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Office of the President

TO MEMBERS OF THE COMMITTEES ON FINANCE AND COMPENSATION:

ACTION ITEM

For Meeting of September 16, 2010 ***LINK to POWERPOINT***

UNIVERSITY OF CALIFORNIA RETIREMENT PLAN: UNIVERSITY AND MEMBER CONTRIBUTION RATES FOR PLAN YEARS BEGINNING JULY 1, 2011 AND JULY 1, 2012, AND AMENDMENT OF REGENTS POLICY 5601: UNIVERSITY OF CALIFORNIA RETIREMENT PLAN FUNDING POLICY

EXECUTIVE SUMMARY

The President, based on the recommendations of the President's Post-Employment Benefits Task Force (Task Force), recommends that the rates for University and member contributions to the University of California Retirement Plan (UCRP or Plan) for the Plan Years beginning July 1, 2011 and July 1, 2012 be as shown in the recommendation below and that the UCRP Funding Policy be amended to provide for a 30-year amortization period for any gains/losses.

Issues:	Rates for University and member contributions to UCRP for Plan Years beginning July 1, 2011 and July 1, 2012 and UCRP Funding Policy amortization period for any gains/losses.
Relevant Policy:	UCRP Document Regents Policy 5601: UCRP Funding Policy
Previous Actions:	**October 1990:** The Regents suspended University contributions and redirected most member contributions to the Defined Contribution Plan (DC Plan). **March 2006:** The Regents adopted a long-term targeted funding level for UCRP of 100 percent. **September 2008:** The Regents adopted a funding policy for UCRP effective with Plan Year 2009-2010 under which policy contributions equal Normal Cost plus an amortization charge for any Unfunded Actuarial Accrued Liability (UAAL) or minus an amortization credit for any surplus.

February 2009: The Regents approved reinstatement of University and member contributions beginning on or about April 15, 2010 at the initial contribution rates shown herein.

Future Action: **November 2010:** Discussion of the annual actuarial valuation reports and additional recommendations of the Task Force.

RECOMMENDATION

The President, based on the recommendations of the Post-Employment Benefits Task Force, recommends that the Committee on Compensation recommend to the Regents that:

(1) University contribution rates for Plan Years beginning July 1, 2011- and July 1, 2012 be as shown below:

Member Class	**Number of Active Members July 1, 2010**	**University Contribution Rates on Covered Compensation**		
		Plan Year 2010-2011 (current rates)	Plan Year beginning July 1, 2011	Plan Year beginning July 1, 2012
Coordinated with Social Security	112,700	*4%*	7%	10%
Noncoordinated	1,796	*4%*	7%	10%
Safety	418	*4%*	7%	10%
Tier Two	14	*2%*	3.5%	5%

(2) Member contribution rates for Plan Years beginning July 1, 2011 and July 1, 2012 be as shown below, subject to collective bargaining for represented members:

Member Class	**Number of Active Members July 1, 2010**	**Member Contribution Rates on Covered Compensation***		
		Plan Year 2010-2011 (current rates)	Plan Year beginning July 1, 2011	Plan Year beginning July 1, 2012
Coordinated with Social Security	112,700	*2% up to Social Security wage base, then 4%*	3.5%	5%
Noncoordinated	1,796	*3%*	3.5%	5%
Safety	418	*3%*	4.5%	6%
Tier Two	14	*none*	none	none

*all contribution amounts are reduced by $19 per month

(3) The University contributions and the member contributions for the Lawrence Berkeley National Laboratory (LBNL) segment of UCRP be made on the same basis as determined for the non-laboratory segment of UCRP (i.e., campuses, medical centers and Hastings College of the Law), subject to the terms of the University's contract with the Department of Energy and subject to collective bargaining for represented members at LBNL.

(4) Authority be delegated to the Plan Administrator to amend the UCRP Plan documents as necessary to implement these changes.

The President, based on the recommendations of the Post-Employment Benefits Task Force, recommends that the Committee on Finance recommend to the Regents that:

(5) The Regents Policy 5601: UCRP Funding Policy be amended as shown in Attachment 1 to increase the period for amortizing any past or future gains/losses from 15 to 30 years, effective July 1, 2010 and to clarify that funding policy contributions are determined by applying a mathematical formula (rather than recommended), while the actual contribution amounts reflect additional factors.

BACKGROUND

Proposed University and Member Contribution Rates for Plan Years 2011-2012 and 2012-2013

University contributions and member contributions to UCRP were required until November 1990 when the Regents suspended University contributions and most member contributions, as the Plan's surplus was then more than enough to cover the Plan's Normal Cost. The Regents also directed that member contributions be redirected to individual accounts in the DC Plan, subject to the Regents' right to direct these contributions back to UCRP in the future as necessary to maintain the Plan's funded status. In March 2006 the Regents adopted a long-term targeted funding level for UCRP of 100 percent.

In September 2008 the Regents adopted a funding policy for UCRP (included as Attachment 1) under which the policy contribution rate equals the Normal Cost plus an amortization charge for any UAAL or minus an amortization credit for any surplus. Each year the Regents determine the actual total contribution rates and the split between the University contribution rates and the member contribution rates based on the policy contribution rate and various other factors, including the availability of funds and the impact of employee contributions on the competitiveness of UC's total compensation package. The member contribution rates for represented employees are subject to the collective bargaining process. In no event will the University contribution rates be lower than the member contribution rates.

In February 2009 the Regents approved reinstatement of University and member contributions beginning on or about April 15, 2010. The initial member contribution rates are the same as the rates for member contributions that had been redirected to the DC Plan since 1990. The Regents

also approved termination of the redirection of member contributions to the DC Plan, resulting in no decrease in members' take-home pay. The initial total contribution rates (the University contribution rates plus the member contribution rates) were considerably below both the policy contribution rate and Normal Cost due to the lack of State funding, limited availability of other funds, and the impact of employee contributions on the competitiveness of UC's total compensation package. For represented employees the effective date for reinstatement of member contributions and the member contribution rates are subject to collective bargaining.

Although the policy contribution rate for Plan Year 2011-2012 will not be available until November when the July 1, 2010 actuarial valuation will be completed and the results reported to the Regents, it is recommended that the amount of the increase in University and member contribution rates be determined now for Plan Years beginning July 1, 2011 and July 1, 2012 to allow sufficient time for location budget planning and the collective bargaining process for represented employees.

The Task Force has recommended that both University and member contribution rates be accelerated more rapidly than originally projected in 2009 to capture more contributions from all fund sources as the liabilities are incurred and to reduce growth of the Plan's unfunded liability. Even with this acceleration, the totals of the University and member contribution rates being recommended for Plan Years beginning July 1, 2011-and July 1, 2012 are less than Normal Cost due to the continued lack of State funding and the adverse impact that a faster rate of acceleration would have on location budgets and on the competitiveness of UC's total compensation package.

In 2005 the Regents committed to a goal of market-competitive total compensation for faculty and staff and adopted the goals of obtaining, prioritizing, and directing funds, to the extent available, to increase salaries to achieve market comparability for all groups of employees over the ten year period from 2006-2007 through 2015-2016. The impact of the recommended increases in member contribution rates on the market-competitiveness of UC total compensation needs to be considered in relationship to these goals. If during the next two years the recommended increases in member contribution rates are implemented and no salary increases are provided, the competitive position of total compensation for faculty and staff will continue to deteriorate and at a faster rate, not only eroding the University's market position, but also undermining the institution's ability to attract and retain quality faculty and staff.

Because member contribution rates for represented employees are subject to the collective bargaining process, changes in UCRP contributions necessarily may take effect on different dates for different groups. The Task Force recommends that, in the interest of equity, members who receive the same level of UCRP benefits should ultimately contribute the same amount and, through the collective bargaining process, adjustments should be made in the amount and/or timing of contributions to achieve this goal. For example, if the effective date of an increase in the member contribution rate is delayed for a group of employees, then the new contribution rate for that group may be set at a higher amount for a period of time to equalize the total contributions from different groups. Alternatively, a group of employees with a later start date

for increased contributions may agree to provide retroactive contributions once the bargaining process has been completed.

Proposed Change in the Funding Policy Amortization Period for any Gains/Losses

Pension Plan Funding Policies

A pension plan funding policy is designed to determine how much should be contributed each year in total to provide for the secure funding of benefits in a systematic fashion. The funding policy starts with an actuarial cost method that allocates a portion of the total present value of the members' benefits to each year of service. In theory, contributing that "Normal Cost" for each year of service will be sufficient to fund all plan benefits, assuming that all actuarial assumptions are met, including the assumed rate of investment return. In that ideal situation, plan assets will always be exactly equal to the value today of all the past Normal Costs (the Actuarial Accrued Liability or AAL), and the current contribution will be only the current Normal Cost.

In practice, for a variety of reasons, the assets will be greater than or less than the AAL, leaving the plan overfunded (i.e., with a surplus) or underfunded (with an Unfunded Actuarial Accrued Liability or UAAL). The funding policy adjusts contributions to reflect any surplus or UAAL in a way that reduces short term, year-by-year volatility, but still assures that future contributions, together with current assets, will be enough to provide all future benefits.

A comprehensive funding policy is made up of three components:

1) An **actuarial cost method,** which allocates the total present value of future benefits to each year (Normal Cost) including all past years (AAL).

2) An **asset smoothing method,** which reduces the effect of short-term market volatility while still tracking the overall movement of the market value of plan assets.

3) A **contribution policy,** which determines the total funding policy contribution for each year based on the Normal Cost, the AAL and the smoothed value of assets.

For UCRP, as for many plans, the **actuarial cost method** and **asset smoothing method** are well established and reflect current industry standards. For that reason, recent discussions of funding policy have mainly focused on the **contribution policy** component. With that in mind, the more general term "funding policy" will continue to be used throughout this document.

For governmental or public defined benefit plans, like UCRP, there are no specific external funding or funding policy requirements such as those established for single employer (corporate) and multi-employer (Taft-Hartley) defined benefit pension plans under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (IRC). The current accounting standards promulgated by the Governmental Accounting Standards Board (GASB) define an Annual Required Contribution (ARC) that, despite its name, is actually the amount of accounting expense that the employer must recognize each year. Also, the current GASB accounting

standards provide considerable policy latitude when determining the ARC. Note that GASB recently released Preliminary Views on proposed changes to pension accounting standards for public sector employers. Later, we discuss the most significant of the proposed changes.

Even though this leaves governmental or public plans relatively free to set funding policy, it is worth noting that all long-term funding policy structures – corporate, multi-employer and GASB – take the same form, at least for underfunded plans (plans with a UAAL):

1) Contribute the Normal Cost for the year, and

2) Contribute an additional amount that will fully fund ("amortize") any UAAL over a period of years.

Implicit in this form of policy is *a funding target of 100 percent*, since at the end of the amortization period the plan will be fully funded. This is in contrast to "corridor" methods that allow contributions equal to only the Normal Cost as long as the plan is within, for example, 5 percent of being fully funded.

UCRP Funding Policy

In September 2008 the Regents adopted a funding policy (Attachment 1) that was more conservative than that followed by most other government plans and reasonable in light of financial reporting requirements. The funding policy was based on the UAAL amortization method. In this case, the policy was designed to fund the UAAL within 15 years. The funding policy is consistent with the long-term targeted funding level of 100 percent adopted by the Regents in 2006 as it targets 100 percent funding of the AAL at the end of the amortization period.

The following table shows the current parameters of the funding policy:

Parameter	UCRP Policy
Actuarial Cost Method	Entry Age Normal
Asset Smoothing	5 Year Asset Smoothing
Amortization Method	Level Dollar
Current Surplus Amortization Period	3 Years
Gain/Loss Amortization Period	15 Years (separate layers, fixed periods)
Assumption, Method, Benefit Change Amortization Period	15 Years
Future Surplus Amortization Period	30 Years

Shortly after adopting this policy, the investment market declined by over 20 percent and the State cut the University's appropriation by over $800 million. While both of these events are

rare, the occurrence of both events at the same time to this degree is unprecedented. In this economic environment, the University will not be able to make contributions to UCRP consistent with the funding policy adopted in 2008. However, the University believes it is still prudent to adequately fund UCRP to meet the current commitments for pension benefits to Plan members.

To establish a policy contribution rate that is more closely aligned with a realistically attainable actual contribution rate, the Task Force recommends amending the funding policy to increase the period for amortizing any gains/losses from 15 years to 30 years. The amended funding policy would be effective with the July 1, 2010 actuarial valuation and would determine the policy contribution rate starting with the Plan Year beginning July 1, 2011. All UAAL amortization bases would be combined as of July 1, 2010, with the 30-year period applying to the combined base and to any future gain/loss amortization bases. The funding policy would also be amended to clarify that the amount determined under the funding policy is the result of applying a mathematical formula and is not necessarily a recommended amount. Other factors, including the availability of funds, the competitiveness of the total UC compensation package, and collective bargaining should be taken into account. All other parameters for the funding policy would remain the same as adopted in 2008. The funding policy, with the recommended changes marked, is included as Attachment 1.

Proposed Changes to Governmental Accounting Standards

The GASB recently issued Preliminary Views on major issues related to *Pension Accounting and Financial Reporting by Employers.* This Preliminary Views is a step toward an Exposure Draft targeted for release in 2011 and, eventually, a new Statement of Governmental Accounting Standards that would replace the current standards. It is important to note that the GASB considers its proposed changes tentative until the final statement is issued.

The proposed changes would apply only within the context of accounting and financial reporting and would not necessarily affect the calculations used to determine funding policy contribution requirements. However, under current standards many employers, including UC, determine funding policy and accounting expense using the same methodology. Under the proposed changes, funding and expensing would be two separate calculations; that is one of the most significant changes in the Preliminary Views.

For UCRP, the other most significant of the proposed changes are:

- *Reporting Pension Liability* – The unfunded portion of the pension obligation would be reported as a net pension liability (total liability minus the fair value of plan net assets) on the balance sheet portion of the employer's financial statements. This would be a significant change from the current practice of reporting pension liabilities in the notes that supplement pension plans' financial statements.

- *Discounting* – The basis for discounting projected benefit payments to their present value would continue to be a reasonable long-term expected rate of return on the plan's investments, *but only to the extent that the current and expected future plan assets will be*

sufficient to cover the future benefit payments. Benefit payments that are expected to occur beyond the point that expected plan assets are projected to be exhausted would be discounted to their present value using a high-quality municipal bond index rate.

- *Amortization Periods for Other Changes in Pension Liability* – Three types of changes in the total pension liability would be reported as expense over a period representative of the remaining service periods of employees: differences between expected and actual experience ("gains and losses"), changes in assumptions about future experience, and changes in pension plan terms that affect benefits for past service. For such changes in liability for active members, this expensing approach is much shorter than the current practice which allows recognition over a period up to 30 years. Corresponding changes in liability for retirees would be expensed *immediately*, which is a *dramatic* departure from current practice. Note that this proposal leads to a measure of pension expense that is no longer a viable basis for determining contribution requirements.

Further details on the GASB Preliminary Views may be found in a bulletin prepared by the Regents' actuary, the Segal Company, that is included as Attachment 2.

Notice

The University will take appropriate action concerning proposed changes that may trigger notice, consultation, and meeting and conferring obligations under the Higher Education Employer-Employee Relations Act, if any such action is required. The reinstatement of member contributions to UCRP for represented employees is subject to collective bargaining requirements.

Attachment 1 – Regents Policy 5601: UCRP Funding Policy

Attachment 2 – Segal Bulletin on GASB Preliminary Views on Proposed Changes to Pension Accounting Standards for Public Sector Employers