UNIVERSITY OF CALIFORNIA ACADEMIC SENATE

UNIVERSITY COMMITTEE ON PLANNING AND BUDGET

Minutes of Meeting
August 5, 2014

I. Chair's Announcements

Don Senear, UCPB Chair

Update: Chair Senear reported to the committee on several items of interest:

- State budget: There are no new funds for UC since neither house's proposed enhancement was included in the budget bill that was passed. As a result, President Napolitano has directed UCOP to explore options to change the nature of some university programs and initiatives including doubling the number of (money making) certificate programs, and increased involvement in technology transfer of faculty inventions. The president has also rescinded some guidelines governing university-industry relations. Regarding the latter, revised guidelines are currently under development, but there are no current policy restrictions on UC accepting equity for incubator access or investing directly in faculty start-ups. The president has also appointed an external innovation council advisory group. High level discussions continue, including the need for revised guidelines to insure the protection of academic freedom for graduate students, post-doctoral scholars and other researchers.
- Self-supporting graduate and professional degree programs (SSGPDPs): The Academic Council has opined on the latest draft guidelines, and UCPB's concerns about the definition of a "compelling" reason and the demonstration of no negative impacts to state-supported programs were widely echoed. A working definition of "compelling" will develop in the form of a body of case law as CCGA approves or disapproves proposals. UCPB should continue to monitor the situation as long-term planning is implicated, including some informal working relationship with CCGA on this topic.
- Capital projects: The project list for 2015-16 is under development and is due to the state Department of Finance by September 1. The intent from UCOP is to fund $150M/year, though it is recognized that this is not adequate to fund the University's capital needs. The submission timelines need adjusted if the Senate (and UCPB in particular) is to have any opportunity to provide feedback on the project list. See also Item IV below.
- Enrollment growth: There are no new funds for this, so implementing new plans, once developed, will be difficult. Campuses with unfunded students face a particularly steep challenge. See also Item VI below.
- UC Care: Preliminary financial and enrollment data will be presented under item VII below.
- Total Remuneration: The Academic Council heard the report last month, and it contained no surprises: UC's competitive position in faculty remuneration has continued to erode over the past 5 years. See also Item IX below.

II. Consent Calendar

1. Draft Minutes of May 6, 2014
   Action: The minutes were approved as noticed.
2. Draft Minutes of June 3, 2014
   Action: The minutes were approved as amended.

III. Fiat Lux, UC's Captive Insurance Program

Cheryl Lloyd, Chief Risk Officer
Sherry Ricker, Captive Specialist
Issue: CRO Lloyd summarized the strategic goals of the Fiat Lux program: A captive insurance program allows a coordinated defense so as not to pit the Regents versus health care practitioners, and helps affiliates and non-employees in the health sciences by limiting medical malpractice premiums and payouts. Having a captive insurance program also expands the insurance market in which UC can operate: because the University account is so large, only specialty insurers can underwrite UC. As a result, UC has been doing business in overseas marketplaces, which do not always offer favorable terms. As a captive, UC can insure and re-insure itself; certain insurers only provide re-insurance, and so were barred from doing business with UC previously. For example, for medical malpractice, because UC now has a larger market, the continuation costs stayed at $5M, rather than rising to 7 or 10. Similarly, UC insures about $2B of its physical plant (not the entire 45B value), but even that requires a syndicate to handle the business. By joining the re-insurance market, UC has more options. UC will still have brokers, but will save in taxes and enjoy broader coverage.
Discussion: Members asked if re-insuring was a discrete business model, and Ms. Lloyd indicated yes, that is their only business. Members asked how the program was funded and how any reserves are treated. Ms. Ricker stated the Fiat Lux charges UC a premium, and then pays claims from that fund. This practice indemnifies the University from excessive cash payouts, and spreads UC's financial risk across different areas. The reserves are currently $26M, and are in STIP for now. Some of the reserves may be moved to TRIP, but federal Department of Insurance approval is needed for some transfers.
Action: UCPB looks forward to on-going updates on the program's finances.

IV. Consultation with the Office of the President – Budget

Patrick Lenz, Vice President

1. State funding
   Update: SB 872 contains the same language as the spring budget act, with the exception of Provision 6 for UC and Provision 7 for CSU. In those, each is given $50M for one-time purposes until June 30, 2016; if the state budget stabilizes, those funds can be moved to cover enrollment costs in the out-years. These funds come from the state's $389M in unanticipated revenue. Some language regarding triggers and revenue assumptions need to be clarified, but UC has been assured that the $50M is in addition to UC's 4% base budget increase.
2. Capital projects
   Update: AB 94 established a new state process (due to debt restructuring). There have been no General Obligation bonds since 2006, and it is unlikely that a GO bond for higher education will be on the November ballot given legislative and gubernatorial opposition, the presence of a "rainy day" initiative on the ballot, and the prospect of a water bond, too. Discussions of new projects are hampered by the need to complete projects already in the pipeline, most of which focus on seismic and fire/life safety concerns; there are only two new classroom buildings on the current list. Possible new projects are still being evaluated for system cost, campus match, and debt capacity implications. UC's list must be to the Department of Finance by September 1, who will pass their recommendations to legislative committees by April 1. It remains unclear how any cuts in expected state funding would impact this program, and given that final approval comes late (2014-15 projects were only approved by the state Department of Finance after the governor signed the final budget in June), the opportunity for meaningful evaluation of projects lists and other aspects of the program are minimal.
   Discussion: Members asked what projects were under consideration, and VP Lenz indicated he would share the list when it is ready. Members asked as to the disposition of 13-14 funds, and VP Lenz said they have been moving since December. The 14-15 projects were only approved

by the state over the summer, and UC is still planning how best to move those projects forward. Chair Senear noted that $130M of 13-14 and 14-15 projects are unfunded. VP Lenz indicated the first priorities for 15-16 will be to complete those projects, which was part of the 14-15 assumptions. The 15-16 plan aims to include $150M for new projects and $130M for continuing projects. Members asked what the cost of debt service is on $150M, and VP Lenz encouraged the committee to direct such questions to the finance office. Members asked if the $150M included campus matching funds, and VP Lenz said it was only the state supported portion. At the conclusion of the consultation with Patrick Lenz, it was also noted that there had been no prior proposal or notice that the program would be proposed for extension to 2015/16, and therefore, no Senate input on this decision vis-à-vis other possible uses for the funds. Chair Senear asked that the timeline for campus submission and OP consideration be moved forward to give time for meaningful Senate consultation.

3. Long-term financing

   Update: The governor's 5-4-4 budget proposal, together with no tuition increases, reflects Governor Brown's view of how UC should "live within its means" by reducing the cost of instruction to achieve a balanced operating budget. The governor's performance metrics remain problematic, and UC is asking for incentives, not just penalties, in the legislation. Both the Regents and President Napolitano have stated that UC quality will not be sacrificed. It is the President's intent to request of the Regents a 4-5% annual tuition increase to accomplish this. OP's long-term sustainability models indicate the need for a 5% tuition increase based upon the assumption of setting aside 1/3 for financial aid. If a tuition increase were only 4% instead of 5, there would have to be consequences, such as a lower set-aside for financial aid. Meanwhile, the legislature continues to call for greater access to complement the envisioned affordability. It does not appear possible to accomplish all these goals simultaneously.

   Discussion: Members asked if 4% annual tuition increases is a national trend, but VP Lenz could not say, noting that different return-to-aid practices complicate calculations. Council Vice Chair Gilly noted that North Carolina returns only 15% to aid, and VP Lenz indicated that UC's practice is to return 1/3 to aid. Smaller tuition increases could harm the neediest students by generating insufficient additional aid to fully cover the tuition increase for these students. Larger tuition increases add to the state's Cal Grant obligation. Members asked if attitudes toward UC were likely to change after the November election, but any guess is only speculation.

V. Consultation with Academic Senate Leadership

Bill Jacob, Academic Council Chair
Mary Gilly, Academic Council Vice Chair
**Note: Item occurred in executive session; other than action items, no notes were taken.*

VI. Enrollment Planning

Debbie Obley, Associate Vice President, Budget and Capital Planning
Todd Greenspan, Director, Academic Planning

1. Eligibility

   Issue: President Napolitano continues to press for an adequately funded budget. If one is achieved (4-5% both from the state and from tuition, annually) 1% enrollment growth is feasible, with Merced, the Riverside School of Medicine, and the Davis School of Nursing having priority. There would be about 1450 students left, both for undergraduate and graduate student growth, after these programs have taken their expected numbers of students. If funds are not received, campuses may be asked to decrease California enrollments to currently funded numbers of students. It is anticipated that a first draft plan should be available by September, which will give UCPB an opportunity to weigh in with our concerns.

Discussion: Members noted that because the unfunded students are not evenly distributed throughout the system, the budget impacts of purging unfunded students would be disproportionate. At some campuses, particularly Riverside, the impact on the operating budget would be drastic if the reduction in California residents outpaced their replacement by non-residents. Members noted that this effort to reduce California enrollments to budgeted levels for the good of the system could exacerbate the "tiering" of campuses: some limited largely to California residents who carry only the state's cost of instruction, while others could enroll large numbers of non-residents who also bring supplemental tuition. Members referred to the Senate Council's Implementation Task Force report that was sent to then President Yudof on Aug 2, 2011 and raised this concern among a list of others arising from the effect of enrollment management on rebenching. Noting that little or no progress has been made in the intervening three years on any of the issues enumerated in that report, AVP Obley and Director Greenspan were asked how the issues discussed therein are being addressed. AVP Obley indicated that stakeholders are now ready to continue those discussions, and Director Greenspan noted that shifting enrollment goals made direct responses difficult. Members added that international students do not have weighted GPAs or as much grade inflation, which complicates comparisons with domestic students.

Members also wondered how 1% growth would be allocated, should it be realized. On what basis could the campuses be persuaded to act in the system's best interest, not their local best interest? AVP Obley reminded the committee that 1% refers to total enrollment growth and noted that the campuses were asked to submit proposals that list their growth goals for each type of student. The campus plans account for more than 1% growth, particularly because of ambitious plans for graduate student growth. Members asked if the growth rates were in people or FTE, and Director Greenspan said that this, among other specifics, is still under discussion.

Finally, members noted that new SSGPDPs could further complicate the issue and have unintended consequences under rebenching. Similarly, the question of what to do when an existing program, such as the Anderson school, is converted from a state supported to self-supported program has not been resolved or even addressed at this point. Given current enrollments, the result of the Anderson School conversion at UCLA will be substantial underenrollment. Also undergoing further analysis are state projections for high school graduation rates; previous estimates have not accurately predicted the Hispanic/Latino rates.

2. <u>Cost of Instruction</u>

Issue: AVP Obley reported that the equation for calculating the cost of instruction remains under dispute. UC has dropped the NACUBO model in favor of a model developed at Berkeley. The Berkeley model still needs clarity regarding the Health Sciences Compensation Plan and what is included under the academic support umbrella. Of course, varying local (campus-level) accounting practices add another layer of complexity.

Discussion: Members asked why the NACUBO model was dropped, and Director Greenspan said that its categories were not nuanced enough for UC's needs. Some members suggested that the 10:1 ratio for health sciences is probably accurate, though. Member asked what issues still needed to be addressed to complete the calculation. AVP Obley responded that a number of outstanding questions involve what cost to include in the calculation, e.g., what fraction of financial aid, cost of libraries, museums, athletics, etc. It was indicated that UCPB opinions on these issues would be welcomed.

VII. UC Care Update

Dan Hare, Chair, University Committee on Faculty Welfare (UCFW)

Update: Chair Hare reported information given his committee's Health Care Task Force (HCTF) on June 23: Financial data from the first quarter were reported; these data are incomplete because billing and payment practices can sometimes lag up to ninety days. The plan's demographic analysis suggests the enrolled population is both older and less healthy than anticipated. As a result, this year's premiums are insufficient to cover the costs of this self-insured program. Consequently, next year's premiums will likely increase more than other plans'. If UC Care incurs an operating deficit, shortfalls will be paid from UC's general budget, and premiums would increase still further in subsequent years.

Discussion: Members asked whether the intent was to increase next year's premiums only as necessary to meet next year's plan costs or also to cover this year's deficit carryforward. Chair Hare indicated his understanding was the latter. Members asked how the demographic profile of UC Care compared against the discontinued plan's profile. Chair Hare said that such information was not presented; data available compare UC's total population with the UC Care enrolled population only; he added that more migrations from HealthNet were expected, but not realized.

Members asked what discount UC's medical centers (UCMCs) gave UC Care. Chair Hare indicated the rate is about 15%, and that non-UC medical centers do not have enough UC employee patient volume to offer similar discounts. -It was necessary to offer a higher reimbursement rate to convince Sansum, the local provider group in Santa Barbara, to join UC Care. This higher rate structure increased costs to the system by about $1M and is expected to continue. In fact, no new providers are expected in the preferred tier for 2015, although some accountable care organizations (ACOs) may try partnering in the UCLA medical center service areas. One change under consideration, as suggested by UC Care external consultant Dr. Lisa Latts, is an expansion of wellness programs to entice a younger/healthier population to enroll in the plan, but HCTF members are dubious that such actions would yield the desired results. Additional plan design changes might include progressive premiums for older participants.

Because UC's contribution toward employee premiums is based on a single baseline, a larger than average percentage increase in the total UC Care premium will be passed on directly to the employees. As a consequence, this fall's open enrollment outcomes will be telling for UC Care. Higher than average increases in employee premium contributions, coupled with possible plan deficits that would further increase premiums and a low enrollment rate could be the early signs of a "death spiral". If, on the other hand, the plan runs a surplus, a 4% target has been set for reserves. Plan sponsors think UC Care could be monetized by offering it to other California employers, but it would need to be proven cost effective internally first. Unfortunately, the goals of ACOs and of UC Care are not necessarily parallel; UCMC business practices are not uniform; and the plan design – e.g., self referrals – does not encourage saving money programmatically. At this time, there is no intent to request outside competitive bids for PPO-type health care delivery. It was noted that it will become increasingly difficult to assess whether UC Care is cost competitive as more time goes by without any external bidding.

Finally, members asked for the results of the health care satisfaction survey conducted by human resources over the summer. Chair Hare replied that the response rate was 26%, but that content summaries are not yet available.

VIII. Consultation with Chief Investment Officer

Jagdeep Bachher, Chief Investment Officer
Steve Sterman, Senior Portfolio Manager

1. CIO Portfolio and Office Overview

   Update: CIO Bachher reported that his office manages $90B in assets: UCRP funds of $52B, defined contribution assets of $15B, working capital (STIP/TRIP) of $15B, and the University endowment of $8B. Last fiscal year, returns were strong: UCRP saw 17%, the endowment 18%, TRIP 14%, and STIP 1.5%. After four months on the job, CIO Bachher is examining his office's efficiency and profile. Short term goals include more broadly collaborating with the university community and improving recruitments and office culture. New roles for the office might include expanding management of some asset classes; currently, the office only manages fixed income in-house, while paying external fund managers ~$600M annually.

Discussion: Members asked how much similar institutions spend on external fund managers, and CIO Bachher said that typically, UCRP pays 80 basis points while other DB plans pay 150 BPs, and the endowment pays 160. Lowering the rates to 70 and 130 could save UC significant funds, and the best way to manage all asset classes is under investigation.

2. Divestment/Responsible Investment

   Issue: CIO Bachher reminded members that the Regents have formed a task force to investigate possible fossil fuel divestment. The task force has five goals: 1) to assess UC's financial exposure, which includes determining the degrees of separation necessary for investments to be considered "clean"; 2) to develop a new frame for investments, especially given President Napolitano's goal to have UC be carbon neutral by 2025 and wide calls for responsible investing; 3) to develop a path toward implementation, including talent management and technical capacity; 4) to develop a new investment strategy that is sustainable and socially responsible, matching UC's service mission; and 5) to explore other, less draconian, efforts that could advance the same goals and be applied in multiple areas of university activity. The task force is expected to give recommendations to the Regents in September.

   Discussion: Members asked if it would be possible to preview the recommendations, and Mr. Bachher responded that a conference call could be scheduled after the task force has completed more of its charge. Members noted that it is wise to let the CIO make investment decisions, but noted that "slippery slope" concerns should not be taken lightly. Members also wondered how well decision-makers could withstand on-going and new pressure from students and other stakeholder groups on this and other areas. Mr. Bachher agreed, noting that his desire is to develop a holistic approach. Members asked if there are external guides to help define the limits of fossil fuel divestment, and Mr. Bachher said no, and that it is better to set one's own standards in these areas. Members speculated what lessons had been learned from previous divestments, and how they can be applied going forward.

3. Venture Capital Investments

   Issue: President Naplitano's rescission of "Guideline 13" has paved the way for UC to invest directly in faculty start-ups, and those decisions may be guided or informed by a recently empanelled external innovation council comprised of prominent California venture capitalists. The council will meet for the first time August 13. The CIO office has a long history of investing in venture capital projects through third party managers. UC has also taken royalties as a form of payment, and now it has the option to take equity. The goal of the rescission is to leverage inevitable commercial success, without the middle man. What is envisioned is a separate entity, comprising a limited fraction of investment funds and with a firewall separating it from normal management. Stanford can serve as a model that illustrates how this program would work while remaining at arm's length from the CIO office.

   Discussion: Members agreed that it would be best to keep any direct investment program firewalled from the CIO office and other university actors. They added that academic freedom concerns should be part of the discussion, not just potential revenues: the rights of students and faculty must be protected from pressure to pursue proprietary research projects. Members also questioned the wisdom of limiting to UC startups and wondered whether any advantage would accrue, and if so whether this would raise issues of conflict of interest with faculty

researchers. Mr. Bachher described a potential investment strategy in which the university would maintain its fractional ownership of an original equity stake in a startup, as that startup moved through successive rounds of capitalization via equity offerings. In this way, the external venture capital market would help to vet individual projects.
Action: Discussion of academic freedom considerations will continue off-line.

IX. Total Remuneration Update

Dan Hare, UCFW Chair
Susan Carlson, Vice Provost, Academic Personnel
Janet Lockwood, Manager, Academic Policy and Compensation
Jim Chalfant, Faculty Representative to Steering Committee

Issue: The study was designed to parallel as closely as possible the 2009 Total Remuneration study. To that end, the same external consultant was used and the methodology was as similar as possible. The results indicating erosion in UC's competitive remuneration position was not surprising to many stakeholders, but the challenges of how to address the problems illuminated and of how to convince reluctant administrators to take action remain.

Discussion: Members discussed whether the salary scales should be retained, and if so, how they could be fixed. Many faculty are dedicated to the scales and the philosophy they represent, but many administrators want more flexibility for recruitment and retention. Recruitment and retention will become more difficult given the significant gap in assistant professor remuneration. Members also felt that the salary scales help to engender loyalty in the faculty ranks. It was noted that UC's competitors are the private institutions, but that UC has only average public institution remuneration. The cost to "fix" the scales is estimated to be $140M.

Members noted that the value of UC's benefits no longer off-sets low cash compensation. The fourth tier for health care premiums also skews the value of benefits, and the value of retiree health should not be overestimated: despite being significantly above market, it only accounts for 2% of total remuneration and will drop. Offering new employees the choice between UCRP and a defined contribution plan would not incentivize loyalty or save UC any money; the lessons learned during the 2010 PEB process may need to be revisited. UC should not strive to mirror the market, but should be exceptional in order to maintain its excellence.

X. New Business

None.

Meeting adjourned at 4:15.

Minutes prepared by Kenneth Feer, Principal Policy Analyst
Attest: Don Senear, UCPB Chair