UCRS Advisory Board

MINUTES
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)
ADVISORY BOARD MEETING
FRIDAY, JUNE 24, 2011
10:00 AM

BOARD MEMBERS PRESENT: Chair John Oakley, Vice Chair John Sandbrook, Vice President Dwaine Duckett (via telephone), Chief Investment Officer Marie Berggren, Vice Chancellor Meredith Michaels, Professor Ross Starr, Interim Human Resources Director Tricia Hiemstra, Maintenance Worker Kandy Piper, CUCRA Chair Marian Gade (via telephone) and CUCEA Chair Ernest Newbrun.

BOARD MEMBERS ABSENT: Executive Vice President Brostrom.

STAFF PRESENT: Chief Financial Officer Taylor, Associate Vice President Obley, Principal Counsel Clark, Director Lange, Director Lewis, Director Lorenz, Director Olson, Director Schlimgen, Associate Director Anguiano, Associate Director Ashcraft, Manager Ryan, Specialist Reicher, Principal Analyst Semple, Principal Analyst West, Principal Analyst Whalen.

OTHERS PRESENT: CUCEA Chair Elect Duffus (via telephone), CUCEA/CUCRA Benefits Committee Chair Harris (via telephone), UCB Retiree Association Representative Sweet, CUCFA Representative Hays, CUCFA Representative Kiskis, AFSCME Representative Johnson, AFSCME Representative Wortes, CUE Representative Anytra, SETC United Representative Haugland, UAW Representative Stiles, UCRS Actuary Angelo (The Segal Company).

The meeting officially opened at 10:05 a.m.

COMMENTS FROM THE CHAIR: Chair Oakley called the meeting to order and immediately commenced the public-comment period.

PUBLIC-COMMENT PERIOD: UCD Professor and CUCFA Representative Kiskis made the following comments: (Item A) - The new UCRS Advisory Board (Board) section on UCOP's At Your Service website is a positive development. (Item D) - He hopes that any future developments or discussions of restoration benefits such as Appendix E are more transparent and that public relations are handled better. He felt that the lack of information from UC on this issue last year caused a damaging public relations situation; (Item F) - He asked if the $2.1 billion being transferred to UCRP over the next two years is equal to UCRP's full modified ARC (i.e., the full Normal Cost plus required interest on the UCRP's unfunded liability); (Item I) - He hopes that the review of a potential defined contribution plan (DC Plan) for Clinical Enterprise employees also includes information on how such a DC Plan would/could impact the UCRP costs and benefits for other UC employees; (Item L) - He wanted justification for maintaining UCRP's rate of return at

7.5%, as recommended by the Plan's Actuary. He also asked how the use of the new mortality table would impact the Plan's Normal Cost; (Item N) - He was concerned with the nominations of only Executive Vice President Brostrom and Vice President Duckett for the positions of Board Chair and Vice Chair. He feels that the Board should operate at arm's length from UCOP administration and urged the Board to consider alternative nominations for the positions of Board Chair and Vice Chair.

APPROVAL OF THE MINUTES: Chair Oakley called for approval of the minutes from the Board meeting of February 25, 2011. The minutes of the meeting were approved by acclamation.

COMMENTS FROM THE CHAIR: Chair Oakley began by announcing that this was his last Board meeting and that the new Academic Senate representative taking his place was Professor Shane White from UCLA. He indicated that he personally knew Professor White and indicated that he would be an excellent addition to the Board. He then mentioned that the President had appointed Associate Vice Chancellor (AVC) Angela Hawkins from UCSF to replace member Kandy Piper, whose term on the Board had also come to an end. Finally, he indicated that two new staff representatives had been elected to replace members John Sandbrook and Tricia Hiemstra, whose Board terms had also come to an end. He indicated that more about the new members and the results of the recent staff election would be discussed as part of Agenda Item M later in the meeting.

CHIEF INVESTMENT OFFICER - REPORT: Chief Investment Officer (CIO) Berggren stated that the first quarter of 2011 had been strong despite global challenges. UCRP had a first quarter return of 3.81%, 10 basis points over its benchmark. She noted that UCRP's performance ranked near the top quartile of public plans with over $1 billion in assets, as reported by Wilshire's Trust Universe Comparison Service (TUCS). She credited asset selection with contributing to UCRP's positive return for the quarter, noting that equities and absolute return investments were the main drivers of UCRP's performance. Over the past two years, UCRP had been slightly overweight in equities and underweight in fixed income and TIPS, which had been beneficial for the Plan. Correspondingly, she noted that 70% of the Plan's active risk was from equities. Despite the drop in performance over the last month, she still expected that UCRP returns would be around 20% for the year. She stated that UCRP had outperformed its benchmark nearly 75% of the time over the last 20 years, with an average return of approximately 8.7% and stressed the importance of diversification in attaining such returns.

EXECUTIVE VICE PRESIDENT, BUSINESS OPERATIONS - BUDGET UPDATE: As Executive Vice President Brostrom was away on business, the budget update was given by Associate Vice President (AVP) Obley. She stated that the legislature had adopted a budget but Governor Brown had vetoed it and State Controller Chiang had decided to withhold legislators' pay as he did not feel that the budget they had provided was balanced, as required by law. She indicated that the withholding of legislators' pay amounted to approximately $334,000 per week and was a serious factor in motivating the legislators to produce a balanced budget. Since Republicans had not shown any inclination to concede to tax increases, she noted that either an all cuts budget would need to be passed or that tax increases would need to be put on the ballot for voter approval. Even if such a ballot initiative materialized, AVP Obley questioned whether voters would approve any tax increases or extensions. She noted that the budget proposed by the legislature had two impacts for UC; a further cut of approximately $150 million and a further deferral of payments to UC. She noted that CFO Taylor was very concerned with a further deferral of payments to UC because it would result in an operating loss which could negatively impact UC's bond rating. As campuses have already cut costs in a number of ways, any further cuts to UC's budget would necessitate tuition increases, which could be required for years to come in the face of dwindling state financial support. In response to a member's question, AVP Obley indicated that some Regents who were previously opposed to further tuition increases now support them in order to preserve quality at UC.

ITEM A. UCRS ADVISORY BOARD - AT YOUR SERVICE REPOSITORY FOR UCRS ADVISORY BOARD MATERIALS: Principal Analyst Semple noted that, in lieu of a password protected SharePoint site as previously discussed with the Board, a web-based repository for Board material had been developed on UCOP's At Your Service (AYS) website. He noted that the Board's section on AYS had been initiated at the request of Chair Oakley and a few other members. In response to questions, he noted that users could link to other relevant forms and publications (e.g., reciprocity factsheet), website links or UCOP Customer Service from the Board's AYS pages. Finally, in response to comments, he indicated that he would investigate the possibility of uploading historical Board documents to the website.

ITEM B. UCRP - LUMP SUM CAHOUT ANNUAL REPORT: Principal Analyst West provided a brief overview of the annual lump sum cashout (LSC) report, noting that LSCs increased by 9.6% from the previous year while retirement elections had increased by 19%. Thus, the turmoil in the financial markets and the decline in UCRP's funded status had not resulted in more retiring members or former spouses electing an LSC in lieu of monthly retirement income. More than half of those who elected an LSC chose to have their payment rolled over to one of the UC defined contribution plans or an IRA and the majority of LSC recipients tended to be inactive members or otherwise ineligible for UC-sponsored retiree health benefits.

ITEM C. UCRS - PLAN ADMINISTRATOR'S ANNUAL REPORT: Director Olson began by noting that the statistics included in the attached chart were a bit dated, since they were from June 30, 2010 and the report had been deferred from the previous Board meeting. He highlighted several statistics, including that UCRS assets as of May 31, 2011 totaled approximately $58 billion, an increase of over 20%. For future reports, the Vice Chair asked Director Lewis to provide comparison historical data in reports dating back five or ten years as opposed to just comparing current results to the previous year's data.

ITEM D. UCRP - APPENDIX E: Chair Oakley informed the Board that, following the closed discussion on Appendix E at the Board's February meeting, he had requested historical Board and Regents items related to Appendix E. Based on his review of the historical documents, which were included as attachments to Agenda Item D, Chair Oakley provided the Board with the following overview of his understanding of the Appendix E and 415(m) restoration provisions:

Appendix E was designed to restore benefits limit that otherwise would be lost by the application of Section 401(a)(17) of the Internal Revenue Code (Code), which caps the amount of compensation that can be taken into account to calculate benefits. The concept was proposed to the Regents in February 1999 as one of two restoration programs. The other program, which became the 415(m) Plan effective January 1, 2000, restores benefits that otherwise would be lost by application of a separate Code limit on the amount of the benefit that can be paid out each year. The Regents approved both programs in concept, but the adoption of the Appendix E program was made contingent upon receipt of a favorable determination letter from the Internal Revenue Service on UCRP as amended to include the proposed Appendix E program. Implementation of the program was delegated to the President and Chairs of the Regents and the Finance Committee. The University received a favorable determination letter on UCRP dated November 8, 2007. To date, the Regents and the President have not taken action to implement Appendix E.

Chair Oakley noted that while The Regents had indicated that Appendix E could apply retroactively, the UCRS Advisory Board had voted against retroactivity. He described the statement issued by President Yudof and Regents Chair Gould in January 2011 in which they assert that Appendix E was not self executing and never became effective. He also cited the letter to President Yudof from the 36 executives in which they claim that they are entitled to Appendix E benefits upon retirement because the program was approved by The Regents and the IRS has issued the required favorable determination letter. He stated that the documents appeared to "cut both ways" and could be interpreted to support both the Presidents and/or the executives' views.

Counsel Clark pointed out that the favorable determination letter that the IRS issued on UCRP did not constitute a waiver of the Section 401(a)(17) compensation limit as claimed by some UC spokespersons. Instead, it represented a finding by the IRS that the form of the plan, taking into account all amendments (including the proposed Appendix E amendment) since the prior determination letter was issued, satisfied the applicable statutory requirements.

UCRP Director Schlimgen said that, based on the statement issued by the Chair of the Regents and the President in January, and because Appendix E has not been implemented, the estimated liabilities associated with Appendix E will not be included with the next UCRP actuarial valuation. Member Piper indicated that UC should not implement Appendix E for highly paid executives while simultaneously laying off lower paid employees, freezing staff salaries and implementing another round of tuition increases for students.

ITEM E. UCRS - COST-OF-LIVING ADJUSTMENT FOR JULY 2011 AND MEASUREMENT OF ANNUITANT PURCHASING POWER: Specialist Reicher indicated that the COLA for July 1, 2011 was 1.98%, based on the average increase in the Consumer Price Index (CPI) for all urban consumers in the San Francisco and Los Angeles metropolitan areas from February 2010 to February 2011. He then described how those who retired prior to July 1, 2006 received a COLA of 2% since they had a balance in their inflation banks. He proceeded to advise that purchasing power for all retirees, including PERS Plus5 Plan retirees who now receive COLAs similar to UCRP retirees, remained above 80% of the original purchasing power they had as of the date of their retirement.

ITEM F. UCRP - ADDITIONAL CONTRIBUTIONS TOWARDS THE ANNUAL REQUIRED CONTRIBUTION: CFO and Vice President Taylor stated that $2.1 billion was scheduled to be transferred to UCRP in fiscal years 2010-2011 and 2011-2012, which corresponds with UCRP's "modified" ARC (annual required contribution). He explained that the modified ARC was equivalent to UCRP's Normal Cost plus the interest on its unfunded liability. He noted that $1.1 billion had already been transferred to UCRP from the Short Term Investment Pool (STIP) on April 1, 2011. Campus and medical centers payroll funds would be assessed a fee to pay the interest and the principal on the STIP note. The fee for FY 2011-2012 was 0.7% of payroll and would be reviewed and reset every year. Further, he noted that a second transfer of $936 million was due to be transferred to UCRP in early July and would be garnered from external borrowing through issuance of a variable rate general corporate bond. The campuses and medical centers would also be assessed a fee to pay the principal and interest on this debt.

A discussion ensued in which a Board member noted that the transfer did not adhere to the UCFW/TFIR recommendation. CFO Taylor noted that the Provost and campuses had not endorsed the TFIR recommendation, but he assured the member that all payroll sources of covered compensation would be assessed the principal and interest on the STIP note, with one exception. Due to regulations, federal funding sources could only be charged the principal portion of the assessed fee, not the portion associated with interest.

ITEM G. CALIFORNIA ACTUARIAL ADVISORY PANEL - UPDATE: Since a description of the California Actuarial Advisory Panel (CAAP) and a summary of its purpose had been provided to the Board by Actuary Monroe of the Segal Company (Segal) in February 2011, Consulting Actuary Angelo from Segal briefly described the CAAP's work to date. He noted that the CAAP had selected its officers, developed a work plan and assigned members to develop model disclosure requirements, funding policies and practices. He noted that there was no other organization providing such models specifically for public sector plans.

ITEM H. UCRS - REQUEST FOR PROPOSAL FOR AUDITING ACTUARY FOR UCRS AND RETIREE HEALTH PROGRAM: Specialist Reicher stated that actuarial audits were a widely accepted best practice among fiduciaries of public sector retirement systems. He indicated that the selected auditing actuary would be asked to simultaneously replicate results produced by Segal (for UCRS) and Deloitte (for the retiree health plan). Specialist Reicher concluded by noting that a request for proposal (RFP) was sent to firms with public sector actuarial auditing experience in May 2010. A final decision regarding the selection of an auditing actuary was expected by the end of June 2011.

ITEM I. STATUS OF FEASIBILITY STUDY REGARDING DEFINED CONTRIBUTION PLAN OPTION FOR NEWLY HIRED CLINICAL ENTERPRISE POLICY COVERED STAFF: Director Schlimgen stated that the feasibility review for a defined contribution plan (DC Plan) option for certain new Clinical Enterprise (CE) employees in lieu of UCRP was based on a recommendation by the President's PEB Task Force, and is being done at the request of CE leadership to help address recruitment issues. The CE has noted that, unlike any of its comparators, UC offers only a defined benefit plan and many potential new CE employees do not plan on working at UC for the five years required to vest in UCRP. Such employees may therefore appreciate having the choice of participating in a DC Plan in lieu of UCRP. Director Schlimgen clarified that whether or not a DC Plan option is eventually implemented for new hires, CE would be responsible for its portion of UCRP's unfunded liability. He concluded by noting that the study of the DC Plan option for certain CE employees will be subject to extensive analysis and consultation and that many program parameters, including target populations and program design, still needed to be determined, in consultation with CE leadership**.**

The Vice Chair inquired if the potential DC Plan option would exclude represented employees. If so, the DC Plan option for new CE employees would exclude nurses, for whom he thought the DC Plan option was originally intended. T he Vice Chair also inquired if student health services were considered part of the CE for this study. Director Schlimgen confirmed that the feasibility study at this time was for policy covered staff and indicated that he would inquire further if student health services employees were considered part of CE. The Chair, noting that the DC Plan option was being considered due to recruitment issues at the medical centers, suggested that the initial study be limited to just the medical centers, not the schools of medicine or other areas.

Member Piper requested to go on record to voice her disappointment that UC was considering a DC Plan option for CE employees. She stated that such an opt-out option was not good for UCRP and that UC should not make special arrangements for employees who would leave UC within a few years. Further, she indicated that, if a DC Plan option were implemented for CE employees, the President would have a hard time denying the option to other groups of employees. A few other members voiced concern that UCRP could become an "orphan" plan if new employees were not required to participate in it and make contributions.

ITEM J. RETIREMENT SAVINGS PROGRAM - VENDOR RELATIONS MANAGEMENT REPORT: Director Lange summarized the report, noting that the number of 403(b) loans initiated continued to decline and that participation in the 403(b) plan appeared to be recovering. She indicated that Fidelity met its administrative performance standards over the first quarter with the exception of the "average speed to answer calls" metric, which it missed by 5 seconds (35 seconds rather than the standard of 30 seconds). She mentioned that financial education workshop attendance was up 82% from the same time last year and that a webinar format had been introduced for the financial education workshops, resulting in 90-100 participants for each session. Finally, she noted that $7.9 million was successfully rolled over to the UC Retirement Savings Program plans as a result of UCLA's acquisition of the Santa Monica Bay Physicians Plan, which was also record-kept by Fidelity. Based on comments on certain reporting elements, Director Lange agreed to work with the future Chair to modify the report so that it can be as informative as possible.

NOTE: Due to time constraints, agenda items K, L, M and O were not presented and the Chair proceeded immediately to agenda item N, the election of Board officers for the next fiscal year.

ITEM N. UCRS ADVISORY BOARD - ELECTION OF OFFICERS FOR FISCAL YEAR 2011-2012: Chair Oakley stated that he wanted to clarify an unintended "glitch" in the Board Handbook related to the conflict of interest provision which appeared to render VP Duckett ineligible to serve on the Board. He clarified that VP Duckett, as the UCRS Plan Administrator, was both a logical and vital member of the Board and that he felt the oversight in the Board Handbook could be easily rectified.

In summary, the Board Handbook indicated that UCOP employees engaged in making UCRS policy were ineligible to serve on the Board, with the exception of the Officer of the Treasurer designee and the Officer of the University appointed by the President. Chair Oakley noted that the President had named two Officers of the University to the Board (EVP Brostrom and VP Duckett) and that the apparent discrepancy could be rectified by applying the exception to "any" officer appointed by The President. Thus, the Board endorsed revising the conflict of interest provision under the "Membership" section on page #5 of the Handbook as follows:

"*This policy does not, however, apply to ~~the~~ any UCRS Advisory Board officer appointed by the President or the Office of the Treasurer designee."*

Based on concerns that only UCOP administrators EVP Brostrom and VP Duckett were nominated for the Board officer positions, Chair Oakley indicated that, in accordance with Roberts' Rules of Order, he would be calling for new nominations for Board Chair and Vice Chair. He then proceeded to call for new nominations and conducted a vote via ballots. The voting process for electing the Chair was conducted first and, with a majority of the votes, member Ross Starr was elected as Board Chair for fiscal year 2011-2012. The initial process for electing the Vice Chair did not result in a majority for any candidate. After a subsequent vote, new member Shane White was elected as Vice Chair for fiscal year 2011-2012.

The open/regular session ended at 1:45