

Letter from the Chair

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Last week I attended a luncheon meeting of the UCSC Emeriti Association, and the speaker, a young Associate Professor, said that he was very happy to be there in part as he was looking forward to eventually joining this Emeriti group after he retired. This started me to reflect on what it means now for me to be an emeritus of the University of California, and what will be his experience in 30 or more years. Unfortunately these musings introduce a far larger set of issues than I have any hope to cover in this letter. Instead I will provide some comments about changes presently considered that may greatly affect Emeriti in the future.



New Pension Tier

As Emeriti and Retirees may have heard there is likely to be a new pension Tier for UC employees hired after July 1, 2016. This is the result of the budget negotiations between UC President Napolitano and Governor Brown, whereby the University agreed to start the new Tier in exchange for a \$436 million State payment (spread over three years) toward the unfunded liability of State funded UC employees. UC will be able to leverage this payment with medical center and grant supported units to allow a substantial payment of about \$1.5 billion toward the unfunded liability of UCRS. However the net unfunded Actuarial liability for UCRS stood at \$12.3 billion on July 1, 2014, which is the difference between the Actuarial Value of Assets (\$48.3 billion) and the Actuarial Accrued Liability (\$60.4 billion). The Funding ratio is the ratio of the Actuarial Value of Assets to the Actuarial Accrued Liability - valued at 80% in 2014. If the \$1.5 billion is assumed to directly apply to the Actuarial liability (perhaps a questionable assumption) it appears that the University will be able to increase the funding ratio by about 2.5% to greater than 82%. The 2015 valuations should be available in November 2015, and this will allow a better assessment of the likely increase in the funding ratio due to the welcome State funds.

However the State contribution to UCRS comes with a cost! New employees must be offered either an income capped Defined Benefit (DB) plan or a Defined Contribution (DC) plan. A big change from the present DB plan is that the maximum payment cannot exceed the PEPRA limit (the Public Employees Pension Reform Act limit). This limit is essentially the social security wage base, and is about \$118,000 per year. The DC plan may yield retirement income in excess of the PEPRA limit but, unlike DB plans, DC plans place the investment risk on the employee and not the employer. Clearly a DB plan will cover the pension needs of many UC employees, but the problem comes for many if not most Emeriti who have pensions greater than the PEPRA limit. Under the new tier the DB pensions for such higher income people might be augmented with a supplementary DC plan.

The attractiveness of a DC plan depends greatly on the investment yield and assumptions about the salary growth rate. If the investment yield is greater than 7.5% (the value assumed until now for

UCRS) then a DC plan will yield excellent pension payments. However the ten-year annualized return for UCRS investments was only 6.3% on June 30, 2015. Depending on who manages DC funds the investment yield will vary. Employees contributing to a DC plan may find their returns will be greatly influenced by the risks taken with their funds. I have written a simple Excel spreadsheet to model the attractiveness of DC plans. The model includes investment returns, growth rate of salary and pensions, years of employment, desired years and amount of payout, and fraction of salary used to fund the plan. I will send a copy to interested persons if you write to me at anderso@ucsc.edu. Please put "Defined Contribution" as the subject.

I believe that the availability of an attractive DC plan will have significance for recruitment and retention. Prospective faculty members are likely to choose a DC plan if they think that they will want to move to another Institution. Such faculty may seek a better research or living environment, and the portability of a DC plan will fit better with plans for moving. Other faculty may choose a DC plan because they are worried about the fact that UC will have made two significant changes in its pension plans in a three-year period. When will the next change occur?

Financing of UC pension plans

For the past few years UCRS has been funded with employee and employer contributions, borrowing from STIP funds, and now by direct infusion of State funds. However the Regent's budget (Fall 2015) certainly cited the necessity of using some tuition increases to shore up UCRS. But the tuition increases are now off the table for two years, although this money would provide a more or less balanced method to cover pension shortfalls of the general campuses. But a major source of UC funds is now non-resident tuition. Just for the 2015 incoming freshmen this non-resident tuition might reach \$286 million. However the distribution of these funds is rather uneven with some campuses collecting twice or more money per freshman as other campuses. Such non-resident moneys are not going to be a reliable source of pension funds.

Retiree Health

For 2016, insurance plans are unchanged, but there is no information about the rates. However, coverage for high priced drugs is likely to drive higher premiums for the self-insured plans. There is a continuing discussion about prefunding retiree health care, and such prefunding would eliminate the present pay-as-you-go funding of retiree health. There are also continuing discussions about the establishment of a UC Care HMO plan, but as yet no plans have been published. Possibly more information may become available in the upcoming weeks prior to the beginning of Open Enrollment.