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HUMAN RESOURCES AND BENEFITS

300 LAKESIDE DRIVE, 5th FLOOR
OAKLAND, CALIFORNIA 94612-3557

August 12, 1998

MEMBERS OF UCRS ADVISORY BOARD
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM

Enclosed are the final minutes for the UCRS Board meeting of June 24, 1998. If you have any questions please call me at 1-800-239-4002 extension 70274.

Judy Ackerhalt
Director—Retirement Planning
& Analysis and Work/Life Initiatives

Enclosures

cc: (with enclosures)
Sr. Vice President & Provost King
Associate Vice President Boyette
Associate Vice President Hershman
Assistant Vice President Levin
Assistant Vice President Switkes
Managing University Counsel Odell
University Counsel Dana
Actuary Cole - Towers Perrin

FINAL MINUTES

UCRS BOARD MEETING

OFFICE OF THE PRESIDENT

OAKLAND, CALIFORNIA

WEDNESDAY, JUNE 24, 1998

10:00 AM

BOARD MEMBERS PRESENT: Chair Mellichamp, Vice Chancellor Barclay, Economist Drake (via teleconference), former Director Hagen, Professor Sugarman, Assistant Chancellor Armstrong and Senior Specialist Erickson

BOARD MEMBERS ABSENT: Vice Chair Small and Senior Vice President Kennedy

STAFF PRESENT: Associate Vice President Boyette, Director Ackerhalt, Controller Olson, Director Miller, Director Harrington, Manager Devincenzi, Coordinator Partovi, and Actuary Cole

OTHERS PRESENT: CUCEA Chair Professor Emeritus Turner, CUCRA Vice Chair Brugger, and Joseph Toby (representing the UCB Retirees Association)

The meeting was called to order at 10:12 a.m. by Chair Mellichamp.

APPROVAL OF THE MINUTES: The minutes of the meeting of April 28, 1998 were approved.

COMMENTS FROM THE CHAIR:

Chair Mellichamp introduced Director Kay Miller to the University of California Retirement System (UCRS) Board. Director Ackerhalt provided a summary of Director Miller's background and her new duties as the Director of Retirement Services. Director Miller was most recently the Executive Officer and Manager, Benefit and Personnel Services, in Human Resources at the Los Angeles Campus.

TREASURER'S REPORT:

Director Harrington discussed the experience of the University's retirement plans and noted that the assets in the retirement system were up 22.5% for the trailing twelve months. Details are provided in an attachment to the minutes.

NEW BUSINESS:

Associate Vice President Boyette briefed the UCRS Board regarding an informational presentation made at The Regents meeting in May. The presentation concerned Chancellors' pay and the limitations imposed on some University of California Retirement Plan (UCRP) Members retirement benefits due to Internal Revenue Service (IRS) regulations. She informed the UCRS Board that the IRS limitations had become a recruiting and retention issue and that the University is looking into ways of restoring these benefits. Approximately half the people limited are faculty and half are staff.

Director Ackerhalt informed the UCRS Board that there were two populations affected by two different limits in the Code, one limiting the amount that can be paid from UCRP and one limiting the amount of Covered Compensation that can be used in the defined benefit formula. She explained that the Small Business Job Protection Act of 1996 allowed governmental plans to establish an excess plan to restore benefits not able to be paid. She stated that private companies were already allowed to have similar plans. After a brief discussion Director Ackerhalt stated that various types of plans were being considered. Associate Vice President Boyette informed the UCRS Board that whatever plan is put forth, the University of California will ask the IRS for a determination letter or a private letter ruling for the plan to restore benefits lost due to the Covered Compensation limit.

Professor Sugarman asked if the options being considered were outside the current plans. Associate Vice President Boyette stated that not all of the options under consideration were outside the plans. She further explained that a discussion item was being prepared for the July Regents meeting. She advised the UCRS Board that they would be briefed before any action item is presented to The Regents.

Item A. University of California Retirement System Advisory Board—Election of Officers for Fiscal Year 1998-1999

Candidates for the UCRS Board Chair were Vice Chancellor Barclay and Economist Drake. Candidates for Vice Chair were Assistant Chancellor Armstrong and Professor Sugarman. After a brief statement by the candidates, the UCRS Board members cast their ballots. The UCRS Board members absent from the meeting had submitted their ballots prior to the meeting.

University of California

UCRS Board

Meeting of November 12, 1998

AGENDA ITEM C

Item for Discussion

Restoration of University of California Retirement Plan Members' Retirement Benefits

Staff is continuing to prepare a proposal, to be presented to The Regents at a future meeting, that would restore accrued University of California Retirement Plan (UCRP) Members' retirement benefits that would not otherwise be payable due to Internal Revenue Code (IRC) limits. This item is an update of the proposal that Associate Vice President Boyette and Director Ackerhalt gave a brief overview on at the June 24, 1998 University of California Retirement System (UCRS) Board meeting.

UCRP is a tax qualified retirement plan and is subject to Federal tax law in the administration of benefits accrued to its Members. These tax laws affect both the amount of the employee's annual compensation that can be taken into account for calculating the retirement benefits (IRC Section 401(a)(17)) and the maximum annual amount that can be paid out once the Member retires (IRC Section 415(b)). These tax laws have the effect of creating recruitment and retention issues at the locations and a lack of equity in UCRP retirement income. Recent changes in the tax laws for the public sector have allowed supplemental plans to be created that can provide solutions to these limitations.

Two solutions under consideration are an IRC Section 401(a)(17) restoration plan that can be paid out of UCRP assets and an IRC Section 415 (b) restoration plan that would be funded independently from UCRP. Costs, funding methods and legal requirements are continuing to be researched. A discussion item will be presented to The Regents at a future meeting so that staff has approval to do further research on the feasibility of implementation.

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HUMAN RESOURCES AND BENEFITS

300 LAKESIDE DRIVE, 5th FLOOR
OAKLAND, CALIFORNIA 94612-3557

January 11, 1999

MEMBERS OF UCRS ADVISORY BOARD
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM

Attached for your information are two items that are going to The Regents. The first is the Plan Administrator's review of investment options available for UC employees through external vendors and was mailed to The Regents on January 5, 1999 as an informational item between meetings. As this report is informational only, no action is necessary by either the UCRS Board or The Regents.

The second item is a discussion item for the January Regents meeting on the restoration plans. Associate Vice President Boyette and I briefed you on this item at our last two UCRS Board meetings. Similar to the first item, this is for discussion only and no action is necessary by either the UCRS Board or The Regents at this time.

Please call me if you have any questions at 1-800-239-4002, extension 7-0274.

Judy

Judy Ackerhalt
Director--Retirement Planning,
Services Center and Work/Life Initiatives

Attachments

cc: Associate Vice President Boyette (w/o attachments)

Office of the President
January 6, 1999

TO MEMBERS OF THE COMMITTEE ON FINANCE:

ITEM FOR DISCUSSION

For Meeting of January 14, 1999

RESTORATION OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN MEMBERS' RETIREMENT BENEFITS

This item will provide background for considering a proposal to restore to retiring and retired University of California faculty and staff the University of California Retirement Plan (UCRP) benefits denied due to Internal Revenue Code (IRC) limitations. These limitations were directed primarily at the private sector, particularly corporations, to limit pre-tax contributions to pension plans and increase tax revenues. When extended to the public sector, they limited pension benefits of Members of the UCRP. Recent changes to the IRC allow the University to mitigate these limitations.

It is important for the University to address these IRC limitations because they are becoming a significant deterrent to recruitment and retention of both faculty and staff, a problem that will worsen as the number of affected employees grows in the years ahead. As noted below, a number of the University of California's comparison institutions have already made changes to mitigate the IRC limits.

Most career employees of UC participate in UCRP, a defined benefit plan. Their benefits at retirement are calculated using (1) their age at retirement, (2) their years of UCRP membership, and (3) their Highest Average Plan Compensation (HAPC).

Federal Tax Law Limitations Applying to UCRP Benefits

UCRP is a tax-qualified retirement plan subject to the federal tax law in the administration of benefits accruing to its Members. Two federal tax limits can reduce the amount of UCRP benefits that can be paid to Members:

A) IRC Section 401(a)(17) - This rule sets the maximum compensation that can be used for retirement calculations at $160,000 per year for UC employees who first became active UCRP Members after June 30, 1994. Therefore, certain faculty and staff cannot receive benefits on the full compensation that UCRP would otherwise use for benefit calculations.

B) IRC Section 415(b) - This section limits the amount of benefit paid by UCRP to a maximum per year based on age at retirement. Therefore, certain faculty and staff cannot receive the full benefit resulting from their UCRP benefit calculations. This limit is set at a maximum of $130,000 per year at age 65 for UC employees who

became active UCRP Members after December 31, 1989, and is reduced for those faculty and staff retiring at an earlier age.

Both IRC Section 401(a)(17) and Section 415(b) employ grandfathering rules that may apply to certain faculty and staff who became Members before implementation of these rules.

Consequences of Tax Laws

As a result of federal tax law limits applying to UCRP, employees with different UC hire dates that are brought into similar jobs, at the same time, and at the same salary may be treated differently for their retirement income from UCRP. This lack of equity applies to faculty and staff across the UC system, including the Department of Energy (DOE) Laboratories.

It is estimated that over the next five years, about 20 UC faculty and staff retirees each year will be adversely affected by the Section 401(a)(17) limit on compensation covered for UCRP purposes. Ten years from now approximately 50 faculty and 75 staff retirees, including DOE Laboratory scientists and engineers, will be affected. It is estimated that over the next five years, about 65 faculty and staff retirees each year will be adversely affected by the IRC Section 415(b) limits. Initially, twice as many faculty retirees as staff will be affected by the Section 415(b) limits each year; by the tenth year approximately 50 faculty and 35 staff retirees will be affected.

The tax laws as they apply to UCRP will make recruitment more difficult as market salaries rise. Every new faculty and staff Member hired from outside the UC system will be subject to the most stringent limits under both IRC Sections 401(a)(17) and 415(b). Prospective new hires who are grandfathered in their current institutions will lose this status if they move to UC, and therefore will forfeit the ability to earn full retirement benefits.

Another consequence is that retention, already an issue, will become more difficult. Several institutions have taken steps to solve the problems presented by IRC Sections 401(a)(17) and 415(b). UC employees who are recruited by these institutions can be promised benefits that UC cannot currently match. In particular, long-term faculty and staff who cannot receive the full benefit earned and accrued under UCRP will have an incentive to go to institutions where they can accrue additional benefits.

A number of UC's comparison institutions have taken steps to address this problem. While many universities will not publicly disclose their benefits packages, our consultant William M. Mercer, Inc. has determined that at least 8 of our 26 comparison institutions have acted to restore retirement benefits. Since more favorable tax laws have been established, we can expect that additional universities will follow this trend.

Recent Tax Law Changes

Before the recent changes in the tax law, non-tax qualified restoration plans in the public sector were available only if participating employees were willing to be "at risk" for vesting. When vesting did occur, employees were taxed on the full present value of the benefit even if no assets had actually been paid to them.

Recent changes in the tax law have provided public institutions with more attractive solutions for resolving both IRC Sections 401(a)(17) and 415(b) limits.

Proposed UCRP Benefit Restoration Plan

The proposed UCRP Benefit Restoration Plan consists of two parts, each designed to replace UCRP benefits lost due to the IRC limits. It is expected that the majority of UCRP Members will be affected only by one of the limits, not both.

Outside counsel has completed a favorable review of the concepts underlying the proposed UCRP Benefit Restoration Plan. Actuarial and legal considerations are being refined in coordination with the UCRP actuary, consultants, and counsel.

Part A: Restoring benefits subject to the compensation limits of IRC Section 401(a)(17)
It is proposed that benefits be restored for all faculty and staff who are limited in the amount of compensation that can be taken into account in calculating UCRP retirement income because of IRC Section 401(a)(17). These Members would receive a separate benefit to restore the loss to UCRP retirement income caused by the IRC compensation limit. This benefit would apply to both retiring and retired UC faculty and staff.

Technically, this could be done by amending the UCRP to add a "pension equity" restoration benefit. Through this method, tax-qualified plan advantages would be given to the affected Member using existing UCRP assets to provide these benefits. This is the most cost-efficient way to provide these restoration benefits.

The estimated annual benefit disbursements of projected IRC Section 401(a)(17) restoration benefits would start at about $20,157 for the 1999-2000 fiscal year. They are projected to increase to $1.5 million in the tenth year of benefit disbursements. Additionally, the cost to UCRP to make whole Members who were affected by the IRC Section 401(a)(17) limit before implementation is estimated at $100,000. This cost to the UCRP would not have a material effect on the Plan assets or liabilities, which as of July 1, 1998 were $27.1 billion and $20.6 billion, respectively.

Part B: Restoring benefits subject to the annual payment limits of IRC Section 415(b)
It is also proposed that benefits be restored for all faculty and staff who are unable to receive their full UCRP benefit due to the annual payment limits of IRC Section 415(b). The Small Business Job Protection Act of 1996 (SBJPA) allowed sponsors of governmental retirement plans such as UCRP to establish a non-qualified retirement plan to provide for the payment of accrued retirement benefits that would not otherwise be payable due to the limitations of IRC Section 415(b). Private sector plans have had this flexibility for years; the passage of SBJPA extends this ability to governmental employers.

These benefits would be restored for all affected faculty and staff, retiring and retired, through a "non-qualified" restoration plan that was specifically provided for in the federal tax law. Under the law, this part of the restoration plan must be "non-qualified," so UCRP assets cannot be used to provide the benefits. This non-qualified restoration plan can be designed to provide the best available tax advantages to the Members limited by IRC Section 415(b).

Because of the potential adverse financial effects of large lump-sum payments, in most cases the restoration plan for IRC Section 415(b) benefits would not pay lump sums and would be limited to annuity benefits (subject to a de minimus threshold).

The estimated annual benefit disbursements of projected IRC Section 415(b) restoration benefits would start at about $671,389 for the 1999-2000 fiscal year and increase to approximately $1.6 million in the tenth year of benefit disbursements. Additionally, the cost to restore UCRP benefits for the approximately 240 Members affected by the IRC Section 415(b) limit before implementation is estimated at $3.8 million. The Voluntary Early Retirement Incentive Programs' (VERIP's) Transition Assistance payments would not be restored since these were one-time payments to assist participating Members into an unplanned retirement.

Method of Funding for IRC Section 415(b) Restoration Plan

A hybrid approach is recommended for funding non-qualified restoration benefits that would involve annual assessments equivalent to the estimated cash payout for the year, plus an additional amount to fund the initial liability over a period of years. The amortization period could be 30 years, based upon typical retirement planning and financial reporting practices. However, the portion relating to benefits for employees at the DOE National Laboratories could be amortized over four years, which coincides with the expiration date of the current contract with the DOE.

The following indicates the required level of funding on a prospective basis only ($ in thousands).

Fiscal Year	Campuses	Labs	Total
1999/2000 - 2002/2003 (cost per year)	$1,138	$795	$1,933
2003/2004	1,138	60	1,198

This chart does not include the cost of retroactive restoration benefits for UCRP Members who were limited by IRC Section 415(b) before implementation. As the legislation allows for retroactivity, it is recommended that this be done for UCRP Members who have already retired. The cost of providing retroactive restoration

benefits is estimated to be $3.8 million: $2.9 million associated with campuses/UCOP and $843,630 associated with the Laboratories.

Source of Funds

Campuses/UCOP - Funding for the campuses' and Office of the President's costs will come from a variety of sources. For example, to the extent that the IRC Section 415(b) costs can be attributed to salaries paid from special compensation plans in the health sciences, it would be appropriate to charge these costs to those plans. A detailed review of the potential fund sources is underway and will be available soon. The General Fund would not be used for these payments.

DOE Laboratories - In 1993, the University established the Short Term Contingency Fund (STC). This pool has been used to provide funding for a variety of purposes including annual and one-time costs related to the University's management and oversight of the Laboratories as an alternative to charging these costs to the management fee or reducing discretionary research spending. The STC fund is composed of one-time allocations from the 1993 and 1994 indirect cost payments made to UC as well as Short-Term Investment Pool (STIP) interest on the reserve liability funds associated with contract operations. The present STC fund balance is approximately $2.8 million and is deemed sufficient to cover the projected retirement restoration costs through the end of the current contract.

University of California

UCRS Board

Meeting of January 27, 1999

AGENDA ITEM A

Item for Action

Restoration of University of California Retirement Plan Members' Retirement Benefits

The Regents were presented a discussion item at their January 14, 1999 meeting on the restoration of University of California Retirement Plan (UCRP) Members' retirement benefits. University of California Retirement System (UCRS) Board members were provided notification and a copy of The Regents discussion item in a memo dated January 11, 1999.

At the January 14, 1999 Regents meeting, The Regents approved further research on behalf of staff on the Restoration Plans. Further, President Atkinson advised The Regents that staff would provide an action item to The Regents at their February 18, 1999 meeting. At this meeting, UC Human Resources and Benefits will ask The Regents to approve the concepts and philosophy of the Restoration Plans and to delegate the establishment of the Plans to the President of the University with the concurrence of the Chairperson of the Board of Regents and the Chairperson of the Committee on Finance. In this manner, staff can continue to develop and refine the Restoration Plans and seek Internal Revenue Service (IRS) approval where appropriate. It is expected that the implementation date of the Restoration Plans will be January 1, 2000.

The portion of the proposed Restoration Plans that will affect UCRP is the restoration of benefits related to the limit on compensation that can be considered for the accrual of UCRP benefits under Internal Revenue Code Section 401(a)(17). The UCRS Board is being asked to approve the concept and philosophy of this portion of the Restoration Plan, and changes to UCRP, subject to IRS approval.

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OAKLAND, CALIFORNIA 94612-3557

March 30, 1999

MEMBERS OF UCRS ADVISORY BOARD
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM

Enclosed are the final minutes for the UCRS Board meeting of January 27, 1999. If you have any questions please call me at 1-800-239-4002 extension 70274.

Judy Ackerhalt
Director—Retirement Planning,
Services Center and Work/Life Initiatives

Enclosures

cc: (with enclosures)
Sr. Vice President & Provost King
Associate Vice President Boyette
Associate Vice President Hershman
Assistant Vice President Levin
Interim Assistant Vice President O'Rourke
Managing University Counsel Odell
University Counsel Dana
Actuary Cole - Towers Perrin
Actuary Finertie – Towers Perrin

FINAL MINUTES

UCRS BOARD MEETING

OFFICE OF THE PRESIDENT

OAKLAND, CALIFORNIA

WEDNESDAY, JANUARY 27, 1999

10:00 AM

BOARD MEMBERS PRESENT: Chair Drake, Professor Mellichamp, Senior Specialist Erickson, Benefits Manager Edwards, Professor Sugarman, and Vice-Chair Armstrong (via teleconference)

BOARD MEMBERS ABSENT: Senior Vice President Kennedy, Treasurer Small, and Vice Chancellor Barclay

STAFF PRESENT: Associate Vice President Boyette, Director Ackerhalt, University Counsel Dana, Director Olson, Director Miller, Director Harrington, Manager Devincenzi, Actuary Cole and Actuary Finertie

OTHER PRESENT: CUCEA Chair Professor Emeritus Gable

Chair Drake called the meeting to order at 10:25 a.m.

APPROVAL OF THE MINUTES: The minutes of the meeting of November 12, 1998 were approved.

worked with the Treasurer's Office to produce a brochure describing the investment objectives and philosophies of the UC funds so that Participants can make educated choices about fund selection.

Item A. Restoration of University of California Retirement Plan Members' Retirement Benefits

Chair Drake stated that this item is an action item that requires the UCRS Board's vote; Director Ackerhalt presented the item. She stated that in January the UCRS Board members were mailed a copy of The Regents discussion item that Associate Vice President Boyette presented to The Regents at their January meeting. Director Ackerhalt summarized the four main points of the restoration plans:

- some UC employees cannot receive the full amount of retirement benefits because of certain IRS limits;
- recent tax law changes make it possible to restore these benefits;
- the essence of the proposal is to make people whole in University of California Retirement Plan (UCRP) Retirement Income so every UC employee is treated the same; and
- the proposal would ease problems with recruitment and retention that currently exist because of these limits on UCRP benefits.

Director Ackerhalt explained that, as a tax qualified plan, UCRP must adhere to Internal Revenue Code (IRC or Code) Section 401(a)(17) which limits the amount of compensation that can be considered in the calculation of retirement income and IRC Section 415(b) which limits the total amount that can be paid in retirement income. Under IRC Section 401(a)(17) the limit is $160,000 for those employees who became UCRP Members July 1, 1994 or later. Under IRC Section 415(b) the limit is $130,000 a year at age 65 for UC employees who became Members January 1, 1990 or

later and the limits are reduced for retirements at earlier ages. She further explained that both limits have grandfathering rules for those hired before these dates which leads to varying treatment for UCRP Members across the system including faculty, staff, scientist and engineers at the laboratories, and management. She continued by indicating that the problem is that every new faculty and staff member hired from outside UC will be subject to the most stringent limits under both sections of the Code and that prospective new hires may be grandfathered at their current institution.

Director Ackerhalt explained that UC Human Resources and Benefits has been working with external consultants, William M. Mercer Incorporated, who studied 26 comparison institutions and found that 8 have acted to restore these benefits. Recent tax law changes now provide the public sector with solutions for resolving these problems. She reported that President Atkinson informed The Regents at their January meeting that an action item would be brought to them in February. The Regents will be asked to approve the concept and philosophy of the restoration plans to be effective January 1, 2000, subject to Internal Revenue Service (IRS) approval where appropriate. She further explained that outside counsel has completed a favorable review of these plans and that UC Human Resources and Benefits will continue to work on actuarial and legal considerations and will bring this information back to the UCRS Board at a future meeting. She stated that The Regents would be asked to delegate the establishment of the plans to the President, with the concurrence of the Chair of The Board of Regents and the Chair of the Committee on Finance.

Director Ackerhalt stated that the IRC Section 401(a) (17) restoration plan is a pension equity provision that will be part of UCRP and will restore lost UCRP Retirement Income caused by the IRC compensation limit. The benefit disbursements are projected to start at approximately $8,500

in the first year and increase to $580,000 in the tenth year. Associate Vice President Boyette stated that the cost assumptions are based on the same assumptions that are currently used for UCRP. Director Ackerhalt summarized the UCRP actuarial assumptions and reported that if this provision were applied retroactively the cost would be approximately $100,000. Implementation of this provision is subject to IRS approval. She stated that the cost would not have a material effect on UCRP and the population that is expected to be affected over the next ten years is 144 Members, including 33 faculty, 4 staff, and 107 management and executive employees which includes scientist and engineers at the laboratories.

Director Ackerhalt then summarized the details of the IRC Section 415(b) restoration plan that would be designed as a stand-alone plan under IRC Section 415(m). Benefits would be calculated to restore the loss to UCRP Retirement Income caused by the IRC Section 415(b) annual payment limits. She stated that private sector plans have had this flexibility for years. Benefit disbursements are projected to start at approximately $670,000 in the first year and increase to $1.7 million in the tenth year; if applied retroactively the cost would be approximately $3.8 million. Benefit disbursements cannot be paid out of UCRP assets but can be paid out of the University's general assets. She reported that the population that is expected to be affected over the next ten years is 405 Members, including 188 faculty, 10 staff, and 207 management and executives (note that the report of the affected population has been refined and is now 367). The management and executive group also includes scientists and engineers at the laboratories.

Professor Sugarman asked if these limits could prevent a member from getting the full Capital Accumulation Provision (CAP) payment. Director Ackerhalt responded that the CAP payment would

be paid under the IRC Section 415(b) restoration plan. A lengthy discussion ensued regarding the appropriateness of restoring benefits to UCRP Retired Members retroactively.

The UCRS Board decided to break out the populations and then vote on the endorsement of three variations of the populations that would benefit from the plans:

- the concept and philosophy of the restoration plans for current and future employees
- the concept and philosophy of the restoration plans for current and future employees and prospectively for currently limited retirees
- the concept and philosophy of the restoration plans for current and future employees, prospectively for currently limited retirees and retroactively for retirees that were impacted by the IRC limits.

The UCRS Board voted to endorse the first two populations and voted to not approve the third.

Item B. University of California Retirement System Board Chair—Communication with University President

Chair Drake presented this item, explaining that one of the principal duties of the UCRS Board Chair is to communicate to the President the activities of the UCRS Board. He further stated that he has had conversations with Professor Mellichamp, Treasurer Small, Vice Chair Armstrong and Director Ackerhalt about establishing a new and regular communication mechanism. Chair Drake stated that in the recent past the UCRS Board Chair has lacked a regular channel of communication and that he, in his present role, does not have a direct channel of communication due to his employment location at the Los Alamos National Laboratory.

The Regents of the University of California

COMMITTEE ON FINANCE
February 18, 1999

A Special Meeting of the Committee on Finance was held on the above date at UCSF-Laurel Heights, San Francisco.

Members present: Regents Atkinson, Bagley, Davies, Johnson, Khachigian, Miura, and Parsky; Advisory member Taylor

In attendance: Regents Eastin and Nakashima, Regent-designate Vining, Faculty Representatives Coleman and Dorr, Secretary Trivette, General Counsel Holst, Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Gomes, and Gurtner, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Dynes, Orbach, and Vanderhoef, Executive Vice Chancellor Simpson representing Chancellor Greenwood, Laboratory Director Shank, and Recording Secretary Nietfeld

The meeting convened at 2:27 p.m. with Chairman Davies presiding.

RESTORATION OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN MEMBERS' RETIREMENT BENEFITS

The President recommended that:

A. Approval be granted to establish plans, effective January 1, 2000, to restore to University of California faculty and staff, including Department of Energy Laboratories scientists and engineers, the University of California Retirement Plan (UCRP or Plan) benefits earned but denied due to Internal Revenue Code (IRC) limitations.

B. These UCRP benefits also be provided to affected UCRP members who retired before the effective date of the restoration plans.

C. Implementation of the restoration plans be delegated to the President, with the concurrence of the Chairman of the Board and the Chairman of the Committee on Finance.

The Committee was informed that the University of California Retirement System Advisory Board endorsed these restoration plans at its January 27, 1999 meeting. The plans, which are subject to Internal Revenue Service (IRS) approval, would apply to faculty, staff, and retirees from the date of implementation. The item submitted to The Regents in January 1999 included the cost of restoring these benefits retroactively for current retirees; upon further examination, retroactivity was judged to be inappropriate.

It was recalled that several years ago Congress modified the IRC to limit pre-tax contributions to pension plans. These limitations, directed primarily at the private sector, resulted in the imposition

of certain limits on pension benefits in public institutions as well. Recognizing the negative impact of these limitations in the public sector, Congress recently enacted revisions to the IRC that make it possible for public institutions, including the University of California, to mitigate them. At the January 1999 meeting, the Regents were presented with information on the problems created by the IRC limitations and on plans to address them.

IRC §415(b) limits the amount of benefits that can be paid by UCRP to a maximum per year; IRC §401(a)(17) sets the maximum compensation amount that can be used for retirement calculations. These IRC limitations are a significant deterrent to recruitment and retention of faculty, staff, administrators, scientists, and engineers. This problem will worsen as the number of affected employees grows in the years ahead. Various UC sites have reported an increasing employee awareness of both the personal impact of the IRC limitations and the actions other institutions have taken to mitigate the impact. To remain competitive in the recruitment and retention of employees, many of whom are highly specialized, it is imperative that UC offer similar solutions.

Due to the IRC limits and special grandfathering rules, faculty and staff employees with different UC hire dates who are later brought into comparable jobs at the same time and at the same salary may be treated differently for their retirement income. Regardless of salary level, an employee affected by either or both of the IRC limits will have a lower percentage of retirement income provided by UCRP than an employee retiring at the same age with the same service who is not affected by the limits. Restoring lost benefits due to these limits will result in fair and equitable treatment of all employees. Further, employees who have entered University service based upon representations of UCRP retirement income may have a basis to claim that they are not being treated fairly if they are unable to receive their earned benefits due to the IRC limitations. The restoration plans would eliminate this problem by restoring their UCRP benefits.

Most career employees participate in UCRP, a defined benefit plan. UCRP is based on the principle that all career employees will be treated equitably and receive benefits based on (1) their age at retirement, (2) their years of UCRP service credit, and (3) their Highest Average Plan Compensation. UCRP is a tax-qualified retirement plan subject to federal tax laws in the administration of benefits accruing to its members. As noted above, two federal tax limits can reduce the amount of UCRP benefits paid to members upon retirement. Because IRC §415(b) limits the amount of benefits that can be paid by UCRP to a maximum per year, based on age at retirement, certain faculty, staff, scientists, and engineers cannot receive the full benefits resulting from their UCRP benefit calculations. For UC employees who became active UCRP members after December 31, 1989, this limit is set at a maximum of $130,000 per year at age 65 and is reduced for those retiring at an earlier age. For example, the maximum benefit these members can receive from UCRP is $57,783 per year at age 55 and $41,295 per year at age 50.

IRC §401(a)(17) sets the maximum compensation amount that can be used for retirement calculations at $160,000 per year for UC employees who first became active UCRP members after June 30, 1994. As a result, certain faculty, staff, scientists, and engineers cannot receive benefits based on the full compensation that UCRP would otherwise use for benefit calculations. It is estimated that 367 members will be affected by the IRC §415(b) limit over the next ten years. This group consists of 178 faculty and 189 staff employees, including management, and scientists and

engineers at the Department of Energy laboratories. The average age of the affected faculty member is 60.9 years, and the average income is $177,044 annually. Ninety-seven percent of the members have twenty or more years of service credit. This group includes 108 medical school professors.

The average age of the affected staff group is 55.6 years, and 94 percent have more than twenty years of service credit. The average salary is $167,578. More than half of this group are employed at the Department of Energy laboratories.

IRC §415(b) employs grandfathering rules that can make a significant difference in the benefits that can be paid to UCRP members, depending upon their UCRP membership date.

It is estimated that 144 members will be affected by the IRC §401(a)(17) limit over the next ten years. This group consists of 33 faculty and 111 staff, including management, and scientists and engineers at the laboratories. In the affected faculty group, the average age is 54.2 years and the average income is $186,202 annually. Eighty-eight percent of the faculty have less than five years of service credit. The average age of the affected staff group is 51.4 years, and 89 percent have less than five years of service credit. This group, which has an average salary of $192,286, includes scientists, engineers, and staff physicians. IRC §401(a)(17) employs grandfathering rules that can make a significant difference in the benefits that can be paid to UCRP members depending upon their hire date.

Benefit restoration plans will replace UCRP benefits that are not currently paid because of the IRC limits. It is expected that most of the UCRP members involved will be affected by only one of the limits. Outside counsel has completed a review of the proposed benefit restoration plans. Actuarial and legal considerations have been refined in coordination with the Plan's actuary, consultants, and counsel. For employees covered by the Higher Education Employer Employee Relations Act, these changes may be subject to labor relations requirements such as notice, meeting and discussing, consulting, or conferring.

All affected faculty, staff, and retirees will receive a separate benefit to restore the amount that the IRC annual limit now prevents them from receiving. This will be done through a "non-qualified" plan that is specifically provided for in federal tax law. The annual disbursements of projected IRC §415(b) restoration benefits are estimated to be $670,000 in the year 2000 and will increase to approximately $1.7 million in the tenth year.

Benefits will be restored for all affected faculty, staff, and retirees. This will be done by amending UCRP to add a provision to restore benefits that may be lost due to IRC §401(a)(17), using existing UCRP assets. Providing restoration of benefits through UCRP is contingent upon IRS approval. The annual disbursements of projected IRC §401(a)(17) restoration benefits are estimated to be $8,500 in the year 2000 and will increase to approximately $580,000 in the tenth year. This cost to UCRP will not have a material effect on the Plan assets or liabilities, which as of July 1, 1998 were $27.1 billion and $20.6 billion respectively. Due to a recent IRS notice that an annual cost-of- living adjustment can be applied to the grandfathered IRC §401(a)(17) limit that applied prior to July 1, 1994, the cost of this provision is lower than was indicated in the January Regents item.

Under the law, UCRP assets cannot be used to provide the benefits provided in a "non-qualified" plan. The method for funding the non-qualified IRC §415(b) restoration plan benefits will involve assessments on a quarterly basis equivalent to the estimated cash payout for the year, plus an additional amount to fund the initial liability over a period of years. The amortization will be thirty years, based upon generally accepted retirement planning and financial reporting practices. However, the portion relating to benefits for employees at the DOE laboratories will be amortized over 11 quarters, which coincides with the expiration date of the current contract with the DOE. The following indicates the estimated level of funding ($ in thousands).

Fiscal Year	Campuses	Laboratories	Total
1999-2000	$ 569	$ 578	$1,147
2000-2001	1,138	1,156	2,294
2001-2002	1,138	1,156	2,294
2002-2003	1,138	334	1,472
2003-2004	1,138	60	1,198

Funding for the campuses' and Office of the President's costs will come from several sources. For example, to the extent that the IRC §415(b) restoration plan costs can be attributed to salaries paid from special compensation plans in the health sciences, it would be appropriate to charge these costs to those plans. To fund the ongoing cost of the restoration plan, an assessment of campuses and UCOP will occur on a quarterly basis for the amounts shown above, plus a small amount to cover the administrative cost of the plan. State funds would not be used for these payments.

In 1993, the University established the Short Term Contingency Fund (STC). This pool has been used to provide funding for a variety of purposes, including annual and one-time costs related to the University's management and oversight of the DOE laboratories as an alternative to charging these costs to the management fee or reducing discretionary research spending. The STC fund is comprised of one-time allocations from the 1993 and 1994 indirect cost payments made to UC, as well as Short-Term Investment Pool interest on the reserve liability funds associated with contract operations. The present STC fund balance is approximately $2.8 million and is deemed sufficient to cover the projected retirement restoration costs through the end of the current contract.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

The meeting adjourned at 2:28 p.m.

Attest:

Patricia L. Ornelas

Secretary

UNIVERSITY OF CALIFORNIA

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HUMAN RESOURCES AND BENEFITS

300 LAKESIDE DRIVE, 5th FLOOR
OAKLAND, CALIFORNIA 94612-3557

February 26, 1999

MEMBERS OF THE UCRS ADVISORY BOARD
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM

At their February 18, 1999 meeting, The Regents approved the concept and philosophy of restoring to University of California faculty and staff the University of California Retirement Plan benefits earned, but denied due to Internal Revenue Code limitations.

The Regents delegated the establishment of the Restoration Plans to the President of the University with the concurrence of the Chair of the Board of Regents and the Chair of the Committee on Finance. With The Regents' approval of this action item, staff can continue to develop and refine the Restoration Plans and seek Internal Revenue Service approval where appropriate. As soon as the Restoration Plans are developed they will be presented to the University of California Retirement System Board. It is expected that the implementation date of the Restoration Plans will be January 1, 2000.

Attached for your reference is a copy of The Regents item. Note that the Restoration Plans will not provide benefits retroactively for current retirees.

Sincerely,

Judy

Judy Ackerhalt
Director—Retirement Planning,
Services Center and Work/Life Initiatives

Attachment

cc: Associate Vice President Boyette

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Office of the President
February 17, 1999

TO MEMBERS OF THE COMMITTEE ON FINANCE:

ITEM FOR ACTION

For Meeting of February 18, 1999

RESTORATION OF UNIVERSITY OF CALIFORNIA RETIREMENT PLAN MEMBERS' RETIREMENT BENEFITS

The President recommends that the Committee on Finance recommend to The Regents that:

(1) Approval be granted to establish plans, effective January 1, 2000, to restore to University of California faculty and staff, including Department of Energy Laboratories scientists and engineers, the University of California Retirement Plan (UCRP or Plan) benefits earned, but denied due to Internal Revenue Code (IRC) limitations.

(2) These UCRP benefits also be provided to affected UCRP members who retired before the effective date of the restoration plans.

(3) Implementation of the restoration plans be delegated to the President, with the concurrence of the Chairman of the Board and the Chairman of the Committee on Finance.

The University of California Retirement System Advisory Board endorsed these restoration plans at its January 27, 1999 meeting. They are subject to Internal Revenue Service (IRS) approval, and would apply to UC faculty, staff, and retirees from the date of implementation. The item submitted to The Regents in January 1999 included the cost of restoring these benefits retroactively for current retirees; upon further examination, retroactivity was judged to be inappropriate.

BACKGROUND

Several years ago, Congress modified the IRC to limit pre-tax contributions to pension plans. These limitations, directed primarily at the private sector, resulted in the imposition of certain limits on pension benefits in public institutions as well. Recognizing the negative impact of these limitations in the public sector, Congress recently enacted revisions to the IRC that make it possible for public institutions, including the University of California, to mitigate them. At their January 1999 meeting, The Regents were presented with information on the problems created by the IRC limitations and on plans to address them.

IRC Section 415(b) limits the amount of benefits that can be paid by UCRP to a maximum per year; IRC Section 401(a)(17) sets the maximum compensation amount that can be used for retirement calculations. These IRC limitations are a significant deterrent to recruitment and

retention of faculty, staff, administrators, scientists, and engineers; this problem will worsen as the number of affected employees grows in the years ahead. Various UC sites have reported an increasing employee awareness of both the personal impact of the IRC limitations and the actions other institutions have taken to mitigate the impact. To remain competitive in recruitment and retention of employees, many of whom are highly specialized, it is imperative that UC offer similar solutions.

Due to the IRC limits and special grandfathering rules, faculty and staff employees with different UC hire dates who are later brought into comparable jobs - at the same time and at the same salary - may be treated differently for their retirement income. Regardless of salary level, an employee affected by either or both of the IRC limits will have a lower percentage of retirement income provided by UCRP than an employee retiring at the same age with the same service who is not affected by the limits. Restoring lost benefits due to these limits results in fair and equitable treatment of all employees.

Further, employees who have entered University service based upon representations of UCRP retirement income may have a basis to claim that they are not being treated fairly if they are unable to receive their earned benefits due to the IRC limitations. The restoration plans would eliminate this problem by restoring their UCRP benefits.

Federal Tax Law Limitations Applying to UCRP Benefits

Most career employees participate in UCRP, a defined benefit plan. UCRP is based on the principle that all career employees will be treated equitably and receive benefits based on (1) their age at retirement, (2) their years of UCRP service credit, and (3) their Highest Average Plan Compensation (HAPC). UCRP is a tax-qualified retirement plan subject to federal tax laws in the administration of benefits accruing to its members. Two federal tax limits can reduce the amount of UCRP benefits paid to members upon retirement:

(A) IRC Section 415(b) - This section limits the amount of benefits that can be paid by UCRP to a maximum per year, based on age at retirement. Thus, certain faculty, staff, scientists, and engineers cannot receive the full benefits resulting from their UCRP benefit calculations. For UC employees who became active UCRP members after December 31, 1989, this limit is set currently at a maximum of $130,000 per year at age 65, and is reduced for those retiring at an earlier age; for example, the maximum benefit these members can receive from UCRP is $57,783 per year at age 55 and $41,295 per year at age 50.

(B) IRC Section 401(a)(17) - This section sets the maximum compensation amount that can be used for retirement calculations at $160,000 per year for UC employees who first became active UCRP members after June 30, 1994. Therefore, certain faculty, staff, scientists, and engineers cannot receive benefits based on the full

compensation that UCRP would otherwise use for benefit calculations.

IRC Section 415(b) Profiles

It is estimated that 367 members will be affected by the IRC Section 415(b) limit over the next 10 years. This includes 178 faculty and 189 staff employees, including management, and scientists and engineers at the Laboratories.

- The average age of the affected faculty is 60.9 years; average income is $177,044 annually. Ninety-seven percent of the members have 20 or more years of service credit. This group includes 108 medical school professors.

- The average age of the affected staff group is 55.6 years, and 94% have more than 20 years of service credit. The average salary is $167,578. More than half of this group are employed at the Laboratories.

IRC Section 415(b) employs grandfathering rules that can make a significant difference in the benefits that can be paid to UCRP members, depending upon their UCRP membership date. Two examples of the potential effects of IRC Section 415(b) on UCRP retirement income are given in Appendix A.

IRC Section 401(a)(17) Profiles

It is estimated that 144 members will be affected by the IRC Section 401(a)(17) limit over the next 10 years. This includes 33 faculty and 111 staff, including management, and scientists and engineers at the Laboratories.

- In the affected faculty group the average age is 54.2 years; average income is $186,202 annually. Eighty-eight percent have less than 5 years of service credit.

- The average age of the affected staff group is 51.4 years, and 89% have less than 5 years of service credit. This group, which has an average salary of $192,286, includes scientists, engineers, and staff physicians.

IRC Section 401(a)(17) employs grandfathering rules that can make a significant difference in the benefits that can be paid to UCRP members depending upon their hire date. Appendix B gives an example of two UCRP members with only slightly different hire dates that illustrates this inequity.

Benefit Restoration Plans

Benefit restoration plans will replace UCRP benefits that are not currently paid because of the IRC limits. It is expected that most of the UCRP members involved will be affected only by one of the limits, not both. Outside counsel has completed a review of the proposed benefit restoration plans. Actuarial and legal considerations have been refined in coordination with the Plan's actuary, consultants, and counsel. For employees covered by the Higher Education Employer Employee Relations Act (HEERA), these changes may be subject to labor relations requirements (such as notice and meeting and discussing, consulting, or conferring).

Plan for restoring benefits subject to the annual payment limits of IRC Section 415(b)

All affected faculty, staff, and retirees would receive a separate benefit to restore the amount that the IRC annual limit now prevents them from receiving. This will be done through a "non-qualified" plan that is specifically provided for in federal tax law. The annual disbursements of projected IRC Section 415(b) restoration benefits are estimated to be $670,000 in the year 2000 and would increase to approximately $1.7 million in the tenth year. Appendix C gives an example of how a retired UCRP member currently subject to the limitations of IRC Section 415(b) would have benefits restored from the date of implementation.

Plan for restoring benefits subject to the compensation limits of IRC Section 401(a)(17)

Benefits will be restored for all affected faculty, staff, and retirees. This will be done by amending UCRP to add a provision to restore benefits that may be lost due to IRC Section 401(a)(17), using existing UCRP assets. Providing restoration of benefits through UCRP is contingent upon IRS approval.

The annual disbursements of projected IRC Section 401(a)(17) restoration benefits are estimated to be $8,500 in the year 2000 and would increase to approximately $580,000 in the tenth year. This cost to UCRP would not have a material effect on the Plan assets or liabilities, which as of July 1, 1998 were $27.1 billion and $20.6 billion, respectively. Due to a recent IRS notice that an annual cost of living adjustment can be applied to the grandfathered IRC Section 401(a)(17) limit (the limit that applied prior to July 1, 1994), the cost of this provision is lower than indicated in the January Regents' item.

Method of Funding for IRC Section 415(b) Restoration Plan

Under the law, UCRP assets cannot be used to provide the benefits provided in a "non-qualified" plan. The method for funding the non-qualified IRC Section 415(b) restoration plan benefits will involve assessments on a quarterly basis equivalent to the estimated cash payout for the year, plus an additional amount to fund the initial liability over a period of years. The

amortization will be 30 years, based upon generally accepted retirement planning and financial reporting practices. However, the portion relating to benefits for employees at the DOE National Laboratories will be amortized over 11 quarters, which coincides with the expiration date of the current contract with the DOE. The following indicates the estimated level of funding ($ in thousands).

Fiscal Year	Campuses	Labs	Total
1999-2000	$ 569	$ 578	$1,147
2000-2001	$1,138	$1,156	$2,294
2001-2002	$1,138	$1,156	$2,294
2002-2003	$1,138	$ 334	$1,472
2003-2004	$1,138	$ 60	$1,198

Source of Funds

Campuses/UCOP: Funding for the campuses' and Office of the President's costs will come from several sources. For example, to the extent that the IRC Section 415(b) restoration plan costs can be attributed to salaries paid from special compensation plans in the health sciences, it would be appropriate to charge these costs to those plans. To fund the ongoing cost of the restoration plan, an assessment of campuses/UCOP will occur on a quarterly basis for the amounts shown above, plus a small amount to cover the administrative cost of the plan. State General Funds and Restricted Funds would not be used for these payments.

DOE Laboratories: In 1993, the University established the Short Term Contingency Fund (STC). This pool has been used to provide funding for a variety of purposes, including annual and one-time costs related to the University's management and oversight of the Laboratories as an alternative to charging these costs to the management fee or reducing discretionary research spending. The STC fund is comprised of one-time allocations from the 1993 and 1994 indirect cost payments made to UC, as well as Short-Term Investment Pool (STIP) interest on the reserve liability funds associated with contract operations. The present STC fund balance is approximately $2.8 million and is deemed sufficient to cover the projected retirement restoration costs through the end of the current contract.

Appendix A – Examples of limits on amount of benefits that can be paid from UCRP due to IRC Section 415(b)

Member 1

Assumptions: 30 years of UCRP Membership, Retirement age 60. Figures are rounded.		
36 months average compensation	$15,833/mo	
UCRP Benefit without IRS Limits	$11,447/mo	
UCRP Benefit with IRS Limits	$ 9,256/mo	
Lost Benefits due to Section 415(b)	**$ (2,191)/mo**	**(19%)**

Member 2

Assumptions: 30 years of UCRP Membership, Retirement age 50. Figures are rounded.		
36 months average compensation	$15,833/mo	
UCRP Benefit without IRS Limits	$ 5,177/mo	
UCRP Benefit with IRS Limits (limit prior to January 1, 1990)	$ 4,588/mo	
Lost Benefits due to Section 415(b)	**$ (589)/mo**	**(11%)**

These examples illustrate the different IRC Section 415(b) limits at age 60 for Member 1 and age 50 for Member 2. Also note that both members in these examples were hired prior to January 1, 1990, the date that the lower IRC Section 415(b) limit became effective.

Appendix B– Examples of limits on amount of benefits that can be paid from UCRP due to IRC Section 401(a)(17) based on different hire dates

Member 1 (not limited)

Assumptions: Hire date June 30, 1994, 5 years of UCRP Membership, Retirement age 60. Figures are rounded.

36 months average compensation	$16,666/mo
UCRP Benefit without IRS Limits	$ 2,008/mo
UCRP Benefit with IRS Limits	$ 2,008/mo
Lost Benefits due to Section 401(a)(17)	**-0-/mo**

Member 2 (limited)

Assumptions: Hire date July 1, 1994, 5 years of UCRP Membership, Retirement age 60. Figures are rounded.

36 months average compensation (note the average compensation amount that can be used for retirement income calculations is $13,055/mo)	$16,666/mo	
UCRP Benefit without IRS Limits	$ 2,008/mo	
UCRP Benefit with IRS Limits	$ 1,573/mo	
Lost Benefits due to Section 401(a)(17)	**$ (435)/mo**	**(22%)**

These examples illustrate that Member 2 receives $435 less in UCRP retirement income per month than Member 1 due to the lower IRC Section 401(a)(17) limit in effect as of July 1, 1994.

Appendix C– Example of a UCRP Retired Member's benefit that is limited by IRC Section 415(b) and that would be restored from the date of implementation

Assumptions: Member retired July 1, 1998 at age 60 with 28 years of UCRP Membership. Figures are rounded.

36 months average compensation	$16,083/mo	
Current UCRP Benefit without IRS Limits	$10,852/mo	
Current UCRP Benefit with IRS Limits	$ 9,256/mo	
Lost Benefits due to Section 415(b)	**$ (1,596)/mo**	**(15%)**

This example illustrates that this Retired Member would receive $1,596 per month from the IRC Section 415(b) restoration plan, from the date of implementation, until the Retired Member's benefit is no longer limited based on periodic increases in the IRC Section 415(b) limit.

University of California

UCRS Board

Meeting of June 28, 1999

AGENDA ITEM F

Item for Information

Update on Implementation of Restoration Benefits

On February 26, 1999, members of the University of California Retirement System (UCRS) Advisory Board were notified that The Regents, at their February 18, 1999 meeting, approved the concept and philosophy of restoring to University of California faculty and staff the University of California Retirement Plan (UCRP or Plan) benefits earned, but denied due to Internal Revenue Code (IRC) limitations.

The Regents delegated the establishment of restoration benefits to the President of the University with the concurrence of the Chair of The Regents and the Chair of the Committee on Finance. Subsequent to The Regents' approval of this item, staff has continued to develop and refine restoration benefits; this information item is an update on UC Human Resources and Benefits' progress in that regard.

Restoring Benefits Subject to the Compensation Limits of IRC Section 401(a)(17) – UCRP Appendix E

An appendix to UCRP has been developed, in coordination with the Plan actuary, consultants and counsel, to generally restore benefits that may be lost due to the limitations of IRC Section 401(a)(17). These provisions, contained in the proposed Appendix E, will provide retirement, disability and preretirement and postretirement survivor benefits under the same terms and conditions as UCRP.

On June 17, 1999, UC Human Resources and Benefits filed a determination letter application with the Internal Revenue Service (IRS) on behalf of the Plan Administrator. As required, prior to filing with the IRS, Benefits Offices posted the "Notice to Interested Parties" throughout each location. In addition, Labor Relations noticed collective bargaining

representatives and local exclusive representatives of the IRS filing.

Adoption and implementation of the provisions of Appendix E, and thus the ability to provide restoration of benefits through UCRP, is contingent upon IRS approval. UC Human Resources and Benefits has been informed that the current IRS processing time for a determination letter request is, at minimum, six months. Thus, implementation of the restoration of benefits due to IRC Section 401(a)(17) limitations cannot occur until IRS approval has been received. At the time this occurs, restoration benefits will be provided prospectively from January 1, 2000.

Separate from the development of UCRP Appendix E, UCRP will be amended to reflect that cost of living increases can be applied to the annual IRC Section 401(a)(17) limit in effect for UCRP Members who entered the Plan prior to July 1, 1994. Previously, the limit was fixed at $235,840; recently the IRS announced that cost of living increases can be applied to this limit. The President, under his authority as Plan Administrator, has approved an amendment to allow cost of living increases to be applied in accordance with the provisions of the IRC. Thus, the new limit for July 1, 1999 will be $270,000.

Note that there is no change to the lower annual limits for UCRP Members who entered the Plan after July 1, 1994; the limit is currently $160,000.

Restoring Benefits Subject to the Annual Payment Limits of IRC Section 415(b) – IRC Section 415(m) Restoration Plan

A non-qualified plan will be established to provide payment of accrued retirement benefits that would not otherwise be payable due to the limitations of IRC Section 415(b). At this time, this non-qualified plan is being referred to as the IRC Section 415(m) Restoration Plan.

UC Human Resources and Benefits formed a work group on April 20, 1999, to develop the policies and procedures necessary to implement the IRC Section 415(m) Restoration Plan on January 1, 2000. The work group will continue to meet throughout the year to finalize the IRC Section 415(m) Restoration Plan document, and to develop the systems modifications, funding mechanisms, financial and tax reporting, applicable forms/communication materials and training for internal staff and Benefits Representatives.

Future updates will be provided to the UCRS Board as the development of restoration benefits continues.

University of California

UCRS Board

Meeting of January 26, 2000

AGENDA ITEM L

Item for Information

Update on Implementation of Restoration Benefits

At the June 28, 1999 University of California Retirement System (UCRS) Advisory Board meeting, an update was provided on the development of restoration benefits that The Regents approved at their February 18, 1999 meeting. The following is an update on UC Human Resources and Benefits' progress in that regard.

Restoring Benefits Subject to the Compensation Limits of Internal Revenue Code (IRC) Section 401(a)(17)—University of California Retirement Plan (UCRP or Plan) Appendix E

An appendix to UCRP has been developed, in coordination with the Plan actuary, consultants and counsel, to generally restore benefits that may be lost due to the limitations of IRC Section 401(a)(17). These provisions, contained in the proposed Appendix E, will provide retirement, disability and preretirement and postretirement survivor benefits under the same terms and conditions as UCRP. Adoption and implementation of the provisions of Appendix E, and thus the ability to provide restoration of benefits through UCRP, is contingent upon Internal Revenue Service (IRS) approval.

On June 17, 1999, UC Human Resources and Benefits filed a determination letter application with the IRS on behalf of the Plan Administrator. On November 23, 1999 the IRS requested additional information about the filing and advised that the determination letter request will need further review. UC Human Resources and Benefits will continue to work with the IRS on these issues through the Plan's external counsel.

Implementation of the restoration of benefits due to IRC Section 401(a)(17) limitations cannot occur until IRS approval has been received. At the time this occurs, restoration benefits will be provided prospectively from January 1, 2000. Future updates will be provided to the UCRS Board.

Restoring Benefits Subject to the Annual Payment Limits of IRC Section 415(b) – University of California 415(m) Restoration Plan

A non-qualified plan was established, effective January 1, 2000, to provide payment of accrued retirement benefits that would not otherwise be payable due to the limitations of IRC Section 415(b). The non-qualified plan has been named the University of California 415(m) Restoration Plan (415(m) Restoration Plan). The major provisions of the 415(m) Restoration Plan are as follows:

- For a UCRP Member electing a Monthly Retirement Income option that is limited by IRC Section 415(b) – a separate monthly payment will be made from the 415(m) Restoration Plan. The 415(m) Restoration Plan payment will equal the difference between the earned UCRP benefit and the amount that can be paid from UCRP due to the IRC Section 415(b) limit. The UCRP Member's total benefit will be recalculated each year based on cost of living adjustments. Over time, as the IRC Section 415(b) limit increases through indexing, more of the total benefit will be paid out of UCRP and less from the 415(m) Restoration Plan until the Member is no longer limited.
  - For those Members who are Grandfather limited and thus not able to receive the Capital Accumulation Provision (CAP) Accumulations from UCRP, the CAP Accumulations will be paid from the 415(m) Restoration Plan in a single payment.

- For a UCRP Member electing a Lump Sum Cashout (LSC) that is limited by IRC Section 415(b) – a monthly payment will be made from the 415(m) Restoration Plan for 10 years from the LSC Date. These payments will reflect the value, paid monthly over 10 years, of the difference between the earned LSC benefit and the amount that can be paid from UCRP due to the IRC Section 415(b) limit. These payments will be made to the Member and/or the beneficiary if the Member were to die prior to the end of the 10-year payment period. The monthly payment will include a built in 2% Cost of Living Adjustment and these payments are not subject to recalculation.
  - An exception to this provision is in the case where the limited amount of the LSC (the difference between the earned LSC benefit and the maximum amount payable from UCRP) is $35,000 or less. In these cases, a single payment will be paid from the 415(m) Restoration Plan.

- Form of Payment – all 415(m) Restoration Plan benefits are paid separately from the UCRP payment and are reported as wages on a W-2 form. As these payments are considered wages, no payments from the 415(m) Restoration Plan are eligible for rollover. These payments are considered non-qualified deferred compensation payments, are not considered wages that would impact the Social Security earnings limits and are not subject to FICA (OASDI and Medicare) withholding or taxation.

- Retroactivity – No retroactive benefits shall be paid under the 415(m) Restoration Plan. Therefore, any Member of UCRP who retires before January 1, 2000 and has benefits limited by IRC Section 415(b) will not receive any restoration benefits prior to January 1, 2000. In addition, any Member of UCRP who has a LSC Date prior to January 1, 2000 will have no benefits payable from the 415(m) Restoration Plan.

- The first 415(m) Restoration Plan payments are scheduled for mailing on January 27, 1999 for the month of January. Current Retired Members who are limited by Section 415(b) on January 1, 2000 were noticed in December 1999 of the implementation of the 415(m) Restoration Plan and of the payments they will be receiving.