UNIVERSITY OF CALIFORNIA ACADEMIC SENATE

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To: **Members of the Academic Senate**

From: **John Oakley, Chair, Academic Council**

Date: **May 25, 2006**

Re: **Academic Council Memorandum on the Resumption of Contributions to the University of California Retirement Plan**

The purpose of this memorandum is to provide Senate members with information about plans to resume contributions to the UC Retirement Plan (UCRP) in July 2007, and to make them aware of the role played by representatives of the Academic Senate in making this decision.

UC's Retirement Plan is one of the most valuable rewards of working at UC. UCRP is a "Defined-Benefit Plan," in that it promises to pay employees a fixed percentage of a defined base salary after they retire. For UCRP, this base is referred to as the HAPC, which is the Highest Average Plan Compensation over a consecutive 36-month period. Not all forms of compensation qualify as "Plan Compensation." For example, summer salary is excluded. In addition, there are inflation-indexed IRS limits that, as of January 1, 2006, limit total qualifying plan compensation to $220,000 and that cap the annual pension payable by a defined-benefit plan at $175,000.

Like other Defined Benefit Plans, UCRP is required to maintain a pool of assets sufficient to meet the liabilities to current and future retirees that it accumulates over time. Until 1991, UC employees contributed varying amounts, which when contributions ceased were set at 2% of their pay up to the Social Security wage base and 4% above the Social Security wage base, less $19 per month. UC paid the rest.

Both UC and employee contributions to UCRP were suspended in 1991 because strong investment returns during the 1980s had increased the value of UCRP assets faster than the plan was accruing liabilities for future pension benefits, leading to a significant "overfunding" of the plan. Thanks to the bull market of the 1990s, that situation persisted until relatively recently (around 2000) when the downward slope of UCRP assets versus funding obligations took on a steeper descent. As a result, during this period, UC, its employees, and the taxpayers of the State of California have enjoyed an apparently "free" retirement pension plan. However, it was always anticipated that it would be necessary to resume contributions in the future when accrued liabilities of the plan equaled or exceeded assets. That day is close at hand.

Representatives of the Academic Senate and of the Office of the President meet regularly through a number of Senate committees, of which the most relevant to the UC Retirement Plan are the University Committee on Faculty Welfare (UCFW), and UCFW's Task Force on Investment and Retirement (TFIR). Both the Senate and the Office of the President have been sensitive to this increasing drawdown in the UCRP surplus for several years. It has been clear for some time that contributions to UCRP would soon have to be resumed to maintain viability of the retirement plan. Under normal circumstances, pension funds require continuous contributions, and both UCFW and the Office of the President agree that UCRP is now returning to the normal situation. It would be irresponsible to allow UCRP to fall significantly below 100% funded status. The Regents have adopted a mandate that UCRP's funded status be maintained in a "corridor" between 95% and 110%.

With the support of the Academic Senate, The Regents voted in March 2006 to reinstate contributions to UCRP as of July 2007. This Regental action does not specify the amount or source of these contributions. At the May Regents' meeting, just completed, The Regents took no further action on the reinstatement of contributions, in essence deferring action until the July Regents' meeting. The details of any reinstatement are subject to funding, the budget process, and collective bargaining requirements. Many represented employees work under contracts that do not expire until 2008. Contributions cannot be required of these employees in 2007 without their unions' agreement.

The actuarial "normal cost"[1] of retirement benefits that UC employees accrue every year of service is currently estimated at 16% of their covered compensation. Over time, it is anticipated that the sum of UC and employee contributions to UCRP will increase to cover the full 16% cost of accruing benefits. This "normal cost" means that continuation of the full-funded status of the plan requires that in any given year which begins with the plan funded at 100%, contributions to the plan must equal 16% of payroll *and* the plan's assets must earn a 7.5% rate of return in order for the plan to remain 100% funded at the end of that year.

Starting contributions in July 2007 allows them to be ramped up slowly – what the Office of the President and The Regents have called a "soft landing" – rather than suddenly jumping from 0% to 16% of covered compensation. If, as some stakeholders have advocated, any reinstatement of contributions were deferred until the funded status of UCRP drops to 100%, the result would be catastrophic. UC's annual payroll is $7 billion. Suddenly, about $1 billion per year in new money would have to be found solely to maintain UCRP's full-funded status, and even more if the long-term expected return on investments of 7.5% was not achieved in the prior year. And any shortfall in the needed contributions would only compound the amount needed to be contributed the following year.

Since suspension of contributions in 1991, the 2%/4% amount that employees then contributed to UCRP has been "redirected" to a Direct-Contribution plan (DC plan), which accumulates additional retirement assets in the personal account of each employee. Once employee contributions to UCRP are reinstated, it is anticipated as a first step that these funds will no longer be redirected into the DC plan, but instead will be contributed to UCRP, and will be matched by an equal contribution by

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[1] The normal cost of the plan is the percentage of covered compensation that would have to be contributed each year in steady state in order to fund the benefit, given actuarial assumptions about factors such as employee retirement decisions, separations, life expectancy, future salary increases, inflation and investment returns.

the University. Employee take-home pay would not be reduced by this redirection of contributions. However, since this contribution would no longer accrue to the personal benefit of individual employees, it would reduce the value of the benefits provided to UC employees as part of their total compensation.

A major decision that lies before us is how the cost of the retirement plan will be shared between UC and its employees. Two important factors that will affect cost-sharing determinations are that for represented employees, reinstatement of contributions to UCRP is subject to the collective bargaining process, and for UC, funding of contributions without impairment of our educational mission depends on appropriations made by the state legislature. The Academic Senate will continue to engage the Office of the President on this important question.

A major concern of the Academic Senate, as well as The Regents and the Office of the President, is maintaining UC's ability to compete for the best employees. Consultants to The Regents have informed us that salaries paid to UC faculty and other employees are 10-15% behind those paid at comparable institutions, but the value of our fringe benefits is substantially greater than that of those at comparable institutions. The Academic Senate has taken a strong position that if any benefits are changed, there must be no deterioration in UC's competitive position in total remuneration. If a benefit is reduced, or additional employee contributions are required, additional cash compensation must be provided equivalent to the reduction in the value of the benefit or cost of the additional contribution required. In continuing consultations with representatives of the Office of the President, the Senate has repeatedly urged that the amount of any resumption of UC employees' contributions to UCRP be matched by an equal or greater increase in salaries. These salary increases need to be in addition to the increases needed to keep up with salary increases at competing institutions. Otherwise, UC's competitive position will suffer as a result of resumption of contributions to UCRP.

In November 2005, The Regents committed themselves to the goal of raising UC salaries to levels paid by our comparison institutions within the next ten years. In pursuit of this goal, The Regents hope to spread a series of "catch-up" pay increases over the same period of years in which contributions to UCRP will be on the rise. As with contributions to UCRP, The Regents' planned "catch-up" pay increases are subject to collective bargaining, for some employees, and to the vagaries of the state budgetary process, for all of us. The Academic Senate is very concerned that the "catch-up" increases indeed materialize so that resumption of contributions to UCRP will not reduce overall remuneration of employees or damage the University's competitive position. It will continue to advance this position as implementation of the resumption of contributions to UCRP goes forward.

We anticipate that employee unions will bargain over the level of employee contributions to the UCRP. UCFW and the Academic Council have informed the Office of the President that it is essential that the total (employer plus employee) contributions going into the plan be the same percentage of covered compensation for each employee. Otherwise, represented employees making reduced contributions for the same UCRP benefits would be subsidized by the higher contributions of non-represented employees, which would be unacceptable.