglin summarized the 2016 Retirement Choice Program statistics that had been distributed to the Board. She noted that as of mid-February 2017, UC had hired roughly 5,300 employees who were eligible for choice under the new retirement program. She clarified that the statistics were not all-inclusive as some new eligible hires were represented by unions that had yet to bargain the 2016 Retirement Choice Program. She also noted that nearly half of the employees hired since July 1, 2016 were rehired employees who would not be subject to the PEPRA maximum on Covered Compensation under the Pension Choice option since they previously worked for UC. With respect to the 3,418 new (or rehired) employees whose 90-day election window period had closed as of mid-February 2017, 25% had affirmatively elected the Pensions Choice, 35% had affirmatively elected the Savings Choice, and 40% had not made an affirmative election and automatically defaulted to the Pension Choice. She noted that while the Savings choice is initially the more prevalent elected option, some employees who preferred the Pension Choice may have just allowed themselves to be defaulted to it. She concluded by noting that choice reminders are sent on days 15, 30 and 70 and the average election time is 30 days (with a spike at 8 days).

ITEM D. UCRS – RETIREMENT BENEFIT COMMUNICATIONS AVAILABLE ON UCNET – OVERVIEW: Based on comments regarding the importance of communications with respect to the 2016 Retirement Choice Program made during the previous item, Communication Strategist Wendy Welsh noted that Communications is in the process of updating the retirement choice decision guide to more prominently indicate that choice eligible employees won't make or receive contributions (or UCRP service credit as applicable) until they make their election. She then proceeded to provide an overview of the benefit communication pieces available on UCnet and where to find them. She indicated that UC net contained both written communication pieces as well as videos, some of which were available in Spanish. She also indicated that the UCnet pages and communication pieces ranged from broad subjects to very unique and specific topics, such as the benefits associated with reciprocity between UCRP and CalPERS. She highlighted the Board's dedicated pages on UCnet and the relevant information and documents found on them. She closed by highlighting the variety of benefit documents available in the UCnet Forms & Publication section.

ITEM E. RETIREMENT SAVINGS POGRAM – OPERATIONS AND EDUCATION REPORT: Manager Swanson began by stating that Fidelity had met all of its performance standards for the previous quarter. Addressing Fidelity's master recordkeeping and member services role, she noted that Fidelity continues to work with UC to identify, monitor and implement processes to resolve retirement choice operational issues. She also noted that Fidelity is working with UCPath to maximize effectiveness related to payroll processing and the transmission of files. Turning to communications and education, she indicated that the 2017 Retirement Review statement, which provides an estimate of a member's readiness to retire based on projected UCRP and RSP benefits, was almost ready to be posted on the myUCretirement.com website. She indicated that roughly 60% of employees are projected to have a retirement replacement ratio of 80% at a retirement age of 65. She also clarified that employees may modify the projected results on myUCretirement.com by making changes to RSP contribution amounts or changing their highest average plan compensation (HAPC) or retirement age for UCRP. She concluded by providing statistics on RSP participation, noting that approximately 54% of active employees voluntarily contribute about 10.5% of pay monthly.

ITEM F. RETIREMENT SAVINGS POGRAM – FEE ALLOCATION METHODOLOGY PROJECT: Executive Director Schlimgen began by summarizing past improvements to the RSP and indicated that the next RSP matter to be addressed was fees. While fees for UC-managed funds have historically been very low, he indicated that the goal is to make the fees more transparent and in alignment with best practices as viewed by the Department of Labor (DOL) and comparator plans. He stated that the investment management fee and the recordkeeping/administrative fees are currently bundled by assessing a fee of up to 15 basis points on the UC-managed funds.

Manager Swanson then explained the components of the RSP recordkeeping and administrative costs estimated for FY 2017/18. She indicated that Fidelity currently charges $24 per unique Social Security number for recordkeeping services. Based on a projected 320,000 RSP participants, the estimated recordkeeping cost forth next FY is $7.68 million. She indicated that UC engages with Fidelity under a separate contract to provide communications and financial education services, and the estimated cost for such services for the next FY is $1.7 million. Finally, she stated that the last component of RSP administrative costs is attributable to the work performed by UCOP staff, excluding personnel from the Office of the CIO, with an estimated cost of $2.1 million for the next FY. Thus, the total projected RSP administrative cost for the next FY would be approximately $11.3 million, after miscellaneous credits and other smaller cost items.

Referencing a set of slides distributed to the Board at the meeting, Executive Director Schlimgen described the three proposed options for allocating RSP administrative fees, which were presented to the University Committee on Faculty Welfare's Task Force on Investment and Retirement (TFIR) prior to being presented to the Board. This first option (option #1) is an asset based fee approach. The second option (option #2) is based on an allocated fixed per-participant fee of $35. The third option (option #3) is a combination of a fixed $24 per-participant fee and an asset based fee of 1.85 basis points. He then proceeded to summarize the implications of the three options in more detail.
With respect to option #1, he noted that a level fee would be charged across all funds, but market performance could impact fee revenue. In addition to being less transparent, this option is affected by fee subsidization in which participants with higher account balances pay a greater share of total fees.

Finally, he noted that this option does not align with best practices. With respect to option #2, he noted market performance would not impact fee revenue and fee subsidization by participants with higher account balances would be eliminated. On the other hand, as a percentage of assets, the fixed fee may represent an increase for participants with lower account balances. The advantages of this option include full fee transparency, simplicity with regard to administration and communication, and alignment with best practices. Also, over the course of a career, a participant would pay less in total fees under this fixed fee approach (even assuming a 1% annual increase in the $35 fixed fee). With respect to option #3, market performance still could have an impact on fees, but to a lesser degree than under option #1. This option would also lessen the impact of fee subsidization by participants with higher account balances while limiting the potential increase for those with lower account balances. However, this option would not provide for full fee transparency, would be more complex to administer and communicate, and does not align with best practices.

Chair Michaels then asked if any Board member wanted to share their views with respect to the options under consideration. With one abstention, the Board members present and participating via telephone unanimously viewed option #1 as unacceptable. Following an extended discussion, it was noted that that UC has no reasonable alternative to charging a per-participant fee for costs charged to UC by Fidelity on a per-participant basis. There were mixed views with respect to options #2 and #3, with some member preferring option #2 while others were satisfied with either option. The rationale for option #2 was its simplicity, transparency and alignment with best practices; option #3 reduces the impact of subsidization on large account balances and reduces the fee increase for lower account balances. Chair Michaels deferred to the Plan Administrator regarding the final decision. Executive Director Schlimgen noted that the collective opinion of Human Resources, the Office of General Counsel, and the Office of the CIO is that the fixed participant fee under option #2 is considered the best approach. He closed by thanking the Board members for the discussion.

ITEM I. RETIREMENT ADMINISTRATION SERVICE CENTER – UPDATE: Director Lorenz summarized the Retirement Administration Service Center (RASC) 2016 calendar year service metrics for the Board. She stated that RASC Customer Care exceeded its call and correspondence goals despite a 6% increase in such activity from the prior year, and that 89% of customers were satisfied with their Customer Care experience compared with 84% in 2015. She mentioned that 34 onsite retirement presentations had been provided in 2016 with a customer satisfaction rate of 96%. She also noted that the Fulfillment Operations Unit had exceeded its goal for processing UCRP benefit payments. Turning to some recent initiatives, she noted how UC has been conducting eligibility/verification audits targeting older retirees residing outside of California and especially outside the U.S, as timely death reporting from some countries is questionable. Finally, she noted that UC initiated an 18-month engagement with International Customer Management Institute (ICMI) to assist RASC in strengthening its culture of service and to develop best practices.

The meeting adjourned at 1:45 p.m.