## Are 14% Employer Contributions Sufficient to Fund UCRP?

At their July 2013 meeting, the Regents approved UCRP employer/employee contributions of 14%/8% respectively, effective July 1, 2014.[1] Since the normal cost of UCRP is approximately 18%[2], this means that contributions exceed the value of new service credit earned each year. However, this action is not sufficient to resolve the serious concerns about the UCRP funding deficit:

- The Market Value of Assets (MVA) remains well below the Actuarial Accrued Liability (AAL), the present value of future benefits based on *past service*. The UCRP funding deficit (AAL minus MVA) was $12.8 Billion as of 6/30/12. Although earnings in 2012-13 of approximately 12% comfortably exceeded the actuarial assumption of 7.5%, that return was earned only on the lower MVA and not on the AAL. In calculating the UCRP funding deficit, the return on MVA is offset by the foregone return on the deficit, a *negative amortization of 7.5%x$12.8 Billion = $960 Million*. As a result, the estimated deficit as of 6/30/13 is about $12.1 Billion, *up from $9.9 Billion as of 6/30/10 and only slightly smaller than the record high of $12.9 Billion as of 6/30/09, which reflected the effects of the Financial Crisis*.
- **The UCRP funding deficit will grow over time.** Assuming a 7.5% rate of return going forward, the new contribution level is sufficient to maintain the funding ratio (MVA/AAL) at approximately 80%. However, since the AAL grows by 7.5% annually (plus normal cost, less value of benefits paid, which are currently roughly in balance), the *funding deficit will continue to increase***.** This is illustrated in the chart, which shows a stable funding ratio but a deficit growing at an alarming rate. This is *only* an illustration; a precise calculation requires demographic data on the UC employee and retiree population, and we call on UCOP to obtain projections of the deficit from the Segal Company, on the assumption that employer contributions stay capped at 14%.

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[1] These rates apply to employees hired on or before June 30, 2013. The employee rate for those hired on or after July 1, 2013 is 7%.

[2] 18.09% for employees hired on or before June 30, 2013. The normal cost for employees hired on or after July 2, 2013 is about 15%.

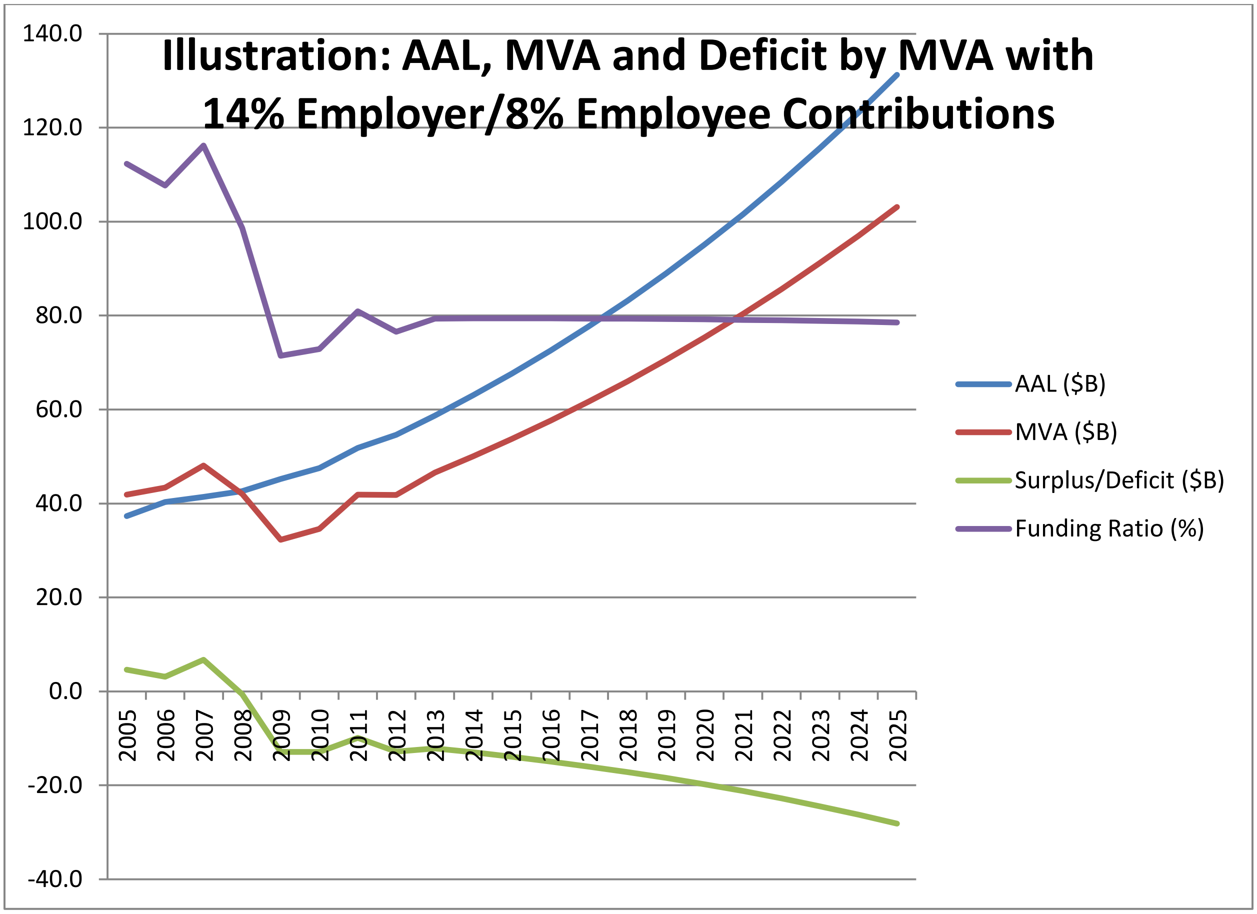
Illustration: AAL, MVA and Deficit by MVA with 14% Employer/8% Employee Contributions
140.0
120.0
100.0
80.0
60.0
40.0
20.0
0.0
-20.0
-40.0
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
AAL ($B)
MVA ($B)
Surplus/Deficit ($B)
Funding Ratio (%)

- The foregone return on the unfunded liability, at 7.5%, currently, amounts to approximately $900 Million per year. With the Regents' adopted 14%/8% employer/employee contributions starting 7/1/14, contributions will exceed normal cost by about $320 Million. The difference, about $580 Million annually, adds to the unfunded liability; it is exactly like a negative amortization mortgage.[3]
- The Chief Financial Officer has indicated that UC holds approximately $4 Billion in excess liquidity in STIP and TRIP. This money can be borrowed from ourselves at interest rates well below 7.5%. It makes no sense to incur negative amortization at a 7.5% interest rate when we can borrow at 1%-4%. This borrowing can eliminate the negative amortization, and be repaid by a surcharge on future employer contributions; the overall effect is to *reduce* the employer contributions needed for UCRP because it replaces negative amortization at 7.5% with borrowing at a much lower rate.[4]
- Historically, the US stock market has declined by as much as 50%. approximately once per decade. A 50% decline in the US stock market would result in a decline of about 30% in UCRP MVA. If the funding ratio were only 80% just before the decline, it would fall to about 55%, a level from which it would be nearly impossible to recover. For that reason, it is critical to return to 100% funding as quickly as is reasonably feasible, to protect the plan against reasonably foreseeable future market declines. A policy to target funding at 80% is, in effect, a policy that will guarantee a critical problem in the foreseeable future.

[3] See http://senate.universityofcalifornia.edu/reports/tfir-reaching-ucrp-required-contribution.pdf.
[4] See http://senate.universityofcalifornia.edu/committees/ucfw/TFIRLiquidityStatement050613.pdf.