University of California

UCRS Advisory Board

MINUTES
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)
ADVISORY BOARD MEETING
FRIDAY, FEBRUARY 27, 2015
10:00 AM – 2:00 PM

BOARD MEMBERS PRESENT: Chair Shane White, Vice Chair Meredith Michaels (via telephone), Chief Investment Officer (CIO) Jagdeep Singh Bachher, Associate Vice Chancellor David Odato (via telephone), Professor James Chalfant (via telephone), Assistant Director Deborah McWilliams, Administrative Clinical Care Partner Monica Martinez, CUCRA Chair Lee Duffus, and CUCEA Chair Roger Anderson.

BOARD MEMBERS ABSENT: Executive Vice President (EVP) Nathan Brostrom, Vice President (VP) Dwaine Duckett

STAFF PRESENT: Executive Vice President and Chief Operating Officer (EVP/COO) Rachael Nava, Associate CIO Arthur Guimaraes, Associate Vice President (AVP) Debora Obley, Executive Director Gary Schlimgen, Principal Legal Counsel Barbara Clark, Senior Legal Counsel Ina Potter, Senior Investment Analyst Susie Ardeshir, Director Kris Lange, Director Ellen Lorenz, Associate Director Tony DiGrazia, Manager Ken Reicher, Principal Analyst Melissa Rad, Principal Analyst Robert Semple.

OTHERS PRESENT: CUCRA/CUCEA representative Adrian Harris (via telephone)**,** , CUCEA Chair Elect Marianne Schnaubelt, UCB Emeriti Association representative Caroline Kane, UCB Emeriti Association representative Amy Block Joy, UCB Retiree Association representative Marian Gade (via telephone), UCB Retiree Association representative Antonia Sweet, UCB Retiree Association representative Julia Walsh, CUCFA representative Eric Hays, CUCFA representative Joe Kiskis, AFSCME representative Claudia Preparata, Teamsters Local 2010 representative Catherine Cobb, Teamsters Local 2010 representative Mary Higgins, Teamsters Local 2010 representative Timothy Matthews, UPTE representative Mike Fehr, CUCSA representative Matthew Leet, CUCSA representative Karla Wood, Actuary John Monroe (The Segal Company).

The meeting officially began at 10:04 a.m.

PUBLIC COMMENT PERIOD: CUCFA representative Kiskis feels that UCRP is becoming a political issue again and thinks UC should explain that the state was partially responsible for UCRP's contribution holiday. He also feels that UC should explain that UCRP benefits represent deferred compensation and that employees receive lower pay in return for promised pension benefits. Referencing recent State Assembly discussions about the Public Employee Pension Reform Act (PEPRA) and UC, he questioned whether the "committee of two" consisting of Governor Brown and UC President Napolitano would result in additional changes to UCRP. UPTE representative Mike Fehr noted that UC staff members are still concerned with UCRP's unfunded actuarial accrued liability

(UAAL) and wondered what further actions UC will take to address it. He also noted that staff would like a Roth option for the UC 403(b) and/or 457(b) plan. Teamsters' representative Mary Higgins suggested that UC should also offer a tax-deferred IRA.

APPROVAL OF THE MINUTES: Chair White called for approval of the minutes from the Board meeting of November 21, 2014. The minutes were approved by acclamation.

COMMENTS FROM THE CHAIR: Chair White introduced Rachael Nava, the new COO at UCOP and asked her to address the Board. COO Nava stated that she was happy to be part of UC and that she was an alumna of UCSC. She noted that she had experience in health care and the administration of complex organizations, having served as the COO for Central Alliance for Health, a public, non-profit Medicaid managed health care plan serving over 310,000 members in Northern California. She said that she is not yet an expert with respect to UC's benefits, but mentioned that Executive Director Schlimgen had briefed her on UCRS and she was glad to hear that UCRP will receive its full annual required contribution (ARC) this year. She stated that she respects the shared governance structure with the Academic Senate and the collective bargaining process for represented employees and will strive for transparency in dealing with all UC constituencies. She closed by stating that she will be replacing EVP Brostrom on the Board, but that her appointment has not yet been made official by the President. Chair White closed his comments by noting that while EVP Brostrom may no longer be a Board member, he would still be available to provide budget briefings, as his schedule permits.

CHIEF FINANCIAL OFFICER – BUDGET UPDATE: In EVP Brostrom's absence, the budget update was provided by AVP Debora Obley. She noted that legislative hearings had started and the focus was on UC's budget and funding allocation. Legislators were upset about the distribution of funds among UC locations, noting that higher-paying, non-residents students enroll at the higher-profile campuses while newer, less well-funded locations have more economically disadvantaged resident students. EVP Brostrom explained that the older, prominent campuses have a larger number of established graduate programs to attract non-resident students. Although UC is not subject to PEPRA, legislators also questioned why UC did not adopt all the PEPRA provisions, especially the lower compensation cap used in retirement calculations. They felt that UC had not done enough to limit excessive pensions and executive compensation or to increase faculty workload. EVP Brostrom explained that UC must pay sufficient salaries to remain competitive and that increasing faculty workload would diminish research at UC. There was further discussion of scrutinizing UC's costs, but several legislators noted that UC wasn't being adequately funded by the state and they were willing to recommend additional UC funding to avoid tuition hikes. There will likely be additional meetings to discuss UCRP costs and faculty workload.

In response to a question from the Chair, AVP Obley stated that some UC administrators also feel that UC has not done enough to reduce pension costs. She stated that some medical centers wish to implement a lower-cost, more portable defined contribution plan for new employees. In closing, she stated that discussions between the Governor and President Napolitano are ongoing and that the Governor has invited some prominent academic leaders to provide budgetary expertise. She noted that the Governor is focused on UC graduation rates, recommending that UC develop a 3-year degree program. In response to a final question from the Chair, she indicated that UC is considering further borrowing to address UCRP's UAAL.

Director Bowen (via telephone) provided a summary of the Legislative Analyst' Office (LAO) view of UC's budget. The LAO believes that UC's budget increase should be based on a 2.5% COLA, which would be $66 million. However, the LAO also believes UC should receive roughly $60 million to avoid tuition hikes, so it recommends an overall UC budget increase of $126 million. From a funding perspective, the LAO indicated that UCRP is being treated unfairly in comparison to CalPERS and CalSTRS. The LAO also recommends that each UC segment should provide strategies for further efficiencies and that UC enrollment growth be based on projections from the Department of Finance.

CHIEF INVSTMENT OFFICER – REPORT: Associate CIO Guimaraes summarized the market update contained in the investment highlights distributed to Board members, noting that global equities are diverging with only US equities showing significant returns. There is a lot of volatility in the market, but that might provide investment opportunities. He feels US equity returns will slow in the future. However, since the fixed income rates in some countries is negative due to low inflation, US investments, particularly equities, are really the best choice at the present time. CIO Bachher added that quantitative easing that has started in Europe and Japan was also a factor in the flight to US investments. The CIO is surprised at the continued strength of US equities, but agreed that better alternatives do not presently exist since returns on US Bonds and Treasuries are so low. He stated that UC has accumulated a significant amount of cash and is remaining defensive and cautious, which is the key in deploying capital. He also noted that UC has signed on to the United Nations Principles of Responsible Investment and that his office is committed to environmental, social and governance (ESG) investing, although the approach is still evolving.

Senior Investment Analyst Ardeshir summarized the investment highlight for UCRP, noting that it had nearly $53 billion in assets as of the end of 2014, up $3.5 billion from the 2013 year end. She stated that UCRP had a return of 6.9% for the past calendar year. Due to the market returns and the influx of money borrowed from STIP, she noted that UCRP currently had a positive cash flow. Echoing previous statements, she indicated that equity returns would most likely slow in the future and might drop below UCRP's assumed annual rate of return of 7.5%.

Associate CIO Guimaraes closed with a discussion of the UC Retirement Savings Program (RSP). Noting that Director Kris Lange would cover the RSP in more detail as part of the Vendor Relations Management report, he mentioned his concern regarding the large percentage of RSP assets invested in the UC Savings fund. As an example, he stated that an employee who began contributing five years ago and invested solely in the UC Savings Fund would have a balance that was 50% less than it would be had the employee invested solely in the UC Balance Growth Fund. He noted that the change in the investment default fund from the UC Savings Fund to the appropriate UC Pathways Fund was a critical step in the right direction, especially since such a significant percentage of RSP single fund holders are invested in the Savings Fund. He noted that appropriate RSP asset allocation can have a significant impact on retirement readiness and that this should be an important financial education issue.

ITEM A. UCRP – RECOMMENDED CHANGES TO THE UCRP FUNDING POLICY: This item was presented by UCRS Actuary John Monroe of Segal Consulting (Segal). Following a brief overview of the role of the Government Accounting Standards Board (GASB), he summarized the main components of UCRP's annual actuarial valuation, which include UCRP policy provisions (such as eligibility rules) member data, financial data, assumptions, and funding policy. He noted that the item focused on recommended changes to UCRP's funding policy, which is designed to determine the amount that should be contributed to UCRP each year, so that it conforms to model practice recommended by the California Actuarial Advisory Panel (CAAP) and the Conference of Consulting Actuaries Public Plans Community (CCA PPC). He further clarified that the recommended changes only apply to a portion of UCRP's funding policy; namely, the amortization periods that apply to future changes in the Plan's UAAL due to actuarial gains or losses, assumption or method changes, and plan amendments affecting non-active Members. He stated that Segal is recommending that these amortization periods be changed as follows: from 30 to 20 years for actuarial gains or losses; from 15 to 20 years for assumption or method changes; and from 15 to 10 years for Plan amendments affecting non-Active members. He stated that Segal's recommendation is for UCRP to continue to use an accepted practice of "level dollar" amortization method versus a model practice of the "level percent of payroll" amortization method used by most public pension plans in which payments increase each year in proportion to the assumed growth of the active workforce/payroll. Level dollar amortization is an acceptable amortization method according to the CAAP and CCA PPC and UC has an established rationale for using it, given that: (1) it amortizes the UAAL faster in early years, thereby incurring less interest payments; (2) it avoids "negative amortization" which can occur under the level percent of payroll method in which early amortization payments could be less than the interest on the UAAL, temporarily causing the UAAL to increase instead of decrease; and (3) it is more appropriate for an employer like UC that doesn't have taxing authority and has less reliable funding sources.

ITEM B. UCRP – PREVIEW OF UPCOMING EXPERIENCE STUDY: Manager Ken Reicher began by stating that a UCRP Experience Study is conducted by the Plan's Consulting Actuary (currently Segal) every 3-5 years and that such a Study is underway. He explained that an Experience Study compares the expected experience under a pension plan's actuarial assumptions to the actual experience over a set observation period. The comparisons determine if adjustments to the plan's assumptions are warranted in order to calculate the best estimates of future liabilities. Such Studies also determine whether a plan's economic assumptions, including price inflation, wage inflation, and investment rate of return assumption, are appropriate. He stated that the Study underway covers the observation period from July 1, 2010 through June 30, 2014 and that the results and any recommended changes will be presented to the Regents for review and approval in July. He noted that the demographic assumption with the most significant impact on UCRP costs and liabilities is a change in mortality and that since UCRP annuitants continues to live longer than expected, such a change was likely to be recommended. The economic assumption with the most significant impact on UCRP costs and liabilities is the investment rate of return (7.5% for UCRP since 1994). Segal may recommend a reduction in UCRP's investment rate of return to 7.25% or 7%.

ITEM C. UCRS – RETIREMENT READINESS STUDY – UPDATE: Director Kris Lange reiterated that the purpose of the Retirement Readiness Study was to evaluate actual retirement data garnered over the last 3 years to see how it compared to the annual retirement readiness scores that Fidelity, in conjunction with UC, projects for active members. She stated that the study is still ongoing and that it has grown more than originally expected. She indicated that results of the study should be available for presentation at the Board's June meeting.

ITEM D. RETIREMENT SAVINGS PROGRAM – FUND MENU MANAGEMENT– UPDATE: Director Kris Lange provided an overview of the final phase of the Fund Menu project; the creation of a single RSP Core funds menu consisting of approximately 26 investment options. As previously reported, participants with money in funds being removed from the menu who fail to take action will have their assets defaulted to an age-appropriate UC Pathway Fund. Funds being eliminated from the menu will still be available through the Brokerage Link, which no longer has a $25 annual fee. She referenced the communication timeline that was attached to the item, specifically mentioning that a personalized statement and decision guide will be mailed to affected participants on April 22. The default transfer process will occur on July 2, 2015.

ITEM E. RETIREMENT SAVINGS PROGRAM – VENDOR RELATIONS MANAGEMENT REPORT: Director Kris Lange provided highlights of the 2014 fourth quarter (Q4) report, noting that the RSP had $20 billion in assets at year end. The participation rate in the 403(b) Plan remained steady at 50% with an average contribution rate of 10%. The 2014 Q4 new hire enrollment rate jumped up to 24%, whereas it is normally 14-16%. She attributed the increase in 2014 Q4 new hire enrollments to the implementation of the Easy Enroll tool. (Associate CIO Guimaraes commented that we should consider auto-enrollment.) Director Lange mentioned that Fidelity missed two performance measures in the Q4; average speed to answer calls and portal maintenance/link accuracy. She concluded by noting that Fidelity performed a Q4 search of 9,000 participants with bad addresses (i.e., lost participants) and was able to obtain updated addresses for 7,000 of them.

ITEM F. RETIREMENT ADMINISTRATION SERVICE CENTER – ANNUAL REVIEW: Director Ellen Lorenz began by clarifying that attached Retirement Administration Service Center (RASC) Quick Facts was a monthly report, not an annual review. However, as the report is for the month of December 2014 and contains fiscal year-to-date (FYTD) numbers, it can serve as a semi-annual summary. She stated that RASC service levels remain high and that 85% of customers are happy with their experience. RASC generally exceeds its measurement goals of answering 80% of calls within 90 seconds and responding to correspondence within 7 days. She noted that RASC stayed open during the holiday break, during which time it received 33% of its normal call activity. She also mentioned that RASC provides retiree counseling for all but four UC locations. In closing, she noted that RASC is continually focused on improvement.

ITEM G. UCRS ADVISORY BOARD – ELECTION OF STAFF MEMBERS: Principal Analyst Semple provided an update on the upcoming election for two staff representatives on the Board, as the terms of the two current staff representatives, Monica Martinez and Deborah McWilliams, expire on June 30, 2015. He noted that the terms of the new staff members would run from July 1, 2015 through June 30, 2019 and that both Ms. Martinez and Ms. McWilliams were eligible submit nominations materials to run in the election. He provided the timeline for the nomination and voting periods and announced that the winning candidates would be announced by the end of June 2015. He noted that all active staff members who were not Academic Senate members could run as candidates, with the exception of staff who work in the Offices of Internal Audit at any location or UCOP staff members who help make UCRS policy, work in a department where UCRS policy is made or who provide legal advice to the UCRS plans. He noted that the election would be supported by a multi-channel communication campaign and that complete election information and materials would be available on the UCnet website. He indicated that voting would be conducted primarily via an internet application hosted by an external vendor, VR Election Services (VRES), which is the same vendor used for the 2011 Board staff election. VRES will send broadcast emails to all known UC-email addresses of eligible voters (provided by UC). VRES will also mail ballots and candidate statements to eligible voters without a UC e-mail address. Only eligible voters may access the internet voting site using a PIN provided by VRES. The physical ballots that can be mailed to VRES contain a security bar code to prevent duplication of votes.

The meeting adjourned at 1:57