UNIVERSITY OF CALIFORNIA, ACADEMIC SENATE

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*Chair of the Assembly and the Academic Council*
*Faculty Representative to the Board of Regents*
*University of California*
*1111 Franklin Street, 12th Floor*
*Oakland, California 94607-5200*

June 3, 2009

**PRESIDENT MARK YUDOF**
**UNIVERSITY OF CALIFORNIA**

**Re: Academic Council Recommendation to Ensure Adequate Funding for UCRP**

Dear Mark:

At the May 25 meeting of the Academic Council, we considered and adopted the Task Force on Investments and Retirement’s (TFIR) analysis of UCRP's current state and recommendations for restoring and maintaining the strength of UCRP. The Academic Council endorses TFIR's urgent recommendation that The Regents return to the Funding Policy they adopted in September 2008, requiring a total contribution of 11.5% of covered compensation (2% of which would be contributed by the employee, and 9.5% of which would be provided by the employer).

As you know, the Academic Council has recently issued statements and reports on the trade-offs between monthly pension payments and lump-sum payouts, as well as the performance of UCRP investments. TFIR and the University Committee on Faculty Welfare (UCFW) have now completed an analysis of the contributions needed to restore and maintain UCRP's strength. Council recommends dramatically increasing contributions to the fund in accordance with the Funding Policy adopted by The Regents in September, 2008. We believe that The Regents’ current plan to increase contributions gradually and to postpone the start of contributions until April 2010 is inadequate to restore the health of the system.

Under the present scenario, the required contributions could exceed 50% of covered compensation by 2022, in part because for each dollar of state funds not contributed to UCRP, an additional two dollars of non-state funded contributions are lost. Because the long term prospects for UCRP are dire unless contributions to the fund increase significantly, Council requests that you urge The Regents to begin full implementation of the plan they endorsed in September 2008 as soon as possible, but no later than July 1, 2011. Council is fully aware of the difficulties inherent in following this recommendation, but believes the severity of the situation demands no less. I am enclosing UCFW Chair Helen Henry's letter of transmittal along with the full TFIR analysis for your reference.

Please do not hesitate to contact me if you have any questions regarding Council’s recommendation.

Sincerely,

Mary Croughan

Mary Croughan, Chair
Academic Council

Copy: John Sandbrook, Interim Chief of Staff
Academic Council
Martha Winnacker, Academic Senate Executive Director
Gary Schlimgen, Director, Retirement Planning, HR&B
Randy Scott, Executive Director, Strategic Planning, HR&B

Encl (2)

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UNIVERSITY COMMITTEE ON FACULTY WELFARE (UCFW)
Helen Henry, Chair
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May 13, 2009

**MARY CROUGHAN, CHAIR**
**ACADEMIC SENATE**

**RE: Recommendation to Ensure Adequate Funding for UCRP**

Dear Mary,

The attached document, entitled "TFIR Recommendation to Ensure Adequate Funding for UCRP", has been approved for transmission to the Academic Council by UCFW, and we request that Council transmit it to the President, and then to The Regents.

As you know, TFIR and UCFW have been intensely engaged in assessing the current and future funding status of UCRP in the contexts of both the continued lack of contributions and the market turmoil of the past few months. It is now clear that the long term prospects for UCRP are exceedingly dire unless steps are taken immediately to dramatically increase contributions to the fund, in line with the Funding Policy adopted by The Regents in September, 2008. The gentle ramp-up of both employee and employer contributions envisioned by the Regents in their November plan for contribution resumption – and its subsequent deferral until April of 2010 – is entirely inadequate to restore the funding status of UCRP to an acceptable level in the foreseeable future. Neither can reductions in benefits address the funding question.

The enormity of this problem and our recommendation on how to address it are the subject of this communication.

UCFW recognizes that implementation of this recommendation will not be simple and that modifications or adjustments may be required. But we believe that we must not let the inevitable complications deter us from making clear to The Regents the scope of the problem and the urgency and boldness with which it must be addressed.

Thank you for your consideration.

Sincerely,

Helen L Henry

Helen Henry, UCFW Chair

Copy: UCFW
Martha Winnacker, Executive Director, Academic Senate

Encl.

# TFIR Recommendation to Assure Adequate Funding for UCRP

**May 13, 2009**

**Executive Summary**:

Like any pension plan, UCRP needs ongoing contributions to maintain its funded status. Even if the recent declines in securities markets had not occurred, the accumulation of additional liabilities in the Plan from the additional service credit accrued by employees each year would have required the prompt restart of employee and employer contributions to maintain 100% funding.

The current plan is to gradually ramp up contributions until they reach the level recommended under the Funding Policy adopted by The Regents in September, 2008. In light of the current situation in financial markets, the Funding Policy will require large contributions to amortize the unfunded liability. The gradual ramp-up currently planned will result in contributions that fall far short of the level recommended under the Funding Policy for many years, likely twenty years or longer. Each dollar of contributions that is deferred now will increase future required contributions by substantially more than a dollar. As a result, the contributions under the Funding Policy are projected to rise above 50% of covered compensation by 2022, a level that would require draconian cuts in UC operations, likely including the closure of campuses.

The deferral of contributions creates another serious problem. Less than a third of UCRP covered compensation is paid from state funds. The other fund sources will not contribute at a higher rate than the contribution on state-funded employees. Thus, every dollar of state-funded contributions that is deferred results in the deferral of over two dollars in contributions from other fund sources. There is no guarantee that these deferred contributions can be recovered from the other fund sources in the future; as a consequence, deferral of state-funded contributions creates a substantial risk that UC and its state funding will have to absorb the liability for pensions that should have been funded by the other sources.

Reducing UCRP benefits will not solve either problem. At most modest cuts can be made, for both legal and competitive reasons. UCRP with a 5% employee contribution is actually *less* than competitive with the faculty retirement plans offered by the Comparison 8 universities. The bulk of the high projected future contributions comes from the amortization of the past unfunded liability, and UC cannot legally renege on this past unfunded liability.

Painful as it will be, the least bad option is to raise UCRP contributions as soon as possible to the full recommended contribution under the Funding Policy. Doing so avoids far higher contributions in the future, and also ensures that non-state sources pay their fair share of the unfunded liability and the additional pension benefits that are earned each year. Every dollar of contributions made on behalf of employees whose salaries are paid from state funds is matched, on a two-for-one basis, by the contributions that will be made from other fund sources, on behalf of employees who are not paid from state fund sources. TFIR therefore recommends that The Regents commit to allocate funds sufficient to follow the Funding Policy, starting no later than July 1, 2011; in the attached actuarial projections from Segal Company, this is referred to as the TFIR Recommendation.

**TFIR Analysis and Recommendation:**

As of June 30, 2008, UCRP was just slightly more than 100% funded. This means that it had adequate resources to pay the pension benefits that had been accrued as of that date, assuming that future investment returns matched the actuarial assumed 7.5% rate of return and that assumptions about future salary increases and life expectancy were met. However, active employees in UCRP accrue additional service credit each year, and contributions are needed each year to fund this additional liability; the value of the additional liability accrued each year (normal cost) is slightly below 17% of UCRP covered compensation.

In September, 2008, The Regents adopted a Funding Policy for UCRP. The Funding Policy calls for five-year smoothing of investment returns, 15 year amortization of any future actuarial deficit, and 30 year amortization of any future actuarial surplus. Based on this plan, the Segal Company (UCRP's actuary) recommended a total contribution of 11.5% of covered compensation, effective 7/1/2009. At the time, it was anticipated that each employee would contribute 2% of salary up to the Social Security wage base (4% above the wage base), and the fund source which provided the employee's salary would contribute 9.5% of salary. The Academic Senate recommended in favor of The Regents' Funding Policy, and continues to view the maintenance of a healthy UCRP as fundamental to preserving UC's ability to recruit and retain excellent faculty and staff.

In November, 2008, The Regents adopted the employee contribution and a reduced employer contribution of only 4% of salary, effective 7/1/2009. Apparently, the employer contribution was reduced based on the belief that it was unrealistic to hope for state funding of the 9.5% called for under the terms of the September Funding Plan. Subsequently, the Governor's budget reduced state funding to $20M; as a result, The Regents deferred both employer and employee contributions until 4/15/2010. The Legislature did not allocate even this money, and placed language in the Education Code indicating it did not intend to provide incremental funding to UC to support UCRP contributions. Thus, it is not clear whether any contributions will resume on 4/15/2010.

In February 2009, The Regents adopted employer contributions of 4% of covered compensation for the period 4/15/2010-6/30/2010, and at least 4% for the period 7/1/2010-6/30/2011; employee contributions would remain 2%/4% below/above the Social Security wage base for the period 4/15/2010-6/30/2011. The current plan, which has not yet been formally adopted by The Regents, is for employer contributions to rise 2% per year starting 7/1/2010 until they reach the actuary's recommended contribution under the September 2008 funding policy, and employee contributions to rise 1% per year starting 7/1/2011, until they reach 5% of covered compensation.

The gradual resumption of contributions was first envisioned a few years ago. Since that time, the fund's liabilities have increased (as employees have accrued additional service credit) and its assets have been eroded by payments to current retirees, and by declines in the value of financial assets. Even if securities markets had not fallen dramatically in the period since July 1, 2008, the slow ramp-up currently envisaged would have been undesirable; deferring the contributions required under the Funding Plan only results in larger required contributions later. However, taking into account the recent performance of the markets, the slow ramp-up will lead to a catastrophic underfunding of UCRP over the next 15 years.

Since UCRP is now significantly underfunded, the Funding Policy requires contributions equal to the 17% normal cost, plus large additional contributions to amortize the unfunded liability. The Funding Policy requires contributions of just over 20% of covered compensation starting July 1, 2010, rising to approximately 37% of covered compensation by July 1, 2014, then slowly declining. This is a frightening scenario: meeting the Funding Policy contributions will pose enormous challenges to the University budget.

However, following the slow ramp-up currently proposed makes the situation *much* worse. This approach would result in contributions that are far below those required under the Funding Policy for many, many years. Each dollar of contributions that is deferred cannot be invested to meet future pension obligations; the loss of investment earnings drives the Funding Policy contributions higher and higher. By 2022, the required Funding Policy contributions are projected by Segal to exceed 50% of covered compensation! However, in 2022, the 35% contributions (30% employer, 5% employee) proposed under the ramp-up are *still* far short of those required under the Funding Policy. As a consequence, additional deferrals continue until the ramp-up contributions reach the Funding Policy contributions, some time around 2030; it is only at that point that the deferral starts to be made up. *A dollar deferred in 2011 would requires $4.25 to be contributed if the deferral were made up in 2031, including 20 years of earnings at the assumed 7.5% rate of return.*

Further increasing the urgency of making contributions is that fact that less than a third of UC salaries are paid by state funds, with federal grants and contracts and self-supporting entities, such as the clinical enterprises, making up the other two-thirds. The employer contribution on behalf of each employee is charged to the fund source which provides the employee's salary. These other fund sources will not make employer contributions larger than those made on behalf of state-funded employees, but they will contribute at the same rate. Thus, each dollar of contributions on behalf of state-funded employees results in over two dollars in contributions from other sources. *Each dollar of contributions on behalf of state-funded employees that is deferred results in the loss of an additional two dollars of contributions from non-state sources.* The slow ramp-up therefore means that UC is continuing to price its benefits far below cost, effectively giving a discount to outside funding sources; this policy is not sustainable because UC cannot obtain a binding commitment from these fund sources to make up the shortfall through future contributions.[1]

If required contributions were to rise above 50% of covered compensation, it is very difficult to see how UC researchers could continue to attract federal grants and contracts, and how UC clinical enterprises could obtain contracts with health insurers. In other words, the very high future contributions that will result from deferring contributions now threaten to cut off UC's income from the other fund sources. If these fund sources wither away, so will the associated pension contributions. In the absence of these other fund sources, the entire burden of amortizing the unfunded liability will fall on UC's state funds. UC cannot constitutionally renege on its obligation to pay vested benefits, so it would have to bear the entire burden of amortizing the unfunded liability, even though two-thirds of that unfunded liability relates to employees who had been paid from

[1] The only exception is the Department of Energy, which has made a binding commitment to make up any future deficit arising from employees and retirees of Lawrence Berkeley National Laboratory (LBL) and the segment from Los Alamos National Laboratory (LANL) and Lawrence Livermore National Laboratory (LLNL) retained within UCRP; conversely, the Department of Energy is entitled to any surplus arising from the labs that remains after all benefits have been paid. UC cannot obtain a binding commitment from other federal grants and contracts, or the self-supporting entities.

non-state funds. This path can only lead to UC being forced to dramatically curtail its operations and sell off the lands and buildings of several of its campuses. In short, contributions need to rise to recommended levels as soon as possible, both to avoid far higher rates in the future, and to reduce the threat they pose to UC's continued existence.

Reducing UCRP benefits will not solve the funding problem.

- First, there is overwhelming legal precedent saying UC cannot renege on the benefits that have already been accrued.

- Second, any attempt to reduce the future accrual of benefits for current employees is certain to be litigated, and the outcome of that litigation is unpredictable. Even if UC prevailed in court, that decision would certainly be appealed in the political arena, either through Legislative action or the initiative process or both.

- Third, even if UC somehow managed to completely stop the future accrual of UCRP benefits, the cost of amortizing the unfunded liability under the Funding Policy would amount to approximately 20% of covered compensation. But since the active employees would not be accruing benefits under UCRP, it is highly doubtful that UCRP employer contributions could be charged to outside fund sources such as federal grants and contracts;[2] the bulk of the burden of the unfunded liability would become the responsibility of the state-funded portion of the budget, even though only about one-third of the liability arose from state-funded employees.

- Fourth, UC needs to offer a competitive package of cash compensation and benefits to recruit and retain faculty and staff. However, with a 5% employee contribution, the value of UCRP to active faculty is *below* the average value of pension plans at the

[2] Except, as noted above, for the Department of Energy laboratories.

Comparison 8 universities. If the future accrual of UCRP benefits were stopped, there would have to be either dramatic salary increases or a new pension plan, with substantial employer contributions, in order for UC to remain competitive.

- Finally, although UC can legally reduce the pension benefits of new employees hired in the future, it would take a long time for this to significantly reduce the accrued liability compared to current projections. New employees will have to be offered a competitive total remuneration package, so a substantial employer pension contribution will still be required. If new employees are provided with substantially less generous pension benefits, then it may prove difficult to obtain employer contributions on behalf of those new employees to amortize the unfunded liability incurred on behalf of employees with more generous benefits.

Thus, painful as it will be, the least bad option is to raise contributions as quickly as possible to the contribution required by the Funding Policy. Delay only means even higher contributions in the future. This was already clear before the recent collapse of financial markets, but these recent losses mean that future contributions will soon approach unsustainable levels, if the Funding Policy is not followed. Each dollar of deferred contributions on state-funded salaries results in the deferral more than two dollars in contributions from other fund sources. TFIR concludes that a realistic approach to funding the University's liability to UCRP is imperative and must be the highest level budget priority for the University. TFIR recommends that the Regents commit to allocate funds sufficient to follow the Funding Policy , starting no later than July 1, 2011.

# Restart of UCRP Contributions TFIR Recommendation

## UCFW Discussion

## May 8, 2009

May 2009

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# Disclaimer

- **The “TFIR Recommendation” was not developed by The Segal Company**
- **The modeling that follows was authorized by UCOP Human Resources, at the request of TFIR.**
- **Segal remains a neutral party to the proposal**
  - **Neither endorses or opposes the “TFIR Recommendation”**

SEGAL

# New UCRP Funding Policy

- Adopted by Regents in September 2008
  - Effective July 1, 2008 for 2009/2010 Plan Year
- Funding Policy starts with Normal Cost
- Current Surplus and any future Unfunded Liability (UAAL) are amortized in layers
  - 3 year amortization of initial surplus
  - 15 years for future changes in either current Surplus or future Unfunded Liability
  - Level dollar amortization payments
- Retain “Entry Age Normal” method, 5 year asset smoothing

SEGAL

# Approved Contributions

- Adopted by Regents in February 2009
  - Employer and Employee rates for FY 09/10 and FY 10/11 (through June 30, 2011)
- Employer
  - $20 million State funding and 4% contribution target translates into April 15, 2010 implementation date
  - All other employer payroll funding sources will also start at 4% around April 15, 2010
  - Rate for FY 10/11 will be at least 4%, but may be higher
- Employee
  - Also start around April 15, 2010 at amounts currently redirected to the DC Plan
  - About 2% for most employees

# Contribution Projections – "Proposed"

- Lowest (red ) line shows total "Proposed" UCRP contributions (University and employee)
  - Both employer and employee rates start on 4/15/2010 at Regent approved levels
    - Still includes $20 million from State for 2009/2010
    - Employee rates are assumed to increase by 1% per year starting July 1, 2011 until reach an ultimate level of 5%
    - Employer rates are assumed to increase by 2% per year starting July 1, 2010 (until total reaches funding policy)
- Regents have only approved employer and employee rates through June 30, 2011

# Contribution Projections – "Funding Policy"

- **Highest (green ) line shows the resulting total "Funding Policy" contributions if only the "Proposed" contributions are made**
  - **Future Funding Policy contributions increase when Proposed contributions fall short of Funding Policy contributions**
  - **Contribution shortfall increases Unfunded Actuarial Accrued Liability (UAAL), which increases future Funding Policy contributions (pink area)**
  - **Funding less now means funding more later**

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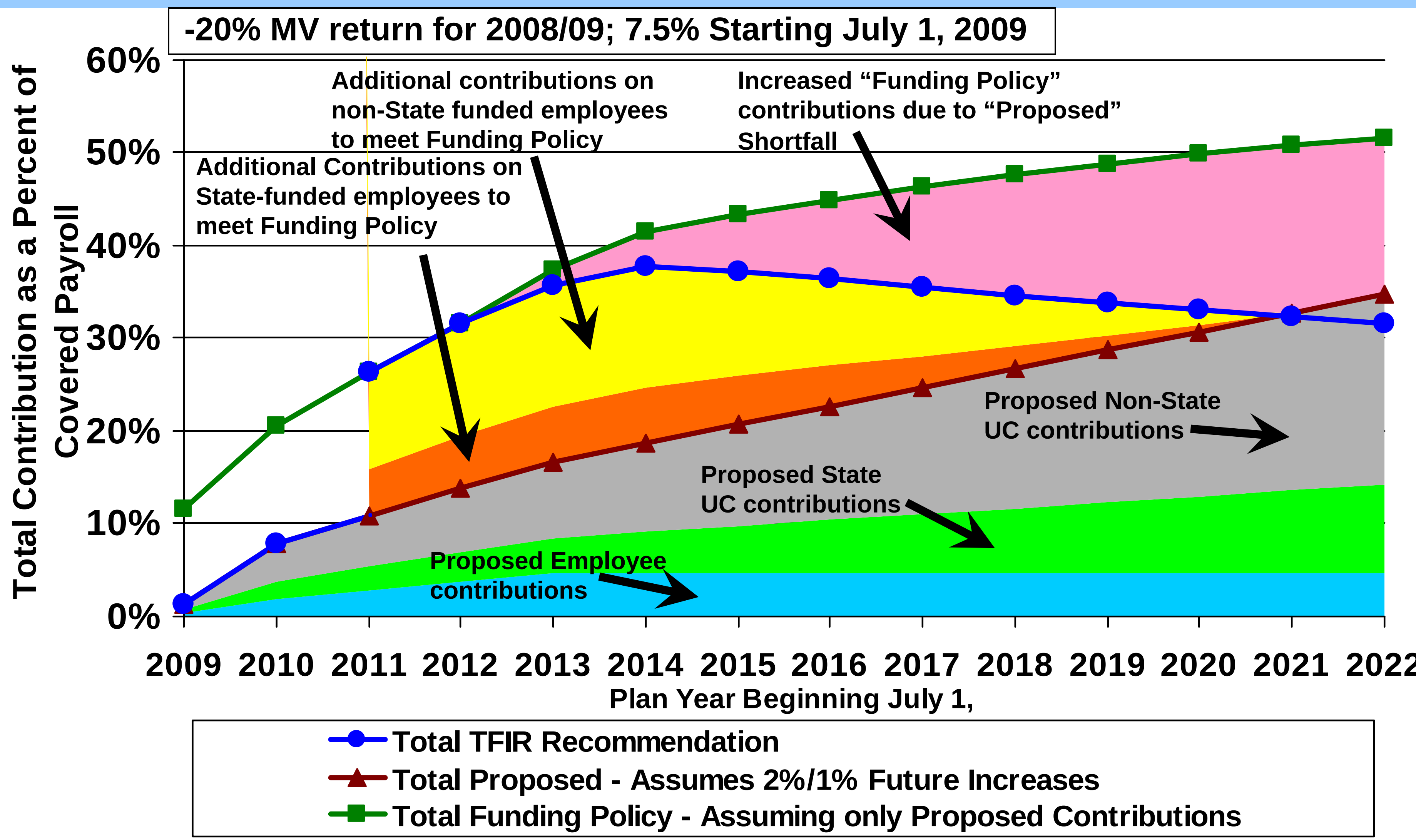
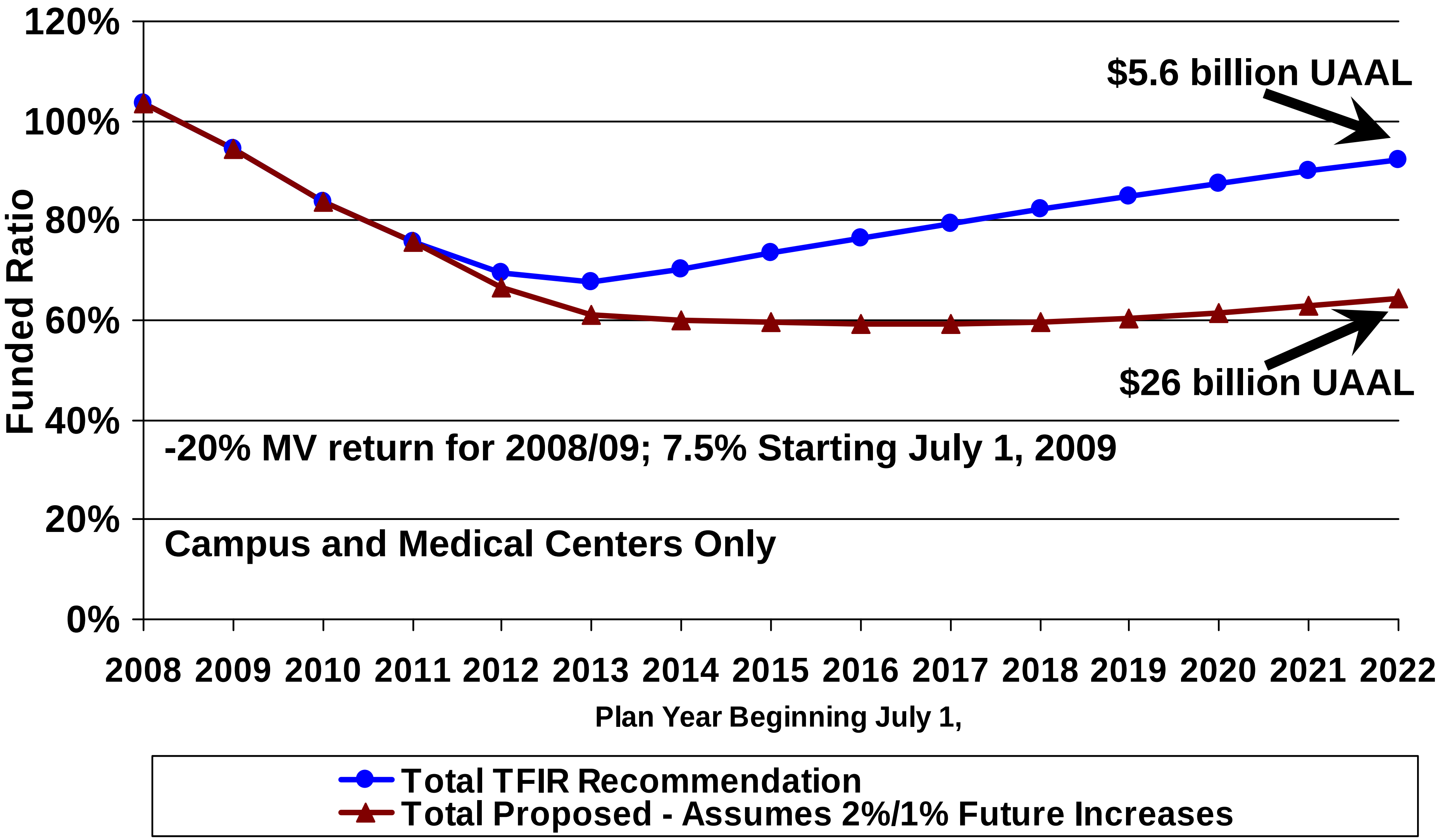
# Contribution Projections – "TFIR Alternative"

- Middle (blue ) line shows total "TFIR Alternative"
  - Same as Proposed contributions for the first two years
  - Thereafter, equals future Funding Policy contributions
- Difference between blue and red lines shows additional contribution needed to avoid increases in future Funding Policy contributions
  - Orange area is additional State portion (funding to be determined)
  - Leverages additional contributions from non-State UC funding sources (yellow area)
- Result is that future Funding Policy contributions follow blue line instead of green line

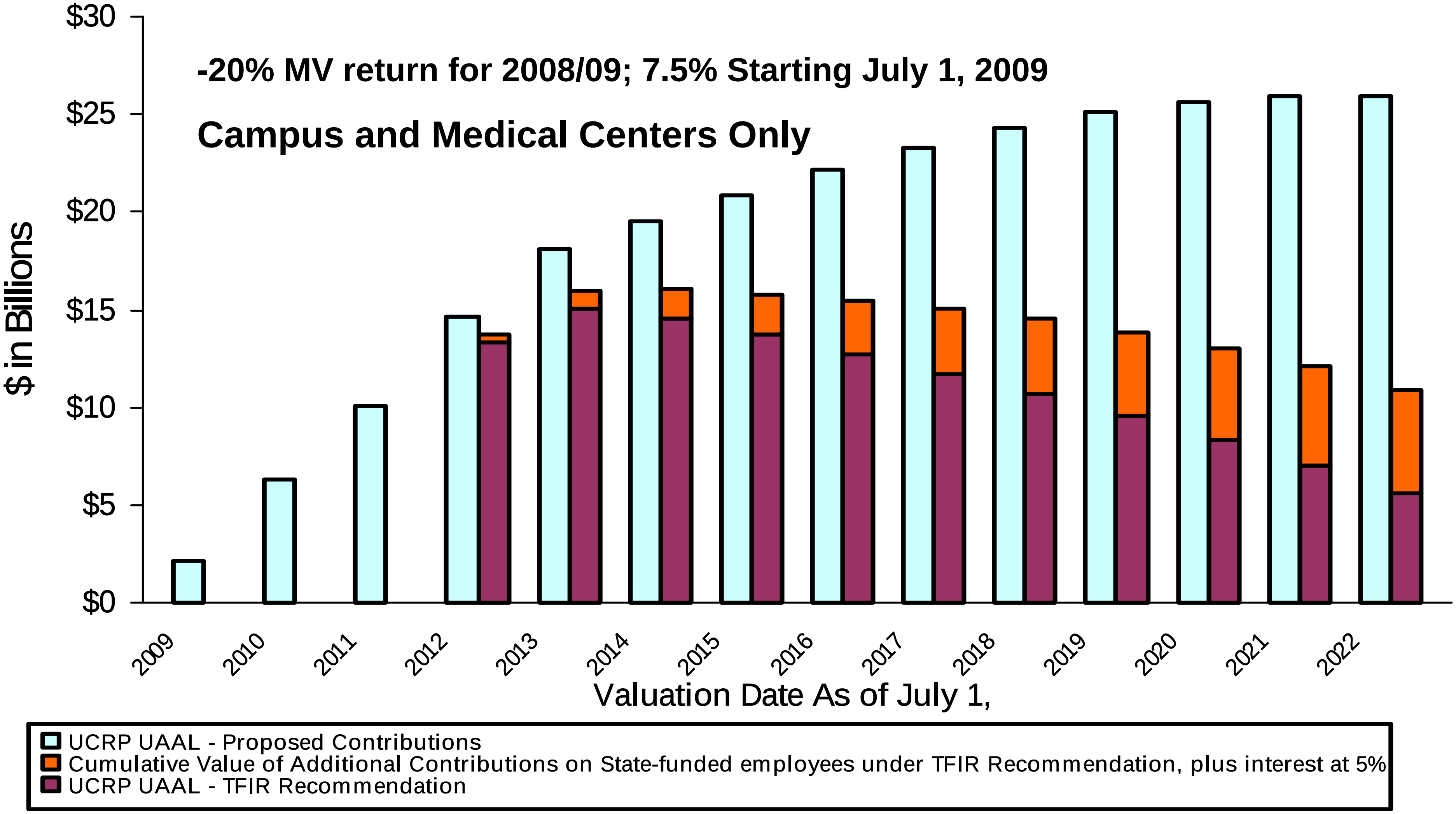
# Proposed and Funding Policy Total Contributions for Campus and Medical Centers Only



# Funded Ratio (Actuarial Value Basis)



# Comparison of UCRP Unfunded Liability and Cumulative Value of Additional Contributions



# TFIR Recommendation
# Total Contributions in Dollars