UCRS Advisory Board

MINUTES
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)
ADVISORY BOARD MEETING
FRIDAY, NOVEMBER 16, 2012
10:00 AM – 2:00 PM

BOARD MEMBERS PRESENT: Chair Ross Starr, Vice Chair Shane White, Executive Vice President (EVP) Nathan Brostrom, Chief Investment Officer (CIO) Marie Berggren, Vice President Dwaine Duckett, CUCRA Chair Marian Gade, CUCEA Chair W. Douglas Morgan, Vice Chancellor Meredith Michaels, Associate Vice Chancellor Angela Hawkins, Assistant Researcher Catherine Brennan, Spectroscopist Paul Brooks.

BOARD MEMBERS ABSENT: (none**)**

STAFF PRESENT: Principal Legal Counsel Barbara Clark, Senior Legal Counsel Ina Potter, Director Kris Lange, Director David Olson, Director Robert Pettit, Director Gary Schlimgen, Associate Director Linda Ashcraft, Associate Director Tony DiGrazia, Manager Adam Chen-Ok, Specialist Ken Reicher, Principal Analyst Mary Jenkins, Principal Analyst Robert Semple.

OTHERS PRESENT: CUCRA Chair Elect Lee Duffus, CUCRA/CUCEA Representative Adrian Harris (via telephone), UCB Retiree Association representative Antonia Sweet, UCB Emeriti Association representative George Goldman, CUCFA representative Eric Hays, CUCFA representative Joe Kiskis (via telephone), AFSCME representative Claudia Preparata, CUE/Teamsters representative Anytra Henderson, UPTE representative Wendi Felson, UPTE representative Paul Phojanakong, UPTE representative Damion Miller, UPTE representative Elisa Cleveland, UPTE representative Karen Galbreath, UPTE representative James Hockridge, UPTE representative Michael Dupray, UPTE representative Michael Fehr, UPTE representative Tonya Tucker-Greene, UPTE representative Vanessa Bakula, 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 questioned whether UC had a contingency plan if UCRP did not meet its assumed rate of return (7.5%) over an extended period or experienced a dramatic market downturn. AFSCME representative Claudia Preparata discussed a report from Pension Trustee Advisors, an outside actuarial firm retained by AFSCME, UPTE and CNA, which questions some of the assumptions used in the actuarial valuation of UCRP. Specifically, the report questions the use of a level dollar amortization (as opposed to a level percentage amortization), which, it alleges, overstates costs in the early years of UCRP's amortization period. Ms. Preparata asserted that the use of level dollar amortization inflates up-front costs to UCRP by approximately $1 billion and was used to help UC justify the new pension Tier. She indicated that this issue should not be limited to collective bargaining discussions. She concluded by requesting that the report be placed on the agenda for the February Board meeting and indicated that she could request a representative from Pension Trustee Advisors be in attendance. The final commenter, CUCFA representative Kiskis, questioned the relevancy of comparing UCRP's performance to its benchmarks when UCRP's returns were negative.

COMMENTS FROM CHAIR STARR: Chair Starr began by welcoming the Board's newest member, W. Douglas Morgan, who is the new Chair of CUCEA, replacing Ernest Newbrun. He then noted that it was the last Board meeting for member Marian Gade, since her position as Chair of CUCRA ends on December 31, 2012. He praised Marian's accomplishments and service to the Board and presented her with a thank you letter and certificate of appreciation signed by President Yudof. (*Marian thanked the Board and noted that the new CUCRA Chair and UCRSAB member is Lee Duffus*.) He concluded by noting that the complete actuarial analysis by Pension Trustee Advisors should be added as an agenda item for the Board's February meeting at the recommendation of member Brooks and AFSCME representative Preparata.

APPROVAL OF THE MINUTES: Chair Starr called for approval of the minutes from the Board meeting of June 29, 2012. With the addition of some clarifying comments on agenda items B and C and the correction of a typo, the minutes were approved by acclamation.

EXECUTIVE VICE PRESIDENT, BUSINESS OPERATIONS – BUDGET UPDATE: EVP Brostrom thanked Marian Gade for her work on the Board and the President's Post-Employment Benefits (PEB) Task Force and noted that the UC retirees and their associations had been instrumental in the passage of Proposition 30. He clarified that Proposition 30 does not add new money to UC's budget, but rather preserves the $125 million tuition buyout and forestalls the $250 million budget cut that UC would have faced if Proposition 30 had failed. He expressed hope that UC would be able to formulate a stable budget plan to help restore student/faculty ratios and address other issues. He indicated that UC would be submitting a budget request for an additional $1 billion, spread over the next eight years, and stated that UC would continue its efforts to trim spending through administrative efficiencies. He also indicated that UC would continue to pursue measures for revenue restructuring, such as issuing bonds. He said that UC has a better credit rating than the state, enabling it to issue longer-term bonds with lower rates, which could save UC $80-$100 million annually in operating costs.

CHIEF INVESTMENT OFFICER – REPORT: For the quarter ending June 30, 2012, CIO Berggren noted that equity markets fell based on concerns about world growth, which contributed to UCRP's negative return (-1.94%). However, despite a negative return (-3.1%) in the Russell 3000 (representing equities) over the second quarter, most of the plan's portfolios outperformed their benchmarks and UCRP's returns on a fiscal and calendar year-to-date (YTD) basis were positive, at .37% and 5.75%, respectively. She attributed the positive fiscal and calendar YTD returns to asset selection and noted that fixed income investments performed particularly well (2.08% for the quarter, 7.13% fiscal YTD). Based on uncertainty with respect to the fiscal cliff crisis, she mentioned that the Treasurer's Office is allocating more to neutral investments, such as fixed investments, which are not affected by fluctuations in the economy. She concluded by noting that there should be more clarity in the new year, assuming the fiscal cliff crisis gets resolved.

ITEM A. PROPOSED DEFINED CONTRIBUTION PLAN OPTION FOR UC HEALTH POLICY-COVERED STAFF NEW HIRES – FEASIBILITY STUDY – UPDATE: At the request of the Chair**,** Director Schlimgen provided a brief recap of the feasibility study, noting that the defined contribution plan (DC Plan) was an optional alternative to UCRP and would only be available to UC Health policy-covered (i.e., non-represented) staff new hires. He indicated that UC Health continues to express interest in the DC Plan as a viable option for recruiting employees for certain types of positions and HR continues to evaluate its feasibility in light of labor relations issues and operational considerations. He indicated that if the DC Plan were implemented, less money could be directed to UCRP as a result of new UC Health staff opting to participate in the DC Plan, as there would be no Normal Cost for DC Plan participants. However, he clarified that if the DC Plan were implemented, there would be an assessment to pay down UCRP's unfunded liability.

A discussion of the DC Plan ensued. A few members reiterated that, in addition to potential cost savings, the DC Plan is intended as a recruitment vehicle for short-term employees who would financially benefit from a DC Plan but not from UCRP. They also noted that the portability of a DC Plan is more beneficial to short-term employees. The Vice Chair expressed concern that a DC Plan option, if approved, would spread to other UC divisions looking to cut costs. He also stated that the initial employer DC Plan contribution of 4% is below comparators, and noted that increasing the employer contribution as employees accrue more years of service runs contrary to the concept that the DC Plan is intended for short-term employees who wouldn't vest in UCRP. Another member stated that the DC Plan represents a potential wedge to dismantle UCRP, as locations might become hesitant to pay assessments for UCRP's unfunded liability if a growing number of their new employees opted for the DC Plan. The Chair asked the Plan's Actuary to estimate gains attributable to UCRP members who terminate prior to vesting and questioned whether UCRP's turnover assumptions would change if the DC Plan was implemented. It was clarified that the Plan's Actuary does incorporate turnover assumptions in UCRP's actuarial valuation but that UCRP's turnover assumptions were not modified for the DC Plan feasibility analysis. The discussion ended with a request for more specific details of the DC Plan and its potential impact on UCRP. Director Schlimgen indicated that more information would be provided at the Board's February 2013 meeting.

ITEM B. UCRS – ANNUAL ACTUARIAL VALUATION REPORTS: Plan Actuary Angelo noted that UCRP had a market value return of .3% and an actuarial return of .9% for fiscal year 2011-2012 and referenced a chart illustrating how the 5-year smoothing process determines UCRP's actuarial value of assets (AVA) as opposed to its market value of assets (MVA). He stated that UCRP's funded ratio was declining on both an AVA and MVA basis; as of July 1, 2012, UCRP's AVA funded percentage was 79% and its MVA funded percentage was 77%. Turning to a discussion of UCRP's Normal Cost, he indicated that it rose from 17.83% to 18.09% (as of July 1, 2012) and attributed the increase to a slightly higher entry age of new UCRP members. He also noted that UCRP contributions should cover Normal Cost beginning July 1, 2013. The Vice Chair asked when UCRP contribution rates for fiscal year 2014-2015 would be determined and stressed the importance of covering UCRP's modified ARC (Normal Cost plus the interest on UCRP's unfunded liability) to keep UCRP's unfunded liability from growing. He suggested additional external financing (borrowing) as a possible solution. With respect to the Vice Chair's suggestion for additional external financing, CIO Berggren stated that its impact on UC's credit rating needs to be considered. The Chair asked how the Plan's Actuary would address a situation in which UCRP's extended returns were negative or below its assumed rate of return. Actuary Angelo indicated that it was difficult to predict market returns and cautioned that there were drawbacks to lowering UCRP's assumed rate of return and/or investing UCRP assets too conservatively.

ITEM C. UCRS – AUDITED ANNUAL FINANCIAL REPORTS FOR FISCAL YEAR 2011-2012: Director Olson indicated that the formerly separate financial annual reports for UCRP and the Retirement Savings Plan (RSP) had been combined into one report this year, omitting redundant disclosure information and reducing production costs. Noting that the UCRP financial information had been covered by Actuary Angelo, he summarized key figures for the RSP

ITEM D. UCRS – POWER OF ATTORNEY OR CONSERVATORSHIP: At the request of the Chair, this item was added to review steps that could be taken should an employee or retiree become mentally incompetent. Senior Legal Counsel Potter stated that, as a precautionary measure, members could submit a Power of Attorney (POA) to appoint someone to make decisions on their behalf. In the absence of a POA, the court would normally appoint someone to act as a conservator on behalf of a member determined to be mentally incompetent. She indicated that UC should be cautious about providing any advice with respect to POAs. Director Pettit indicated that Customer Service personnel specifically advise that UC cannot provide advice with respect to POAs. In response to operational questions, Manager Chen-Ok indicated that separate POAs must be submitted to UC and Fidelity for matters relating to UCRP and the RSP, respectively. He indicated that the process for establishing a POA was fairly simple and they could be submitted or rescinded at any time.

ITEM E. UCRP – POST-EMPLOYMENT BENEFITS – IMPLEMENTATION UPDATE: Noting that the many systems, operational and communications issues for the post-employment benefits (PEB) implementation project had been described at previous Board meetings, Director Schlimgen provided a brief status update. He stated that the PEB technical implementation issues had been identified. He also stated that UC's current payroll system, the new UCPath payroll system and the separate UC retirement system would require modifications to implement the PEB changes. He briefly summarized some unique PEB technical implementation issues, such as the complex retirement benefit calculation for rehired members who could have service in the old and new UCRP tiers (aka multi-tier members). In closing, he indicated that he was confident that the PEB project was on track to implement the changes effective July 1, 2013.

ITEM F. UCRP – DISABILITY PROGRAM REVIEW: Director Schlimgen briefly summarized the disability program review findings that he had presented to the Board at past meetings. He noted that the maximum short-term disability benefit provided by UC was $800 per month, which is well below comparators, and that comparator data showed it is unusual to offer a long-term disability benefit through a defined benefit plan and to limit liability for benefits to only vested plan members. He mentioned that UC's supplemental disability program, which is voluntary and entirely paid for by eligible employees on an after-tax basis, exceeds industry standards. He indicated that UC has looked at alternatives means of providing and improving disability benefits but that the costs were substantial. Consequently, due to current budget constraints, there were no plans to make significant disability program changes at this time. However, he noted that future program changes remain under consideration and that he would be discussing the disability program review in more details with TFIR later in the day. Director Lange then described some administrative steps that UC will soon be undertaking to improve member experience, such as standardizing disability filing procedures. She also noted that communications would be enhanced to clarify that UC doesn't participate in the state's disability program and to foster participation in UC's supplemental, employee-paid disability program, which provides up to 70% of a member's earnings on a tax-free basis.

A discussion ensued on the future role of the location Health Care Facilitator (HCF) program, with several members expressing interest in the program's continuation. A brief history of the funding of the program was discussed, and it was noted by VP Duckett that while central funding would be discontinued, individual locations could fund the program at their discretion going forward. An alternative model for delivering similar services through a centralized service center was also discussed. Several UCRSAB members reiterated the value of local delivery of this service and urged that the program be continued at all locations.

ITEM G. RETIREMENT SAVINGS PROGRAM – VENDOR RELATIONS MANAGEMENT REPORT: Director Lange indicated that Fidelity Retirement Services, the master record-keeper for the RSP, met its performance standards. She stated that eight Calvert funds had been successfully transitioned to the institutional class and that communications concerning the "freezing" of contributions and transfers to the UC Insurance Company Contract Fund had been completed. A communication campaign regarding beneficiary designations was also completed, resulting in 1700 updated designations. She mentioned that UC's payroll system and electronic interfaces with Fidelity had been updated, improving the process for making payroll adjustments and reconciliations. She announced that participation in the RSP hit 50% in the last quarter, which had not occurred since the first quarter of 2010. She concluded by announcing that UC had received several awards for its retirement-related communications and tools during the last quarter.

ITEM H. RETIREMENT SAVINGS PROGRAM – MINIMUM REQUIRED DISTRIBUTIONS – 2012 PROCESS: Manager Chen-ok provided a brief overview of the minimum required distribution (MRD) process. He indicated that retirees who wished to specify the tax-withholding and/or the fund(s) from which their MRD should be taken must submit their request to Fidelity by December 12, 2012. He clarified that, in addition to federal tax-withholding, retirees may now dictate state tax withholding for their MRDs. Fidelity will issue default MRDs on December 14, 2012 for participants who failed to submit an MRD election. He clarified that default MRD's are taken proportionately from all of the member's funds and that a standard tax-withholding is applied. Manager Chen-ok was informed that Fidelity did not seem to be complying with the MRD processes as he described. A discussion ensued about varying experiences with alternative timing of and tax withholding for MRDs. In the interest of time, Chair Starr asked that Director Lange and Manager Chen-OK clarify all MRD procedures and report back at the Board's meeting in February.

ITEM I. RETIREMENT SAVINGS PROGRAM – FUND MENU MANAGEMENT: Director Schlimgen started the introduction to this item by stating that the goal of the overall fund menu management project is to minimize participant fees and improve participant experience while reinforcing fund monitoring and program oversight. Director Lange then described the project communication campaign, which commences in January 2013, and will be focused on the 43,000 participants who have money in non-CORE/non-institutional funds. Such participants will be advised that by late March of 2013 these funds will be "frozen" and will not accept new contributions or incoming transfers. Therefore, participants will have to open up a brokerage link account to continue contributing to these funds, or redirect future contributions to the UC Core or institutional class funds. Those who do not elect to redirect their contributions and transfer their existing money in non-

CORE/non-institutional funds to the same (or different) funds under the brokerage link, or to UC CORE or institutional class funds, will have their contributions and existing balances automatically "mapped" to an appropriate UC Pathway fund in late June 2013. Board members stressed that communications on this issue be comprehensive, clear and easily distinguishable from spam or junk mail.

ITEM J. ANALYSIS OF A ROTH FEATURE FOR THE 403(b) AND/OR 457(b) PLAN: Principal Analyst Jenkins summarized a handout comparing features of a Roth defined contribution (dc) plan, in which contributions are made on an after-tax basis, to a traditional dc plan, in which contributions are made on a pretax basis and accumulations are taxed upon withdrawal. She then explained that, due to UC's antiquated payroll system, it has not been operationally or economically feasible for UC to offer a Roth plan under the RSP. However, with the full implementation of a new UC payroll system, a Roth 403(b) and/or 457(b) Plan is very feasible in the future. She indicated that the new payroll system will be rolled out in stages across UC locations and will not be completed until late 2014. Therefore, it is likely that a Roth 403(b) and or 457(b) Plan could be available in 2015. She indicated that more information on this issue will be available as the UCPath project progresses.

ITEM K. CALIFORNIA PUBLIC EMPLOYEE'S PENSION REFORM ACT (PEPRA) – SUMMARY: Principal Analyst Semple began by stating that PEPRA applies to most public pension plans in California but does not apply to UC/UCRP. He then provided highlights of the major PEPRA provisions. In short, PEPRA requires that a new defined benefit formula be applied to any individual who, on or after January 1, 2013, becomes a new member of public pension system that is subject to PEPRA. Under the new formula, the highest age factor for non-Safety employees is attained at age 67 and is 2.5% of the member's highest, 3-year average base salary. Additionally, for purposes of calculating retirement benefits, a member's highest 3-year average base salary is capped at the Social Security (SS) wage base or 120% of the SS wage base, depending upon whether or not the employee is coordinated with Social Security. PEPRA also requires that all employees in public pension systems subject to PEPRA must, over time, make pension contributions equal to at least 50% of the Normal Cost of their benefits.