UNIVERSITY OF CALIFORNIA, ACADEMIC SENATE

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Chair of the Assembly of the Academic Senate
Faculty Representative to the Regents
University of California
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August 8, 2019

JANET NAPOLITANO, PRESIDENT
UNIVERSITY OF CALIFORNIA

RE: Response to 2019 Proposal to Adopt Segal Recommendations

Dear Janet,

The Academic Council has endorsed the attached letter from the UCFW Task Force on Investment and Retirement (TFIR), in support of recommendations made by Segal Consulting and UCOP for addressing revised actuarial assumptions for the UCRP liability through a 2% ramp-up of the UCRP employer contribution rate over four years.

Council urges the University to implement the UCOP plan presented at the July Regents meeting, rather than erode employee compensation by increasing their contribution rates.

Council also requests that the TIFR report be shared with the Regents, so that they are fully apprised of the supporting view of the Academic Senate.

Please do not hesitate to contact me if you have additional questions.

Sincerely,

Robert C. May, Chair
Academic Council

Encl:

cc: UCFW-TFIR Chair Brownstone
Academic Council
Senate Directors

TFIR Response to 2019 Proposal to Adopt Segal Recommendations

August 8, 2019

The Academic Senate Task Force on Investments and Retirement (TFIR) has reviewed the proposals made by Segal to update the assumptions used to estimate the UCRS pension liabilities and UCOP's proposal to increase the employer contribution by 2% spread over 4 years beginning July 1, 2020. Segal has presented their methodology and justifications for their recommendations at 3 meetings of the Task Force on Investments and Retirements and at the recent June meeting of the UCRS Advisory Board. There is general agreement that the changes Segal has implemented are appropriate. We therefore strongly urge the UC Regent's to adopt the changes recommended by Segal and UCOP.

The Plan had been on a path to being over 90% funded by 2024 as a result of following Segal's recommendations in the last study. This was achieved by generally paying the full Actuarially Defined Contribution (ADC) each year to cover both the estimated pension liabilities for current employees (the normal cost) and to gradually reduce the unfunded accrued liability. TFIR shares the Regents' dismay at the significant increase in both the normal cost and the unfunded accrued liability that results from the reduction in the assumed inflation rate (from 3% to 2.75%) and the investment return rate (from 7.25% to 7%), and the increase in the anticipated life expectancy of beneficiaries. The changes in these assumptions increased ADC by 4.62% of payroll. Normal costs increased by 1.81% of payroll and Unfunded Actuarial Accrued Liability (UAAL) amortization rate increased by 2.81% of payroll.

UCOP's recommended 2% increase in the employer contribution spread over 4 years beginning next year is an appropriately measured response to the new estimates. This will more than cover the estimated increase in normal costs, which will ensure the plan does not go deeper into the red. TFIR supports a policy of continued borrowing to reduce UAAL.

TFIR commends Segal for the new, dynamic approach in estimating the anticipated life expectancies of beneficiaries. The new dynamic approach anticipates life expectancies will continue to increase at the historic rate. The change in anticipated life expectancies is responsible for 2/3 of the increases in normal costs and ½ the total increase in UAAL. The new dynamic approach should ensure this increase in estimated cost is a one-time adjustment since future increases in life expectancies have already been taken into account. TFIR also supports Segal's recommendation to change the assumed rate of return only gradually---no further than the .25% reduction they recommend. Although the recommended 2.75% inflation rate is above recent national inflation, it is below the California urban inflation index used to compute cost of living increases for UC pensions (currently about 3%). The implied 4.25% real rate of return on pension investments could have been achieved by investing the assets in worldwide equities and bonds over the last 40 - 50 years, so it is not implausible that these returns can be achieved in the future.

In addition to suggesting increased employer contributions, some Regents have suggested increasing employee contributions beyond their current 8% level. We strongly recommend against increasing employee contributions because: 1) in the short-term it will have a devastating effect on employee take-home pay, particularly for the least well-paid employees, 2) in the long-term it either will not save the University any money because it will be offset by an increase in compensation, or we will lose faculty and staff because our compensation is even less competitive.

Suppose the employee contribution is increased one percent. Since employees in the defined benefit plan[1] get no additional benefit (their pension benefits are not changed at all because of the increase), this is identical to imposing a one percent pay cut. The reduction in take-home pay would be greater. After deductions for social security, Medicare, UCRP, and federal and state income taxes, the take-home pay of the average employee is around 60% of their salary. A one percent pay cut translates into approximately a 1.2% decrease in take home pay. This decrease would hit the least well-paid employees the hardest because they can already barely make ends meet. The effect would be particularly regressive for employees in the 2016 Tier because employees with salaries below the PEPRA cap would have a one percent cut in their total salary while employees with salaries above the PEPRA would have a one percent cut in their salary up to the cap.

Unless this is matched by a pay increase faculty and staff who can get outside offers may leave the University. Note that due to taxes an approximately 1.2% increase in pay would be required to keep employees' take home pay constant, so increasing employee contributions would cost more than increasing employer contributions. It may seem implausible that anyone would change jobs over a 1% increase in employee contributions, but to the employee far from retirement, this would be understood to be permanent and to represent a significant reduction in compensation, accrued over time. Unfortunately the faculty and staff most likely to leave are precisely the ones the University most needs to increase the diversity of our faculty and maintain our quality - high achieving mid-career employees with proven records and promise.

Increasing the employee contribution also causes problems for those employees who have already chosen the defined benefit option over the defined contribution option. They likely assumed that the employee contributions would remain constant, and would feel they have been misled, while new employees seeing the unexpected increase in these contributions would then more likely choose the defined contribution plan. As is well known, such employees are on average more likely to respond to outside offers, without the retention benefits the University derives from the defined benefit plan. This generates inequities between those who choose different plans and also between represented and non-represented groups since the former may be able to delay or mitigate the employee contribution increase through bargaining. All of this hurts employee morale and further contributes to problems with recruiting and retention.

[1] Note that for employees in the defined contribution plan the increase in employee contributions is offset by their increased savings. IRS rules require the same employee contribution rate to both the defined benefit and defined contribution plans. Therefore increasing employee contributions favors those who chose the defined contribution plan.

Finally we stress that pension contributions are part of total compensation. UC has made progress in reducing the wage gap with our competitors, but increasing employee contributions for no increase in benefits will just move us back in the wrong direction. We therefore urge adoption of the Segal proposals, and also continuing our efforts to get additional state support for reducing our unfunded pension liabilities. The Segal proposal is sound and has been carefully reviewed. It represents the best feasible tradeoff between funding our critical core activities and ensuring the stability of our pension system. If the Regents feel that the proposed increased employer contributions are too detrimental to current budgets, TFIR would accept a plan to increase the amount contributed through borrowing from STIP or other sources, but our main message is that it is a false economy to imagine that the University will be better off attempting to shift some of these costs to employees.