UNIVERSITY COMMITTEE ON FACULTY WELFARE (UCFW)
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Jan 22, 2013

ROBERT POWELL, CHAIR
ACADEMIC COUNCIL

RE: TFIR Statement on the Urgency of Reaching the UCRP Annual Required Contribution

Dear Bob,

The need to sustain the University's extant commitments to its current and future retirees demands fiscal health of UCRP. Retirement benefits provide a critical component of employee total remuneration, and play a significant role in the recruitment and retention of faculty and staff, as well as ensuring that both retirements and the resultant work force renewal will occur on an orderly, predictable basis. Currently UCRP has a large unfunded liability of approximately $11 billion and a current funded ratio of only 78%. The Plan got to this point because no employer or employee contributions were made for two decades. The recent financial crisis made things worse. However, the accumulation of additional service credit and the failure to provide funding to cover the benefits accruing to that service credit meant that the Plan was already on a path to becoming less than fully funded before the crisis occurred. Contributions are needed for any plan, and they would have been needed even without the financial crisis.

Currently, even after the restart of contributions in mid-2010, UCRP’s unfunded liability continues to grow, and it will continue to do so until the combination of employer and employee contributions is sufficient to cover the full Modified Annual Required Contribution (Modified ARC). Modified ARC includes both the Normal Cost of operating the plan, approximately 18% of covered compensation, and interest charges on the unfunded liability. If contributions equal Modified ARC and UCRP investments earn the assumed 7.5% rate of return, then the unfunded liability will stay constant. In other words, paying Modified ARC is like making the payments for an interest-only mortgage. To return to full funding, we must, in addition, pay down the principal of the unfunded liability over 30 years; the contribution needed to do that is the Annual Required Contribution (ARC). Paying less than Modified ARC amounts to negative amortization, a type of mortgage popular before the financial crisis. It makes our problem worse.

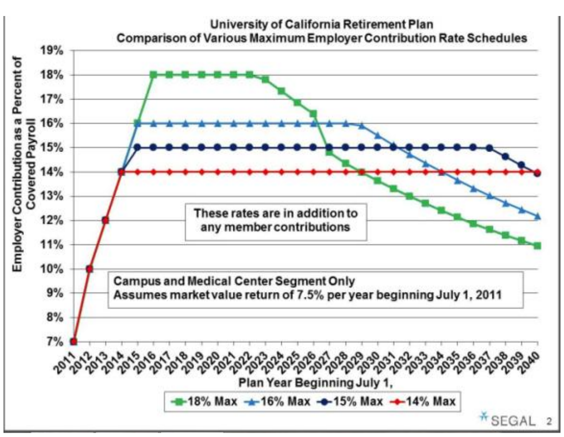
These contributions must be made. The unfunded liability cannot be escaped; it is the result of benefits already earned by employees. Normal cost could be reduced, but only by offering an uncompetitive pension benefit to future employees and accepting the adverse effects on recruitments, retention, and the University’s excellence.

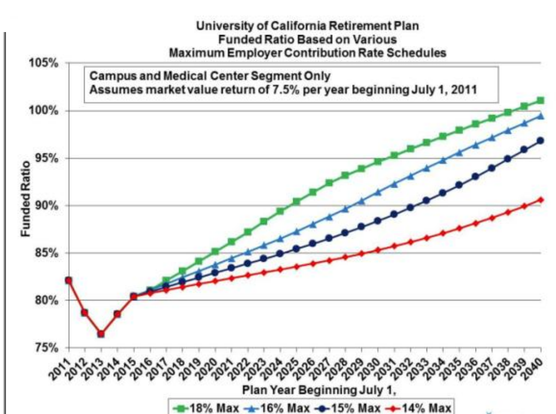
Based on the recommendations of the Post Employment Benefits Task Force and subsequent Regental action in 2010, from fiscal year 2011 to 2018, the University would contribute Modified ARC to UCRP, and thereafter the full ARC. To ramp up towards full ARC, it was assumed that University contributions would be 7% in FY 2011-12, 10% in FY 2012-13, with a 2% increase annually thereafter, to a plateau of approximately 18%. This ramp-up balanced the fiscal rectitude, indeed necessity, of reaching ARC as quickly as possible with the critical need to allow operational units time to accommodate to the reintroduction of their UCRP contributions. Somewhat akin to using a down-payment for a mortgage, internal borrowing from the Short Term Investment Pool (STIP) was used to decrease the liability and to facilitate a faster return towards full funding.

We cannot afford delay, however. All units within UC are affected by these large contribution percentages, and it is not surprising that there are proposals to cap contributions and delay the return to contributing the full ARC. However, such a cap is shortsighted and threatens the University's future quality, by requiring even larger contributions later, and increasing the overall cost of operating UCRP. In effect, until full ARC is met, by seeking to minimize harm to current budgets and limiting contributions, the University is borrowing at a rate of 7.5% to fund its current operations. In other words, when ARC is not being achieved, UCRP forgoes 7.5% earnings on the monies that should be contributed to UCRP, but are being spent elsewhere. This is simply not sustainable. TFIR is very much in favor of borrowing, if necessary, to remain consistent with the Regents funding policy. Indeed, cheaper sources of borrowed funds are available and should be used to augment contributions from current discretionary budgets. Unless additional borrowing is undertaken, even Modified ARC will not be achieved on the Regental timeline. Any delay in reaching full ARC will decrease the funded ratio of UCRP and increase overall cost to the University. A low funding ratio carries fiscal, moral and political risk.

In a summative analogy: UCRP is currently sinking; when Modified ARC is met UCRP will be treading water; when full ARC is met, UCRP will be swimming forward towards dry land, but tides will continue to ebb and flow. Recent years have shown that those tides can be brutal. Using UCRP as a credit card to finance current operations is bad enough. The risk that there will be another financial crisis provides an even more compelling reason to move the plan back to full funding as soon as possible. A fully funded plan is far better situated to weather meltdowns like 2008-09 without bringing about overwhelming political pressure to abandon the goal of providing competitive retirement benefits. To ignore this concern is to risk the University's excellence, and contemplate a future characterized by overwhelming pension contributions and an inability to hire the best faculty and staff.

It has been suggested that capping the employer contribution at 14% might relieve pressure on current university operations. This would represent an irresponsible, short-sighted policy that balances current convenience over long-term fiscal responsibility: we would greatly increase budget pressure on UC's long-term operations, further delay a return to full funding by over a decade, increase the burden on the university in future decades, and encounter great risk.





Ramping the employer contribution up to 18% means that: the unfunded liability will be paid down quickly, 95% funding will be achieved in 2031, and full funding will be achieved in 2039; the employer contribution can begin to decrease as early as 2022, and dropping to a sustainable rate of 11% by 2039 when UCRP becomes fully funded. Whereas, capping the employer contribution at 14% means that it will take an additional decade or two to reach full funding, 95% funding will not be reached until approximately 2047, and full funding will not be reached until approximately 2054; and that at 2039, and long, beyond the employer contribution will remain at 14%, burdening future operations and extending risk. Please note the key underlying assumptions used to create these projections.[1]

These projections assume a long-term average annual rate of return of 7.5%. Should a lower rate be achieved over the long term; these projections would look a lot less rosy. Similarly, unusually good years improve the future trajectory. But it is a mistake to assume that the University can simply invest well to restore the plan to full funding.

Whether or not contributions are made, and regardless of the funded status of the plan, pension obligations must be met by the University. The promise to existing and future members of UCRP would remain. Rights of employees and retirees are highly protected under state and federal law. Unlike a corporation or city, UC as a state affiliated agency cannot declare bankruptcy. The university would be forced to fund shortfalls in UCRP out of its operating budget on a pay-as-you-go basis, an untenable proposition, and eventually sell off its assets including, for example, valuable real estate in Westwood and La Jolla.

Therefore, TFIR recommends that the Academic Senate reiterate past statements that made funding for UCRP the Senate's top budgetary priority.[2] TFIR urges that modified ARC and full ARC be reached no later than the Regental timeline, and if possible sooner. The President has been delegated the authority to do so, "To take all measures necessary, including through the use of internal and external borrowing". There can be no higher budgetary priority. TFIR recommends that the Academic Senate strongly oppose any proposals to protect current budgets with caps on contributions at levels inadequate to fully fund at least the modified ARC, and that Senate leadership convey the Senate's strong support to continuing to follow the responsible plan to restore UCRP to fully funded status. To do otherwise is to place the University's future excellence at risk. Protecting current budgets and current students is an understandable goal, but any notion that this can be done by reducing necessary UCRP contributions translates to far higher costs to future budgets and future students.

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[1] The projections displayed in the above graphs were made using generally accepted actuarial practices and were based on the July 1, 2011 actuarial valuation results, including the participant data and actuarial assumptions on which that valuation was based. The most important assumptions used in the projections are summarized as:

- Applying only to campus and medical center segments;
- A 7.5% market value return per year starting July 1, 2011;
- Reflecting a new pension tier starting July 1, 2013 (along with later retirement rate assumptions for members of this tier);
- Reflecting current tier member rate increases to 6.5% for 2013/2014 and 8.0% for 2014/2015 (less $19 per month) and staying at that level throughout the projection;
- The approved/projected employer rate is as shown in the modeling;
- Normal cost plus interest on unaccrued actuarial liability (UAAL) contributed during June 2011 and July 2011 will be $1.1 billion in 2010/2011 and $935 million in 2011/2012;
- The active member population has been assumed to remain constant in all future years;
- Demographics of future new entrants are assumed to be the same as those for members hired during the two years prior to July 1, 2011.

(http://atyourservice.ucop.edu/ucrs-advisory-board/docs/6-29-12-ucrsab-agenda-items.pdf)

[2] See, for example: http://www.universityofcalifornia.edu/senate/reports/HP2MGY_UCRPfunding_030310.pdf and http://www.universityofcalifornia.edu/senate/reports/mctoyudof.ucrpfunding.june09.pdf

At the January Regent's Meeting, Governor Brown chided the University in having been far too slow to end the 20-year UCRP contribution holiday. Then, as now, the Senate urged long-term fiscal rectitude. This administration's historic legacy can be to assure the long-term stability of the UC or to defer reaching ARC, kick the can down the road, and risk plunging the UC into long-term fiscal crisis.

Please let us know if you have any questions or concerns.

Sincerely,

J. Daniel Hare

J. Daniel Hare, UCFW Chair

Copy: UCFW
Robert Powell, Chair, Academic Council
William Jacob, Vice Chair, Academic Council
Martha Winnacker, Executive Director, Academic Senate