THE UC RETIREMENT PLAN:

A COMMENTARY ON ITS CURRENT STATUS

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The current economic crisis has caused retirees of the University of California Retirement Plan (UCRP) to question its stability and long term viability. While there is no apparent danger of any current retiree or member of the plan suffering a loss or reduction in benefits, it is clear the Trustees of the UCRP, the Board of Regents, will be making changes, particularly in terms of member and University contributions. This article will describe the current financial status of UCRP, some of the issues the Regents and the University will need to address to ensure its future, and the implications for UC retirees.

Since the early 1990s, the UCRP has been contribution free to both the University and plan members. This 18-year "contribution holiday" is a result of strong investment returns that resulted in an over-funded plan and a desire on the part of the University to use funds that would normally be contributed to the UCRP to be utilized for other purposes. In 1991 the UCRP was 150% funded with an actuarial value of assets of $12.9 billion and actuarial accrued liabilities of $8.6 billion. At the end of last fiscal year, June 30, 2008, the plan was still over-funded with actuarial assets of $43.8 billion and actuarial accrued liabilities of $42.6 billion or a funded ratio of 103%. During the "contribution holiday," plan assets were used to pay retiree benefits as well as costs associated with three early retirement plans and seven Capital Accumulation Payments (distribution of a portion of surplus plan assets to members).

The market value of the UCRP on June 30, 2008 was $42.0 billion, down 5.6 % from the June 30, 2007 balance. The variance in the market value of assets and the actuarial value of assets is the result of a smoothing methodology employed by the actuary to remove short term fluctuations in market value to produce a more even pattern of contributions. This is a commonly accepted practice in defined benefit retirement plans.

As of October 31, 2008 the UCRP market value of assets had declined to $31.74 billion or a loss of 22.70% for the current fiscal year. However, the actual impact of the current economic situation will not be known until the end of the current fiscal year and the June 30, 2009 actuarial study is completed in the fall of 2009. It is important to understand that the market value of assets is just one piece of a complex actuarial picture. As I will explain in more detail, public pension plans such as the UCRP do not use market value of assets to calculate contribution rates. Other variables, such as inflation, disability termination, mortality, and salary rates may to some extent offset negative investment returns.

So, what does all of this mean to those of us who are current retirees and can we expect any changes in the future? First, the funds held by the Trustees, the Board of Regents, are in trust for the benefit of the members of the plan. With over $30 billion of current assets there is every assurance that all of us and our beneficiaries will continue to enjoy the monthly deposits to our bank accounts. Benefits provided by UCRP are not affected by gains or losses in plan assets. UCRP is required to pay out vested benefits according to the established formula (generally based on age, service credit and salary) regardless of investment returns. Under Federal law, the assets of the plan can only be used for the exclusive benefit of Plan members, retirees, beneficiaries and plan administrative expenses. UCRP invests for the long term and short term ups and downs are expected, even as dramatic as the current downturn. Over the long haul, the UCRP has had very good investment results and we all benefited from those results over the eighteen years of zero contributions, early retirement incentives, capital accumulation distributions and cost of living adjustments to our retirement benefits. As a retiree I am very optimistic about the future of the UCRP and have every confidence that current and future retirees and beneficiaries will receive their hard earned pensions.

What about the future of UCRP? When the Regents approved the cessation of contributions to the UCRP it was assumed contributions would restart at some point in the future. The mandatory 2-4%

contributions by faculty and staff into a defined contribution plan were in part designed to soften the effect of restarting contribution to the UCRP when necessary. Given the sizable increases in faculty and staff over the last decade and a half, it is a tribute to the investment success and the efficiency of the plan administration that the contribution holiday has lasted this long. At the end of the 1991-92 fiscal year there were 92,479 active and 15,058 inactive members of the UCRP and by the end of the 2006-07 fiscal year the number had grown to 118,885 active and 59,056 inactive members. Anyone hired over the last eighteen years has the benefits of the retirement plan without making a contribution. In a recent memorandum to UC faculty and staff, President Mark Yudof noted that, "nearly 80% of the current UC workforce had not contributed a single dollar to their individual UCRP accounts from which their future guaranteed benefit payments will be drawn." President Yudof went on to state, "At the same time it is clear there are many long-term challenges regarding UCRP, and it is critical that we continue to evaluate options for achieving two equally important goals: keeping the Plan financially sound and offering retirement benefits that help to attract and retain the caliper of personnel needed to maintain UC's quality and competiveness."

As early as the late nineties there was consideration of restarting contributions to the retirement plan. Although the plan was still over-funded by a significant margin, it was believed prudent to put a plan in place to deal with the inevitable need to contribute. In particular, it would be better to initiate such a plan in good times, when salaries were rising, rather than trying to implement it when it became a necessity and times might not be so good – like the current time. However, there was little support for such an approach because it would require the allocation of state and other resources from program needs at a time when the university was increasing enrollments. That plan, similar to what is now being proposed, would have redirected the contributions from the defined contribution plan into the defined benefit plan and over time ramped up both the employee and employer contributions to meet the normal cost of the plan. The "normal cost" of the plan is defined as the cost allocated under the Actuarial Cost Method to each year of active member service. For the 2009-2010 fiscal year, the actuary has calculated a normal cost of 16.91% of the payroll of plan members but recommended a contribution rate of 11.61%. The lower rate reflects the fact that the plan had a surplus in the 2007-2008 fiscal year, the year utilized for the actuarial study, and that the surplus be amortized to reduce the normal cost for the 2009-2010 fiscal year.

In March of 2006, the Regents approved several changes intended to ensure UCRP's long term financial stability. Those changes included a targeted funding level of 100% over the long term, University and member contributions at rates necessary to maintain that 100% level with a range of 95 to 110% and a multi-year contribution strategy under which contributions rates will increase gradually over time to meet the normal cost (at the time 16%.) The Regents also advocated but delayed restarting contributions in fiscal 2007-2008 because of funding and collective bargaining considerations.

At its November 2008 meeting, the Board of Regents received the report of the University's actuary which recommended the restart of contributions in 2009- 2010. The Board accepted the report but deferred any action until a future meeting. It is assumed that sometime in the near future the Board will take action to resume both employee and employer contributions in 2009-2010. It is my assumption that the restart of contributions will be ramped up over time with the initial employee contributions coming from a redirection of mandatory contributions now going into the UC Defined Contribution Plan. I also assume that the contribution approach will be a sharing of contributions between the employee and the University similar to what was done in the past and the current practice with Cal PERS. President Yudof in his recent communication with UC faculty and staff indicated that before any action was taken there would be extensive consultation with members of the University Community including the Academic Council, the campuses and medical centers, emeriti and retirees, and the unions. Obviously, the restart of contributions will have an impact on the University's many fund sources including the State of California budget, the UC medical centers, self supporting entities like food service and housing and our federal and private contracts and grants. Given the current economic times this presents a significant challenge for the University but one that must be faced.

A few comments are in order concerning the fiduciary responsibility for the UCRP. As many of you are aware, there has been an attempt to take away from the Board of Regents the fiduciary responsibility for the retirement plan. The University has had a retirement plan since 1904 with the current UCRP established in 1961. Over the years the plan evolved to include provisions for basic retirement with four payment options, disability benefits, death benefits, pre-retirement survivor benefits and annual adjustments in the cost of living for retirees. The UCRP is a governmental defined benefit plan established and maintained under section 401(a) of the Internal Revenue Code. As mentioned above, plan assets can be used only for the exclusive benefit of Plan members, retirees, beneficiaries and plan administrative expenses. The Regents are the plan fiduciaries and have oversight responsibility for UCRP investment policy and administrative functions. In California public retirement systems are governed by the California Pension Protection Act of 1992 (proposition 162) which amended the California Constitution, Section Four, Section 17 of Article XVI. This act was passed by public referendum with the intent of preventing politicians from "meddling in or looting pension funds." The makeup of most California public retirement or pension system boards includes members that represent constituencies of plan members such as the police, firefighters, municipal employee and retirees. The above cited act prohibits the legislature (or other legislative body) from changing or amending the composition of such boards unless ratified by a majority vote of the electors.

The University enjoys constitutional autonomy and in establishing its own pension plan determined that the plan fiduciaries would be the Regents. In meeting its responsibility, the Regents look to the University Administration to carry out the day-to-day operations of the retirement plan and the Treasurer of the University to invest the assets under policies and oversight of the Board. The Board is also informed by the University of California Retirement Plan Advisory Board, whose members represent a number of constituencies including the Academic Senate, elected non-senate members, retirees, the treasurer and university administrators. The role of the Advisory Board is to develop ideas or new approaches to the provisions of UCRP benefits and to discuss concerns relating to all members, participants and their beneficiaries.

In February 2007 a bill, ACA 5, was introduced in the California Assembly to amend Article IX of the Constitution of California relating to the University by adding a Section 10 concerning the retirement and health benefits. The Legislative Counsel's Digest regarding the bill states the following: "This measure would create a board of trustees to govern the provisions of the retirement plan benefits to employees or retirees of the University of California and any trust or similar arrangement established by the University of California to fund post employment health benefits. The measure would prescribe the composition of the board of trustees. The measure would require that meetings of the boards of trustees be public, subject to exceptions and notice requirements that by statute apply to meetings of the Regents of the University of California. The measure would specify that other constitutional provisions relating to the retirement boards of public pension systems apply to the board of trustees. The measure would also provide that retirement plan benefits, and post employment benefit programs would also be subject to requirement enacted by the statue."

The resolution mandated a thirteen-member board of trustees including three members appointed by the Regents, three ex officio members (the Lieutenant Governor, the Speaker of the assembly, the Superintendent of Public Instruction), an elected retiree, three elected active faculty or staff members, one elected academic senate member, one elected nonacademic member and one elected representative of collective bargaining units. So what is wrong with this picture? For starters it seems that this approach would indeed throw the retirement system into the political arena, with a majority of the board potentially having conflicts of interest as either beneficiaries of the system or because of political considerations. Second, the results of the current UCRP under the auspices of the Regents have had unprecedented results with more than twenty years of over funding and a contribution free system for eighteen of those years. This has been achieved at a very low cost in plan administration and investment expenses. A new board would have to set up an extensive administrative structure and investment team to manage the billions of dollars of assets. This is already being done efficiently by the current UC structure. Third, the UCRP has been instrumental in UC's success in recruiting and retaining the very best faculty and staff. Fourth, the faculty and staff do have a voice in the retirement plan through the University of California Retirement Plan Advisory Board which the University is proposing be changed to include a union represented employee. Finally, the University is a constitutional entity by design and has enjoyed great success as a result. The removal of the UCRP from the control of the Regents can only be a first step in potential future erosion of UC's autonomy.

ACA5 was passed out of committee in the state Assembly, but there were not sufficient votes to bring it to a vote before the full Assembly. With the University apparently moving ahead to add an additional person to the UCRP Advisory Board representing organized labor, it is hopeful that this will not come up at the next session of the legislature.

One final thought: While I have great confidence in the UCRP I am less confident that over the long haul the UC retiree health care benefits will be available as currently structured. Unlike the UCRP retiree health benefits are on a pay-as-you go funding arrangement. The accrued liability for current and future retiree and beneficiaries was $13.3 billion as of July 1, 2008. The pay as you go cost in 2008-2009 is projected at $225 million increasing to $609 million over the next decade. Perhaps this is a subject for a future article.