

UCRP IN CONTEXT: STATE OBLIGATION TO UC

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EXECUTIVE SUMMARY

From 1961 to 1990, the State of California contributed to the University of California Retirement Plan (UCRP) in the same way it contributed to all of the other state and public agency retirement plans—based on the level of employee compensation provided by the State. Between 1990 and 2007 UCRP was overfunded and did not require contributions from anyone-- the State, other UC funding sources, or employees. Since 2008, UC actuaries determined that contributions are again required, but the Governor has refused to allocate the full amount requested by the UC Regents, and the Legislature has not approved any amount. This leaves UC in the precarious position of resuming contributions for state-supported employees without state support.

The CA Legislative Analyst (LA) has gone so far as to question the State's obligation to support UCRP at all. He noted that some features of administration make UCRP ineligible for State retirement support: the UC Regents both fund the Plan and have fiduciary responsibility for the Plan, while most other public pension plans separate these functions. The State funds the plan and an independent Board of Trustees has fiduciary responsibility to the beneficiaries to invest the assets and deliver the promised benefits. The LA's questions and assertions have affected retirement funding not only on a state-supported UC payroll of about \$2.7 B but on the full UC covered payroll of \$7.9 B. Note: See the chapter below, "UCRP Market Numbers" for a brief primer on retirement funding terms. All calculations are estimates to show perspective.

UC's legal status as a public trust did not prevent the State from contributing to the UC retirement plan from 1961 until 1990 when UCRP became super-funded.

Now that the contribution holiday is over, the State's delay in resuming contributions has been costly to the University retirement plan. Total UCRP liabilities are increasing at a steady and predictable rate during this period of full contribution delay and will continue to increase when contributions resume on April 15, 2010 at a level far below what is actuarially required. To fund the mounting pension debt plus the State's share of the actuarial required contribution, the UC Regents will be pushed farther toward privatizing the University.

The UCLA FA urges the State not to break its pension promises to the University of California in order to save money. The contributions UCRP requested from the State in 2009-10--\$180.9 M—is a relatively small amount to the State, which will spend \$6.9 B in retirement contributions to state and public employees in 2009-10 and nearer \$8.5 B in 2010-11.

By using the end of UCRP's contribution holiday as an opportunity to cut off retirement support for the University is financially and politically unwise. The UCRP unfunded liability will grow quickly if contributions do not resume at the levels recommended by the actuaries. More importantly, by not funding the state-supported UC employees, the State stands to assume the liability risk for all the other UC employees whose compensation is not provided by the State but who are covered by UCRP. Taking any actions that increase state pension liability, raise UC tuition, and reduce access will harm the State's interests in the long run. The better choice is to resume contributions to UCRP.

INTRODUCTION

The history of CA public pension plans tracks very closely coverage for public teachers. As early as 1904 the State supported retirement annuities for professors at UC Berkeley and UCSF. Several years later, in 1913, school and community college teachers gained coverage by the CA State Teachers Retirement System or CalSTRS. State college teachers had to wait for coverage until 1932 for the State Employees Retirement Plan, SERS, which later became the Public Employees Retirement Plan, PERS, now called CalPERS.

History also shows that CA public pension plans are independent, neither owned nor controlled by the State. Hundreds of public retirement plans were established according to the provisions set out in the California Government Code, in particular the section devoted to Public Employees Retirement Law (PERL) passed in 1937, which outlined all aspects of public pension plan administration, calling for an independent Board, an annual independent audit and valuation, in order to provide protections for the State, which assumed public pension plan liability. UC is directly referred to in CA public retirement pension law: the UC Regents are required to follow certain procedures to ensure continued funding of its retirement plan. In every way, UCRP fits into the public retirement plans in the State of California and mirrors the requirements the state outlines for their funding or change in funding, benefit structure, and maintenance in return for a continuing obligation on the part of the State to pay the employer retirement contribution on state provided compensation.

UCRP is included in comprehensive studies on growing pension liability in the State. On Dec. 28, 2006, Gov. Schwarzenegger established the Public Employee Post-Employment Benefits Commission (PEBC) to study the problem (www.pebc.ca.gov). The Commission requested that the California Research Bureau (CRB) conduct a survey of all the State's public retirement systems in order to identify the total pension obligation and the amount that is unfunded. The CRB researchers included the two big state-funded plans, CalPERS and UCRP, the school plan, CalSTRS, and estimated the figures for all public agency plans. The survey examined the current funding levels and employer contribution rates since 1990. In looking at financial data as of June 30, 2006, the researchers found that the State's retirement assets were \$516 B, including UCRP, but the liability was \$579.5 B, with \$63.5 B unfunded. The total funding ratio was 89%.

A recent study published by the Stanford Institute for Economic Policy Research updated the unfunded liability figures for the state retirement systems: CalPERS, including the public agency pension plans administered by CalPERS, UCRP, and the School Plan CalSTRS ("Going for Broke: Reforming California's Public Employee Pension Systems," April 2010 (<http://siepr.stanford.edu>)). Stanford researchers found that the State's retirement assets had dropped to \$442.1 B, a drop of \$109.7 B from the previous fiscal year end. This drop in assets and increase in unfunded liability lowered the funding ratio close to the 55% level.

State politicians and legislators link the pension liability squeeze with reduced funding for higher education. In a recent speech, Gov. Schwarzenegger said that skyrocketing public pension payment "is money that cannot go to our universities, our parks and other government functions. Now, for current employees these pensions cannot be changed — either legally or morally. We

cannot break the promises we already made. It is a done deal” (see “pension reform” at <http://www.californiapensionreform.com> and go to Jan. 6th, 2010). Ironically, connecting the State’s mounting retirement liability and the plight of “our universities” compounds the problem the State has created for UC: the needs of the other state and public pension plans in California have pushed aside UC’s modest claim to continued state support for UCRP.

Some part of the confusion in resuming contributions is understandable. It has been so long since contributions have been needed in the UC retirement plan—nearly 20 years—that many, including those in the LAO, have forgotten what it was like for the University of California to fund retirement. Given the University’s size and scope in 2010—ten campuses, three Department of Energy labs that it manages, five Medical Centers, and research stations throughout California and in many foreign nations—funding retirement contributions for over 171,000 active and inactive members will be a significant undertaking. In order to recreate the sense of shared responsibility to support retirement benefits for so many different groups of employees, we need to go back farther in history than 1990 when the Regents suspended all contributions to UCRP, back to the beginnings of the University, to see the pattern of support for retirement that emerged over time.

HISTORY OF THE UNIVERSITY OF CALIFORNIA

CALIFORNIA VOTERS DESIGNATE UC AS A “PUBLIC TRUST” IN 1879

The history of the University of California goes back to 1849 when Legislators included in the first state constitution a vision of a public education system supported by the State for the good of all citizens. Gold was discovered in California in the same year that the image of a future university system began to take shape in the minds of Legislators. A few years later the State took advantage of the federal Morrill Act of 1862, which established the land-grant college program: the federal government donated federal land to the states if they used it to create colleges. However, giving land for colleges did not constitute federal funding, a principle which occasionally resulted in colleges teetering on the brink of bankruptcy, yet located on prime state real estate. In short, states had to take the land donations from the federal government but fund the colleges built upon them to make them grow and flourish.

In 1868, the state Legislature passed the Organic Act, which provided the charter for California's only land-grant university. Signed by Gov. H. H. Haight on March 23, 1868, Charter Day, the new act created the University of California. One of the provisions of the Organic Act allowed the State to create a “corporation...which is ‘The Regents of the University of California’.” The UC Regents first began organizing in Oakland in 1869, but by 1873 moved to Berkeley and opened the first campus of the University of California (http://sunsite.berkeley.edu/uchistory/general_history/overview/index.html).

Creating the University of California meant first creating the concept of a Board of Regents who would govern it like a corporation. However, the early corporation faltered through the interference and meddling of the state legislature in the workings of a university. The Regents knew they needed independence in governance if they were to accomplish their mission to create the highest quality university system of higher education anywhere, but independence guaranteed not by statute, which could be easily changed, but by the state constitution. Just about this time,

across the bay, Stanford began with a very different premise: a private university with enough private resources to govern itself as it wished without any promises to the State or the citizens

It was not until 1879 that UC's special status as a public trust took final shape. During this year the Regents attended the second state constitutional convention and lobbied for an amendment that would give the University of California constitutional autonomy from legislative control. They persuaded enough citizens that it was better to put their trust in the Regents than in the state legislature to manage an academic institution and keep it separate from politics, meddling, and corruption. In May 1879, the voters approved the new constitution that guaranteed the University of California a level of independence shared by few other public institutions in the nation and gave its governing Board of Regents "full powers of organization and government," subject only to limited oversight by the state legislature. (For a general history of shared governance at the University of California, see the work by John Aubrey Douglass, Research and Occasional Paper Series: CSHE.1.98).

CA Constitution: Article 9 Education, Sec. 9.

(a) The University of California shall constitute a public trust, to be administered by the existing corporation known as "The Regents of the University of California," with full powers of organization and government, subject only to such legislative control as may be necessary to insure the security of its funds and compliance with the terms of the endowments of the university and such competitive bidding procedures as may be made applicable to the university by statute for the letting of construction contracts, sales of real property, and purchasing of materials, goods, and services. Said corporation shall be in form a board composed of seven ex officio members, which shall be: the Governor, the Lieutenant Governor, the Speaker of the Assembly, the Superintendent of Public Instruction, the president and the vice president of the alumni association of the university and the acting president of the university, and 18 appointive members appointed by the Governor and approved by the Senate, a majority of the membership concurring; provided, however that the present appointive members shall hold office until the expiration of their present terms.

(b) The terms of the members appointed prior to November 5, 1974, shall be 16 years; the terms of two appointive members to expire as heretofore on March 1st of every even-numbered calendar year, and two members shall be appointed for terms commencing on March 1, 1976, and on March 1 of each year thereafter; provided that no such appointments shall be made for terms to commence on March 1, 1979, or on March 1 of each fourth year thereafter, to the end that no appointment to the regents for a newly commencing term shall be made during the first year of any gubernatorial term of office. The terms of the members appointed for terms commencing on and after March 1, 1976, shall be 12 years. During the period of transition until the time when the appointive membership is comprised exclusively of persons serving for terms of 12 years, the total number of appointive members may exceed the numbers specified in the preceding paragraph. In case of any vacancy, the term of office of the appointee to fill such vacancy, who shall be appointed by the Governor and approved by the Senate, a majority of the membership concurring, shall be for the balance of the term for which such vacancy exists.

(c) The members of the board may, in their discretion, following procedures established by them and after consultation with representatives of faculty and students of the university, including appropriate officers of the academic senate and student governments, appoint to the board either or both of the following persons as members with all rights of participation: a member of the faculty at a campus of the university or of another institution of higher education; a person enrolled as a student at a campus of the university for each regular academic term during his service as a member of the board. Any person so appointed shall serve for not less than one year commencing on July 1.

(d) Regents shall be able persons broadly reflective of the economic, cultural, and social diversity of the State, including ethnic minorities and women. However, it is not intended that formulas or specific ratios be applied in the selection of regents.

(e) In the selection of the Regents, the Governor shall consult an advisory committee composed as follows: The Speaker of the Assembly and two public members appointed by the Speaker, the President Pro Tempore of the Senate and two public members appointed by the Rules Committee of the Senate, two public members appointed by the Governor, the chairman of the regents of the university, an alumnus of the university chosen by the alumni association of the university, a student of the university chosen by the Council of Student Body Presidents, and a member of the faculty of the university chosen by the academic senate of the university. Public members shall serve for four years, except that one each of the initially appointed members selected by the Speaker of the Assembly, the President Pro Tempore of the Senate, and the Governor shall be appointed to serve for two years; student, alumni, and faculty members shall serve for one year and may not be regents of the university at the time of their service on the advisory committee.

(f) The Regents of the University of California shall be vested with the legal title and the management and disposition of the property of the university and of property held for its benefit and shall have the power to take and hold, either by purchase or by donation, or gift, testamentary or otherwise, or in any other manner, without restriction, all real and personal property for the benefit of the university or incidentally to its conduct; provided, however, that sales of university real property shall be subject to such competitive bidding procedures as may be provided by statute. Said corporation shall also have all the powers necessary or convenient for the effective administration of its trust, including the power to sue and to be sued, to use a seal, and to delegate to its committees or to the faculty of the university, or to others, such authority or functions as it may deem wise. The Regents shall receive all funds derived from the sale of lands pursuant to the act of Congress of July 2, 1862, and any subsequent acts amendatory thereof. The university shall be entirely independent of all political or sectarian influence and kept free therefrom in the appointment of its regents and in the administration of its affairs, and no person shall be debarred admission to any department of the university on account of race, religion, ethnic heritage, or sex.

(g) Meetings of the Regents of the University of California shall be public, with exceptions and notice requirements as may be provided by statute.

Only 5 other major public university systems share the designation of public trust, among them the U. of Michigan, another one of the highest-ranking public college systems in the country.

UC AND THE STATE APPROPRIATIONS PROCESS

UC's autonomy from legislative control did not mean autonomy from the state appropriations process, which was controlled by the Legislature and the Governor.

ARTICLE 4, LEGISLATIVE, SEC. 12.

(b) The Governor and the Governor-elect may require a state agency, officer, or employee to furnish whatever information is deemed necessary to prepare the budget.

While the legislative and executive branch allocate funds to the University, they do so with the knowledge that they cannot impair the ability of the Regents to govern the University through the allocation process. (For a more detailed discussion of autonomy and the designation "public trust," see the work by Harold W. Horowitz, "The Autonomy of the University of California under the State Constitution," originally published as a paper at the German-America Conference on the Comparative Constitutional Aspects of Access to Higher Education, available online at http://www.ucop.edu/ogc/pdfs/uc_autonomy.pdf.)

EVOLUTION OF STATE & PUBLIC AGENCY RETIREMENT PLANS

THE SCHOOL PLAN: CALSTRS

The oldest public retirement plan in California is CalSTRS (CA State Teachers Retirement System), created by law in 1913 (CA Education Code, Title 1, Division 1, Part 13). Originally this plan offered retirement benefits to certificated public school teachers and community college teachers in the amount of \$500 per year or roughly 50% of compensation. Funding came from the State in the amount of 5% of the annual revenue from inheritance taxes and from employee contributions of \$12.00. In 1956 CalSTRS was changed to a defined benefit plan (DBP). Currently, CalSTRS is governed by the Teachers' Retirement Law, CA Government Code, Sections 22000-27413.

The CalSTRS Retirement Board has 12 members, some appointed, some elected, some ex officio government officials, which has exclusive control over the investment and administration of the retirement fund. If the Board decides that it needs to increase employer contributions it must go to the Legislature for approval. (See Funding CalSTRS Benefits at http://calstrs.com/Legislation/funding_calstrs_benefits.pdf).

The CalSTRS contribution policy divides the Normal Cost between employer and employee. Currently, the employee pays 8% of his or her covered compensation, and the employer, for example the employing community college district, contributes 8.25% of covered compensation, for an estimated Normal Cost of 16.25%. The State appropriation would cover any amount needed to meet funding requirements, like increases in the Normal Cost and any unfunded liability.

The State is obligated by statute to make the appropriations to CalSTRS that are calculated by the plan actuary and approved by the Board. During the 2003 State budget crisis, the State withheld a \$500 million payment to CalSTRS, after which the Board filed a lawsuit. The courts ruled against the state action, forcing payment of the \$500 million to CalSTRS several years later plus \$200 million in interest.

CalSTRS Snapshot: Dec. 31, 2009

In 2010 CalSTRS is the third largest public pension plan in the nation and the second largest in the state, with about 432,383 total members and about 1,400 different local school district employers. As of Dec. 31, 2009, CalSTRS has \$131B in assets and an estimated unfunded liability of about \$78 billion and a funding ratio of about 75%. The State contribution for 2009-10 to CalSTRS was \$1.1 billion (see www.calstrs.com for info).

THE STATE PLAN: SERS TO PERS TO CALPERS

By the late 1920s, the State was interested in expanding retirement coverage to a larger base of state workers to include state college teachers and employees falling in the "safety" category-- police officers and firefighters. Legislators believed that state sponsored retirement plans would actually save the State money by moving the salaries of older employees off the state budget for current operations and on to a retirement plan, making space for hiring younger employees with

lower salaries. Also pension plans that provide adequate retirement income would keep older, retired state employees off public assistance programs.

However, if the State were to take on the obligation to sponsor these long-term benefits, state government employers seeking state funds for retirement needed to adopt and follow sound actuarial funding principles. In 1927 the state created a Commission on Pensions of State Employees (Chapter 431, Statutes of 1927), which made several recommendations, including prefunding:

An urgent responsibility rests upon the state to see that any retirement system, which it may sponsor, is placed upon a sound financial basis, where liabilities are provided for as they are incurred, rather than when they mature.

The Commission further explained the importance of adopting and following actuarially sound funding principles, like estimating the cost of the current service year, interest rate earned on investments, mortality rates, projected salary increases, etc. In the following year, 1930, California voters approved Proposition 5, which amended the State Constitution (Section 22a, Article IV) to allow pensions to be paid to all state workers, with prefunding explained in the ballot argument (<http://holmes.uchastings.edu/library/california-research/ca-ballot-measures.html#ballotprops>).

In 1931 legislation (Government Code, Title 2, Division 5, Parts 3 and 5; and Article XVI, Section 17, California Constitution) was enacted to establish the State Employees Retirement System (SERS). By 1932, SERS was in operation.

Under the State constitution, the CalPERS Board of Administration has sole and absolute authority and fiduciary responsibility for the investment and administration of PERF, the Public Employees' Retirement Fund, which includes more than 99% of the system's retirement program net assets. The Board has 13 members: six elected by members, three appointed, and four ex-officio members including the state treasurer and state controller. has the authority to set contribution rates, based on an independent audit and actuarial valuation of the plan assets and liabilities. The State then can exercise its rights to pay more, but not less. The employee contribution rate was based originally on age at employment, but after 1970 it was changed to a fixed percentage of pay, with the percentage established by statute, now 5% of covered compensation for most state miscellaneous employees. The employer contribution fluctuated to fund the difference between promised pension benefits and the revenues generated by member contributions and investment earnings.

The State is obligated to pay the employer contribution to SERS to fund the retirement benefits of members in the plan. CA State Government Code Title 3, Division 4, Section Part 3, Chapter 9, Sec. 20814 requires the State to include in the annual budget funding an amount to support the employer-paid retirement contribution rates established by the actuary, and requires the Legislature to adopt the contribution rates and authorize the appropriation in the Budget Act.

20814. (a) Notwithstanding any other provision of law, the state's contribution under this chapter shall be adjusted from time to time in the annual Budget Act according to the following method. As part of the proposed budget submitted pursuant to Section 12 of Article IV of the California Constitution, the Governor shall include the contribution rates submitted by the actuary of the liability for benefits on

account of employees of the state. The Legislature shall adopt the actuary's contribution rates and authorize the appropriation in the Budget Act.

(b) The employer contribution rates for all other public employers under this system shall be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in rate.

The State's obligation to pay retirement contributions was tested in 1983-84, when budget problems affected its ability to pay the retirement benefits requested by SERS, by this time called CalPERS. In 1983, the State did not give CalPERS its full contribution, an omission that forced the CalPERS Board of trustees to take the State to court for non-payment of the full retirement contribution. In 1983, the California Court of Appeals held that the failure of the State to fund CalPERS at the actuarially determined rate was unconstitutional and ordered the State to make up the amounts taken from the PERS annual appropriation for the first half of 1983. The issue was later taken to the State Supreme Court, which denied hearing; the ruling of the lower court stood.

CalPERS Snapshot: Dec. 31, 2009

CalPERS is the largest retirement system in the state and the nation, with over 1.6 million total members, including CalSTRS and all the public agency employers and 1,659 different employers. As of Dec. 31, 2009 CalPERS' assets were \$203.3 B, and the unfunded liability about \$58 billion, with a funded ratio of about 72%. The State contribution to CalPERS for 2009-10 was \$3.3 billion. (see www.calpers.ca.gov for info), with an anticipated increase to \$4.8 billion for 2010-11, an increase of \$1.5 billion (SacBee, 12/06/09, "Governor to give CalPERS more funds than it asked for").

PUBLIC AGENCY RETIREMENT PLANS

After 1939 public agencies and classified school employees were allowed to contract with CalPERS for retirement benefits (Chapter 954, Statutes of 1939). By 2010, over 2,000 local agency pension plans contracted with CalPERS to administer these plans. Like CalPERS, the public pension plans follow the requirements set out in the 1937 Public Retirement Law. The employer contributions are paid by the local employers, who receive state appropriations but also have other sources of revenue, like local taxes.

These public pension plans cover about 19% of all state and local employees statewide. For the members in the local and municipal plans, taxes provide their compensation, and these local and municipal employers pay the employer contributions from their state appropriations.

The State retains liability for the retirement benefits promised by these public retirement pension plans, even though each one is not statutorily created. PERL applies to all present and future public pension plans.

Public Employee Retirement Plans Snapshot: Dec. 31, 2009

As of 2009-10, public agency retirement plans had about 500,000 members. The aggregate unfunded liability for the public pension plans was \$44.7 billion, with an aggregate unfunded

ratio of 78.5%, down from 89.6% on June 30, 2008. Through the allocation process, the State funded about \$2.5 billion to the Public Agency Retirement System fund to cover the employer cost of retirement benefits (see www.pars.org for info).

THE CREATION OF UCRP

From its beginnings, UC had its own retirement plan, but only for faculty. In 1904, the UC plan provided for the purchase of commercial annuities equal to two-thirds salary for Berkeley and UCSF faculty aged 70 or older with 20 years of service. In 1924, the UC Regents established the Pension and Retiring Annuities System (PRAS) for faculty and high-level administrators. PRAS had a Board of Trustees that arranged for an independent annual audit and an actuary who set the contribution rates.

In 1937, the Regents expanded pension coverage by including all non-academic employees in a plan administered by CalPERS. The UC employees who worked in the federal labs were also enrolled in the UC Plan administered by CalPERS (See the “Plan Progression,” UCRP annual Financial Report 2008-09 at <http://www.universityofcalifornia.edu/regents/regmeet/nov09/j1ucrp.pdf> .)

1954-55

In 1951, the faculty, unhappy in PRAS, voted to leave the UC retirement plan and join CalPERS, an act which drew the full attention of the Regents to retirement problems at UC. The faculty’s unrest is understandable. The cost of their contributions was rising, while the benefit level remained unacceptably low. The activities of Distinguished Professor Constantine Maria Panunzio, Anthropology and Sociology, UCLA, brought the plight of the UC faculty to the attention of the Regents. Upon his retirement in 1950, he discovered that he was to receive only \$129 a month as a retirement annuity. The average income for emeriti was about \$108 a month. “Non-academic employees who were enrolled under the state civil service pension system fared much better; whereas a full professor at UC might draw \$110, a plumber with an equivalent time record of service received something in the vicinity of \$210 a month.” Although committees had been meeting for years to study the problem of retirement at UC, nothing had ever happened. Panunzio’s activism led to the reformulation of PRAS benefits in 1954. (To read the full memorial, see <http://content.cdlib.org/view?docId=hb658006rx&query=&brand=calisphere> and click on “Constantine Maria Panunzio.”)

The Regents paid careful attention to the State’s interests before they made any changes to their University Plan because the State provided funding. Before making their decision about what to do in 1954, the Regents hired the actuarial firm of Coates, Herfurth, and England to analyze the current financial condition of PRAS. It was upon their findings that the Special Committee of the Regents announced on Mar. 8, 1954 their unanimous decision: “it is for the best interest of the University, its faculty and administrative officers, and the State of California, that the Regents take the necessary action to provide a pension system affording to its members substantially the same benefits as those afforded by the State Employees’ Retirement System” with the exception “that such system shall not provide pensions or retiring allowances in excess of 80% of the average of the highest three years of salary.” Furthermore, they would restructure PRAS to offer

benefits “at less expense to the State of California and at no greater expense to the members, with the exceptions above noted” (Monthly Meeting of the Regents, University Bulletin, VI. 2, No. 28, March 8, 1954).

However, the reformulated PRAS was not much different from the old PRAS: it was restricted to a small group of employees and thus had a small asset base. The UC Regents had increased the benefit structure in 1954, but that brought the funding ratio of the plan below 100% and required higher employer contributions. In 1954, UC faculty paid the same contribution as the state teachers did in CalPERS, but in the years that followed, the UC contribution increased while the member contributions in CalPERS remained constant (See the Report of the Committee on University Welfare, Berkeley Division, 1957 available in the California Digital Library at <http://www.cdlib.org/>). The advantages of the state system were clear: larger population covered, sounder financial base, lower contributions, and higher benefits.

The State was receptive to the faculty’s desire to join CalPERS. State legislation (AB 3203) was passed on July 10, 1957 to transfer PRAS to CalPERS, but this legislation was put on hold to give the Regents and the faculty time to make their decision. The UC academic senate engaged in vigorous debate on the merits of transferring to the state system or remaining in PRAS. Members in the UC plan did not want to be forced to participate in a small retirement plan with increasing contributions and a lower benefit structure than offered by CalPERS to other state employees. If the Regents decided to maintain a separate UC plan, it would have to include all UC employees to build a bigger financial base. In addition, it would have to be agreed that the member contributions in the UC plan would not be greater than required of state employees in CalPERS. Faculty also expressed concern about autonomy: if UC transferred PRAS to CalPERS, there could be undesirable state interference in setting university retirement policy.

1961

In April, 1961, based on consultation with the faculty, the Regents made their decision: they would maintain a separate UC retirement system, call it UCRP (University of California Retirement Plan), extend it to all the employees, many of whom were currently in CalPERS, and reject the still pending CA legislation that would have transferred PRAS into CalPERS. UCRP is a governmental defined benefit plan established and maintained under section 401 (a) of the Internal Revenue Code. In 1961, some UC employees decided to stay in CalPERS, but many transferred to UCRP, and after 1961, all new UC employees enrolled in the UC plan. And most importantly, the Regents promised they would provide a benefit structure comparable to the one offered by CalPERS at less expense to the State and to UC employees.

The Regents were confident in their decision to create their own retirement plan for all their employees because they were confident of continued State support. Never during the long decision process did the State raise questions of eligibility for continued state support if the UC Regents expanded their separate UC plan. Reports show extensive academic senate debate on the issue of a separate UC Plan, with faculty comparing SERS to PRAS benefits on many factors, such as retirement age and survivor benefits, but never considering the possibility of losing State financial support for those employees whose compensation the State provided. (See the Report on the Academic Council, Northern Section, Dec. 18, 1957). And the continued support after

1961 for 30 years for the University Plan--the state-supported part of the UCRP population--shows that the Regents were correct in their assumption.

The Regents concentrated on a different question entirely: could they use their autonomy to the benefit of everyone--the University, its faculty, federally supported researchers, and the State of California? Although the Regents did not need the approval of the Legislature to make this decision, they needed the good will of the State to make it work. In creating UCRP, the Regents took into account the State's interests because they knew that they did not want to create a retirement system that would be more expensive for the state to fund than CalPERS. The Regents knew that a well managed—well invested—plan could benefit everyone, and at that time, their autonomy gave them the authority to invest the emerging UCRP assets in the full range of options.

And autonomy plus a remarkable history of high investment returns would make the new UCRP succeed while the older, smaller PRAS stumbled. UCRP grew in numbers of employees and asset base. The Regents more than kept their promise to the State to keep UCRP less expensive than CalPERS. Between 1978 and the end of 1982, the State paid close to 5% less for UCRP than CalPERS. In 1983-84, the State contributed 18.3% for State Miscellaneous (including CSU) and employees contributed 5%, for a total contribution of 23.2%. For this same time period, the State contributed (as an IOU) 14.9% for state-supported employees at UC and employees contributed 3%, bringing the total to 17.9%. See Table 2 in the Appendix for a historical perspective on the State's contribution to UCRP and CalPERS.

Now that all UC employees had a single retirement plan, they were no longer eligible to join the State system.

UC's Exclusion from Membership in PERS system

20301. Except as otherwise provided in this section, any person who on October 1, 1963, is employed by the university, and is a member of any retirement system maintained by the university, or who after that date enters university employment, shall be excluded from membership in this system.

A university member who is separated from university employment due to layoff and who is reemployed by the university shall have the right to elect, in accordance with regulations of the board of regents, membership in this system in lieu of membership in any retirement system maintained by the university, if written notice of the election is filed with this system within 30 days after his or her reemployment.

UCRP Contribution Policy

The most complex feature of the University of California Retirement Plan is the evolution of its contribution policy that serves a large public trust, a single employer, with different cohorts of employees funded by different sources. But by 1983-84, the annual process of funding UCRP was long established. After the UC actuaries set the level of the contribution needed, the UC Regents paid the employer contribution for all employees covered by UCRP based on total covered compensation with the expectation that the State, the federal government, and any other private sources, which funded UC employees would reimburse the Regents for their share of the retirement contribution. But the reimbursement process followed a specific sequence. First, the State would reimburse the Regents for the state-supported employees. Second, the Regents would assess a pension contribution on federal research grants at the same level set by the State

but in an amount to cover the employees supported by federal research funds. And third, the Regents would assess the same level of contributions paid by the State from all other non-state sources, which would then flow into UCRP. All UC employees receive the same benefit structure, and all funding sources pay the same amount to cover their employees. But the historical funding policy of the University Plan has let the State set the contribution level for all other funding sources.

The LAO understood the unique situation of UC retirement funding. In analyzing the proposed state budget for 1984-85, the LA listed the “retirement systems” that had requested state contributions: the Legislators, Judges, Public Employees (including State Members and School Members), State Teachers, and the University of California. A footnote to table 70 explained the special funding situation of the University of California: the \$82.9 million state retirement contribution to UCRP for that year “Represents only the state’s share of contributions (about 42% of total contributions) for UC employees whose salaries and benefits are paid from state funds. The balance of contributions comes from federal and private sources” http://www.lao.ca.gov/analysis/1984/pandi_84_part3.pdf). And for that year, about \$83 million flowed into UCRP from federal sources and about the same from private sources, making up a total of about \$249 million in employer contributions toward UCRP (See Table 1).

In such a carefully interlinked system of initial State funding followed by reimbursement, the consequences of nonpayment by any one party are severe, especially the State because it historically set the level of the contribution of others. If the State of California doesn’t pay the retirement contribution for state-supported employees, federal and UC Medical Center retirement funding does not flow into UCRP. Since the State only supports about 33% of UC employees, if it does not pay its 33% retirement contributions, the other 67% does not flow into UCRP either.

State funding follows a different dynamic than other kinds of funding at UC. State funding increases the General Fund support for UC in the year that it is awarded, while many other funding sources at UC committed retirement funding for a longer period years, typically from one to three, but occasionally even longer. If the State pays the retirement contribution, the federal government does not adjust its total payment in any way. Instead, the same level of retirement contribution paid by the State must be taken out of the federal research and grant funding to support those UC employees engaged in these research projects for the duration of the grant at the level of support received by other state-supported employees. However, on newly issued grants, an increase in the state contributions results in an increase in federal contributions. A similar situation exists for the UC Medical Centers. Once retirement contributions are resumed by the State, there is no magical increase in funding for non-state sources: the Medical Centers must reallocate current funds to include the cost of retirement contributions. Furthermore, it would be difficult for the Medical Centers to increase funding to cover retirement because they have only limited ability to pass through increases in their costs to insurance companies, who pay the bulk of the Medical Center revenues.

The State’s response to past fiscal emergencies underscores its obligation to pay retirement benefits for state-supported employees at UC. In 1983, a budget crisis prevented the State from paying the employer contribution to UCRP. After some discussion of what should be the appropriate actuarial assumptions for UCRP, the State and the Regents reached an agreement

acknowledging the State's liability to the University Plan: the State gave the Plan a 30-year bond to cover its liability in lieu of payment. In doing so, it enabled the continuing contributions from the federal government and other non-state sources whose contributions were linked to the State's contribution because the State promised to repay the amount owed in the future.

Had the State not made its contribution – albeit as an IOU – the then roughly 60% of non-State retirement funding would not have flowed into the UC retirement plan. The State knew that nonpayment of its obligation would lead to a loss of all these other sources of funding, which would have financial consequences in the form of increased employer retirement contributions in the future for state-supported employees. It was in the State's financial self-interest neither to delay payment nor pay less than the actuarially determined amount for the state-supported UC employees. In 2010, the State is still paying on those old debts and living up to the promise it made to the Regents to restore the employer contribution of 1984-84.

The UCRP Funding Surplus

These historical dynamics explain, in part, why resuming contributions at UC has been so difficult. It has not been a question of the UC Regents and the UC employees hoping that someone else would pick up a bill that keeps increasing over time, as the LAO has suggested. It has been more a realization that the funding surplus is over. Now federal funding devoted to research, science, and medicine has to be significantly decreased at a time of other budget cuts and general economic downturn in order to spread that funding further to cover retirement. Resuming contributions after such a long suspension will affect every aspect of the University community, from professors accepting a decrease in total compensation at a time of salary cutbacks to researchers in science and medicine realizing that fewer funds will be available to conduct research and serve patients than they had available to them in the past.

The “prefunding” success of UCRP between 1990 and 2010 was extraordinary. Investment return covered the retirement costs for 20 years, without anyone having to pay contributions. The CalPERS Board typically expects that 75% of benefits will be paid from investment earnings. UCRP investment earnings paid 100% of benefits for 20 years.

Actuarial restrictions prevent overfunding as well as underfunding a retirement plan. For UCRP, continued contributions after 1990 would have violated the full funding policy for UCRP passed by the Regents themselves for the 1990 plan year. Under that new funding policy, UC would suspend contributions when the smaller of the market value or the actuarial value of Plan assets exceeded the lesser of the actuarial accrued liability, or 150% of the estimated current liability (The Segal Group, Actuarial Valuation Report for UCRP as of July 1, 2005).

Funding surpluses often encourage retirement Boards to increase benefits, as happened in the State in 1999 when the Legislature passed SB 400, which increased state workers' pensions by as much as 50% and made the benefit increases retroactive. But the Regents were conservative in handling the UCRP funding surplus. The halt of contributions to UC in 1990 reduced retirement costs just as the State was entering a budget crisis, the same crisis that prompted the UC Regents to cut faculty merits for 1991-92. And 1991 saw the first VERIP that provided incentives for UC employees to take early retirement. Indeed, during the State budget crisis of the early 1990s, the

overfunded position of the retirement plan allowed UC to replace older faculty with younger faculty with lower salaries via 3 early retirement incentive programs.

Although no contributions were made to the overfunded pension, the UC Regents did not want employees to forget the process of contributing to retirement (deductions of some percentage of salary from payroll on a pretax basis). So they required employees to contribute roughly 2% of their salary into individual DC accounts (defined contribution) so that when contributions to the basic plan again became necessary, contributions to DC Plans would cease and future contributions would be rerouted back to UCRP.

Over the years, UCRP has not been the only state funded retirement plan to achieve super-funded status—assets exceeding liabilities to the extent that neither the employer nor the employee has to pay contributions. For example, neither the State nor the school teachers and community college professors had to contribute to retirement to CalSTRS between 1998-2002 because of the super-funded status. But in July 2002, the State contributed 2.3% of covered compensation to resume contributions to CalSTRS when the actuaries called for contributions at that level.

UCRP Snapshot: Dec. 31, 2009

In 2009, UCRP was the third largest government pension plan in the state, with about 221,808 total members (178,808 active and inactive and 43,000 retired). As of Dec. 31, 2009, the Market Value of Assets was \$36.58 B. The unfunded liability was about \$9.7 billion, with a funded ratio of about 78.8%. The University Plan or the state-supported percentage of UCRP is about one third. (For investment information as of 12/31/09, see www.ucop.edu/treasurer//invinfo/COI_IAG_Perf_Summary_12-09.pdf and see the highlights of the 2008-09 UCRP Valuation at <http://www.universityofcalifornia.edu/regents/regmeet/nov09/f5present.pdf>).

CALIFORNIA RETIREMENT LAW

CA GOVERNMENT CODE

GENERAL PROVISIONS OF PUBLIC PENSION AND RETIREMENT PLANS

Title 1 Division 7. Miscel Chapter 21. PUBLIC PENSION AND RETIREMENT PLANS. 7500-7514.5

This section of the CA Gov. Code outlines the general provisions of retirement benefits, including the Board, the actuarial assumptions needed to support the contribution, and the general requirements of the participants to give notice of change in any of the basic elements: change in plan benefits, contribution rates, actuarial assumptions

Obligation to Provide Notice of Change in Plan Benefits, Contribution Rates, Actuarial Assumptions

7507. The Legislature and local legislative bodies shall secure the services of an enrolled actuary to provide a statement of the actuarial impact upon future annual costs before authorizing increases in public retirement plan benefits. An "enrolled actuary" means an actuary enrolled under subtitle C of Title III of

the federal Employee Retirement Income Security Act of 1974 and "future annual costs" shall include, but not be limited to, annual dollar increases or the total dollar increases involved when available.

The future annual costs as determined by the actuary shall be made public at a public meeting at least two weeks prior to the adoption of any increases in public retirement plan benefits.

UC's Obligation to Provide Notice

7507.5. It is the intent of the Legislature that the Regents of the University of California provide written notice to the Legislature of any proposed changes to retirement plan benefits, employer or employee contribution rates, or actuarial assumptions affecting the University of California Retirement System, at least 60 days prior to the effective date thereof. The written notice shall be provided to the Joint Legislative Budget Committee and the fiscal subcommittees and shall consist of:

- (a) A description and explanation of each specific proposed change to the benefit structure, contribution rates, or actuarial assumptions.
- (b) The actuarial impact upon future annual costs of each proposed change.

UC and the General Provisions

7507 and 7507.5

- (1) recognize that the University of California Retirement System (UCRS) is distinct from the public retirement plan (otherwise 7505.5 would not be needed),
- (2) recognize that the Regents are empowered to make decisions for UCRS,
- (3) but, since the State has an obligation to fund the University plan,
- (4) the Legislature inserted a clause that required the constitutionally-autonomous Regents to follow certain procedures to secure continued State funding for UCRS.

The exact same wording, "the actuarial impact upon future annual costs" is used for the Regents in 7507.5 as in 7507, to indicate that UCRS is autonomous, the Regents must consider the implications of their decision in terms of the future costs to the State. So the intent of 7507.5 is to make sure that future annual costs of the UC Retirement system are included in the deliberations of the Joint Legislative Budget Committee.

Section 7507.5 is an important formulation of the relationship between the University and the Legislature with respect to retirement funding and the ultimate liability of the State for the state and public pension plans. The implicit assumption appears to be that whatever obligation the state may have for the Public Pension and Retirement plan applies equally to the UC Retirement plan.

Public Employees Retirement Law "Perl" of 1937; Secs 20000-21703

In 1937, the Legislature enacted a comprehensive statutory scheme, the Public Employees Retirement Law (PERL, CA Government Code Title 3, Division 4, Part 3, Chapter 3 and 3.9) establishing the Public Employees Retirement System (see Sec. 20058 for "definitions") This Statute renamed SERS to PERS thus bring the new PERS under the provisions of the Public Employees Retirement Law. A few years later, the "Cal" was added to make it CalPERS and distinguish this public pension plan from those offered in other states. This law provided definitions, explanations of eligibility, membership requirements, and clarification of funding for state and local members.

Definitions in “PERL”

“University”

20071, "University" means the University of California and includes The Regents of the University of California as defined and authorized by Section 9 of Article IX of the California Constitution.

“Employee”

The definition of “employee” establishes that the basic requirement of eligibility to become a member of the PERS system is that compensation be provided by the state.

20028. "Employee" means all of the following:

(a) Any person in the employ of the state, a county superintendent of schools, or the university whose compensation, or at least that portion of his or her compensation that is provided by the state, a county superintendent of schools, or the university, is paid out of funds directly controlled by the state, a county superintendent of schools, or the university, excluding all other political subdivisions, municipal, public and quasi-public corporations. "Funds directly controlled by the state" includes funds deposited in and disbursed from the State Treasury in payment of compensation, regardless of their source.

The “University” and “Employee”

About one third of the UC workforce is in the “employ of the state”: their compensation is provided by the state or by university funds disbursed from the State Treasury. There is always a special step in applying general definitions to UC because it is both a public trust that falls outside of the jurisdiction of the legislature and a state agency, in the sense of an agency that receives funds from the state to pay the compensation of workers. UC needs to request funds every year from the General Fund according to the same general appropriations process that all state agencies follow.

“Employer”

There are several kinds of employers included in PERL who are required to make contributions for an eligible employee.

20030. "Employer" means the state, the university, a school employer, and any contracting agency employing an employee.

20031. "Employer federal contributions" means those contributions required of employers under the federal system with respect to wages paid to individuals who perform services in employment in any coverage group included in the federal-state agreement, at the rate of taxes imposed on employers by Section 3111 of Title 26 of the United States Code for the respective calendar years set forth therein and all penalties and interest that may be required to be paid with respect to those wages under the federal-state agreement.

UC and “employer”

The Regents are the employer for all the employees at UC. They are required to pay retirement contributions for all employees. In the case of those employees supported by federal funds, the federal government reimburses the Regents for those contributions according to the “employer federal contributions” and the federal-state agreement. Again, there is a dual relationship: the UC Regents are the employer in the general sense that UC is a public trust governed by the Regents, but the State also functions as the employer in the limited sense that the State provides funds to UC for retirement of state-supported UC employees.

Membership in PERS

“Member”

20370. (a) "Member" means an employee who has qualified for membership in this system and on whose behalf an employer has become obligated to pay contributions.

(b) "State member" includes:

- (1) State miscellaneous members.
- (2) University members.
- (3) Patrol members.
- (4) State safety members.
- (5) State industrial members.
- (6) State peace officer/firefighter members.

(c) "Local member" includes:

- (1) Local miscellaneous members.
- (2) Local safety members.

(d) "School member" includes all employees within the jurisdiction of a school employer, other than local policemen, school safety members and members included in a risk pool.

UC and “member”

UC is a state member in the sense that the State disburses funds to UC to cover the compensation of some UC employees and that the State assumes the obligation to pay contributions on that compensation for retirement.

“Classification of different kinds of members”

20371. "Member classification" means either of the following:

(a) Miscellaneous member classification, which includes state miscellaneous members, university members, local miscellaneous members, state industrial members, and school members.

(b) Safety member classification, which includes patrol members, state peace officer/firefighter members, state safety members, and local safety members.

20380. "State miscellaneous member" includes all members employed by the state and university, except industrial, patrol, state peace officer/firefighter, and state safety members.

20381. "University member" includes all members who are employees of the university.

UC and Membership

The state-supported UC employees are miscellaneous state members because they are not safety employees and they receive their compensation from the state. There are also some UC employees who are members of CalPERS in the sense that they belong to that retirement plan by virtue of reciprocity agreements between CalPERS and UCRP. Much legal attention has been paid to the UC employees supported by the federal government who were members of CalPERS before and after 1961 because they were not offered the same early retirement incentives as members of UCRP in the nineties.

“employer contribution”

PERL clarifies the process by which the State makes a retirement contribution for State members.

20814. (a) Notwithstanding any other provision of law, the state's contribution under this chapter shall be adjusted from time to time in the annual Budget Act according to the following method. As part of the proposed budget submitted pursuant to Section 12 of Article IV of the California Constitution, the Governor shall include the contribution rates submitted by the actuary of the liability for benefits on

account of employees of the state. The Legislature shall adopt the actuary's contribution rates and authorize the appropriation in the Budget Act.

20830. All payments required by this chapter to be made by the state to the retirement fund, are continuing obligations of the state.

“employer contribution” for contracting agencies followed a different funding procedure:

20463. (a) The governing body of a public agency, or an employee organization, recognized under Chapter 10 (commencing with Section 3500) of Division 4 of Title 1, that represents employees of the public agency, that desires to consider the participation of the agency in this system or a specific change in the agency's contract with this system, may ask the board for a quotation of the approximate contribution to this system that would be required of the agency for that participation or change.

Each of the local contracting agencies has a separate contract with PERS to administer their retirement plan. The funds for these contributions could come from a variety of sources, including state disbursement of funds for the agency as a whole. Some agencies have more financial resources, including the ability to request more tax revenue. The important aspect of the State's employer contribution policy is that it is based on actuarial required contributions, which must be funded in full.

UC and the Employer Contribution

Before 1937

Before and after 1937, the State provided the retirement contribution for UC employees whose compensation was provided by the State. UC followed the procedure pursuant to Sec. 12 of Art. IV of the CA Constitution and PERL, Section 20814 (a): each year the UC Regents presented a budget request to the Governor, who then issued a budget after evaluating the funding requests, which was then passed on to the Legislature for approval. In these annual requests, the UC Regents broke out the retirement contribution for the state-supported members first in PRAS and later in UCRP.

Records show a consistent pattern of annual payment by the State to UC for retirement of state-supported employees until 1990, when UC actuaries announced the temporary cessation of contributions (See Tables 1 and 2 below in the Appendix). When the actuarial analysis called for resumption, then all of the funding sources would be required to resume their obligation to pay contributions for the employees they supported. Other pension plans, like CalSTRS, in California have taken holidays and not had their funding withdrawn when contributions were resumed. Even the State had a holiday for a year—in 2000—and did not have to contribute to CalPERS, but had to resume contributions the following year at 4.2%. Contribution holidays are temporary cessation of contributions and do not terminate obligation.

After 1937

After 1937, PERS administered the UC plan for non-state supported employees. The UC Regents paid the employer contribution for these employees but were reimbursed by the multiple funding sources for these employees. For federal grants and research, UC included the costs of retirement in calculating its annual indirect costs, and the federal government allocated these amounts to the UC Regents in their grants.

Administration

The Board And Fiduciary Responsibility

200151. The board and its officers and employees shall discharge their duties with respect to this system solely in the interest of the participants and beneficiaries:

(a) For the exclusive purpose of both of the following:

(1) Providing benefits to members, retired members, and their survivors and beneficiaries.

(2) Defraying reasonable expenses of administering this system.

(b) Minimizing the employers' costs of providing benefits under this part.

(c) By investing with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an enterprise of a like character and with like aims.

20152. Notwithstanding Section 13340, there is hereby continuously appropriated, without regard to fiscal years, from the retirement fund to the board, the amount necessary to pay for any insurance obtained pursuant to Section 7511, which payments shall be made upon warrants drawn by the Controller upon demands made by the board.

7511. Notwithstanding any other provision to the contrary:

(a) A public retirement system may purchase insurance for its fiduciaries or for itself to cover liability or losses occurring by reason of the act or omission of a fiduciary, if the insurance permits recourse by the insurer against the fiduciary in the case of a breach of a fiduciary obligation by the fiduciary.

(b) A fiduciary may purchase insurance to cover liability under this section from and for his or her own account.

(c) An employer or an employee organization may purchase insurance to cover potential liability of one or more persons who serve in a fiduciary capacity with regard to an employee benefit plan.

The Board and UCRP

The University has constitutional autonomy and in establishing its own pension plan determined that the plan fiduciaries would be the Regents. They have the responsibility for managing and investing UCRP assets. They set investment policy, but delegate the implementation of that policy to the Treasurer's Office. The Regents look to the UC administration to carry out the day-to-day operations of the retirement plan.

In addition, the Regents have a UC Retirement System Advisory Board (UCRS Board) to offer employee feedback to retirement policy. The UCRS Board is composed of five representatives of UC management, two faculty chosen by the Academic Senate, and two representatives elected by staff. The role of the Advisory Board is to develop ideas or new approaches to the framework of UCRP benefits and to provide an open forum to discuss concerns relating to all members, participants, and beneficiaries.

The Advisory Board can only advise and not recommend or consult because of concerns that the Board could be construed as violating the "direct dealing" provisions of the California Higher Education Employee Relations Act (HEERA), the labor law governing UC, its employees, and unions. These provisions prevent UC from "dealing directly" with employees, rather than the unions that represent them, over the terms and conditions of employment. According to court precedents, the direct dealing provisions prevent the UCRS Board from making recommendations to the Regents.

On one level, the UC Regents are both the Plan Sponsors—they fund the employer retirement contribution—and the Plan fiduciaries, thus appearing to violate the independence between these two functions that exists in other public pension plans in California. However, on a more important level, the historic contribution policy of UCRP shows that the Regents are not the actual Plan sponsors. Although they may make the initial employer contribution into UCRP for all covered employees, they are reimbursed by the various funding sources, including the State, the federal government, the UC Medical Centers and other independent enterprises. The actual funding sources are the agencies that reimburse the Regents. Ironically, it is only if one of the funding sources, like the State, refuses to pay its share of the retirement costs of for the employees it supports, the UC Regents are forced into the position of becoming the only Plan Sponsor.

UCRP MARKET NUMBERS & CALCULATION & WHAT THEY SHOW

NUMBERS (as of Dec. 31, 2009)

- Market Value of Assets (MVA): \$36.582 B
- Actuarial Accrued Liability (AAL): \$46.368 B
- Funded Ratio (MVA/AAL): about 78.8%
- Unfunded Actuarial Liability (UAL) (MVA-AAL): \$9.786 B
- UAL amortized over 15 years (UAL/15): \$1,108.8 M
- Cost of 1 year of UCRP benefits (Normal Cost): \$1.309 B
- The UC Regents' request for state funding for UCRP for 2010-11: \$109 M
- State funding for retirement allocated for UCRP: \$0

THE CALCULATIONS

TOTAL UCRP ANNUAL COSTS

The Normal Cost: \$1.309 B (17% of CC)

The Annual Cost to Amortize UAL over 15 yrs: \$1,1088 M (14.4% of CC)

The Total Annual Cost = \$2.418 B (31.4% of CC of \$7.7 B for the next 15 years)

STATE UCRP COSTS

The State's share of the Normal Cost: \$324 M (17% of \$2.7 B less 5% employee contribution)

The State's share of Amortizing UAL: \$389 M (14.4% of \$2.7 B)

The Total Cost for the State=\$713 M.

Note: The "missing" \$9.786 in unfunded liability does not earn 7.5%; it earns 0%. For example, if you had a 15 year \$105,000 mortgage, the lender does not let you pay \$7,000 per year; instead, you must pay interest on the unpaid balance. Similarly, in order to amortize the UAL over 15 years, \$1,108.8 M must be paid into UCRP for each of 15 years.

EMPLOYEE UCRP COSTS

If UC employees paid 5% of CC (the state employee level), they would pay \$390 M.

& WHAT THEY SHOW

HIGHLIGHTS

1. UCRP is 78.8% funded.
2. The unfunded liability keeps growing and is now nearly \$10 B. It would take more than \$1 B per year for 15 years to amortize the unfunded liability.
3. The annual cost of benefits (Normal Cost) is about \$1.3 B.
4. UCRP needs about \$2.4 B per year to restore 100% funding and amortize the unfunded liability over 15 years.
5. The State has failed to pay its share of retirement costs for state-supported employees at UC, which has delayed resuming contributions. The total State contribution would be \$713 M.
6. Contributions are scheduled to begin on April 15, 2010 at 4% of covered compensation for the employer and 2% for the employee, yielding about \$558 M. The unfunded liability would increase by \$1.86 B by June 31, 2011.
7. Within the next 5 years, the unfunded liability will increase to well over \$15 B. If contributions increase every year from 6%, to 9%, to 12%, to 15%, then UCRP will not be receiving 7.5% return on the unfunded liability and contributions will not equal the Normal Cost. For perspective on the enormity of the problem, we outline the "tuition" solution. In order to amortize the UAL, UC would need to charge each and every one of the 200,000 UC undergrads \$5,544 per year for 15 years, or ADD \$3,141 to tuition forever. To pay the Normal Cost, another \$6,500 could be added. Thus, a mere \$10,000 tuition increase would handle the entirety of the UCRP problem.

CONCLUSION/CONSEQUENCES

THE STATE'S OBLIGATION TO FUND UCRP

Resuming Funding to UCRP at less than the Actuarial Recommended Contribution (ARC)

2008-09

In September 2008, the Regents adopted a new funding policy for UCRP, which calls for 5-year averaging or “smoothing” of investment returns, 15-year amortization of any future actuarial unfunded liabilities, and a 30-year amortization of any future actuarial surplus. The Regents also voted to resume contributions to UCRP, subject to the state budget process, availability of funding, and collective bargaining, with the expectation that that the State support would be consistent with the State’s approach to contributions to CalPERS: CalPERS actuaries determine the level of contributions needed by the fund; CalPERS requests that amount from the State; employees contribute a fixed 5%; and the State contributes the amount necessary, when combined with the employee contribution, to reach the level requested by the actuaries (see the UC Regents 2008-09 Budget Request, “Retirement contributions,” p. 21 at the UC Budget website www.budget.ucop.edu).

2009-2010

After the June 30, 2008 Valuation of UCRP, UC actuaries informed the UC Regents that contributions to UCRP would be needed for the Plan Year 2009-10. As of July 1, 2009 on a Market Value basis, UCRP was underfunded for the first time in nearly 20 years- at 99% funding. UCRP’s full funding policy called for a total contribution of 11.5%, which would be split between employer at 9.5% and employee at 2%. Calculated on a total covered payroll of \$7.5 B, the total contribution would be about \$862.5 M (11.5% x \$7.5B). That State’s portion of that would be \$ 256.5 M (9.5% of a covered payroll of \$2.7 B). The other UC funding sources would pay roughly double that amount, \$456 M (9.5% of \$4.8B), with the federal government portion at about \$228 (\$456 M /2). Employees would pay 2% or roughly \$150 M (2% x \$7.5 B).

The UC Regents originally requested 9.5% from the State or \$256.5 M, but in November 2008, they reduced the employer contribution to 4% or roughly \$180.9 M, apparently because they wanted to ease the transition to the full contribution level. This request followed the statutory obligation of the Regents to provide notice to the State of a change in contributions according to the California Government Code. (Title 1 Division 7. Miscel Chapter 21. PUBLIC PENSION AND RETIREMENT PLANS. 7500-7514.5). This code specifically mentions the obligations of the UC Regents with regard to continued state funding of the retirement plan.

According to PERL 20814 (a), the State is required to fund a public retirement system at the level requested by the actuaries, but the Governor allocated only \$20 M. Based on this reduced level of funding, the Regents met again in February 2009 and voted to resume contributions to UCRP at 4% for the employer and 2% for the employee, but they moved the start date to April 15, 2010 so that for three months at least contributions would resume at 6% total. This level of

contribution would continue through July 31, 2011. Later, the Legislature eliminated the \$20 million funding entirely, apparently following the advice of the LA, leaving the Regents to make the State payment without any help from the State.

For 2009-10, the actuarial recommended contribution (ARC) was 11.5% of covered compensation or about \$862.5 M; the actual amount contributed will be 1.5% or \$112.5 M (1.5% x \$7.5 B). The total unfunded contribution will be about \$750 M.

2010-11

For the fiscal year beginning July 1, 2010, the UC actuaries calculated that UCRP needed 20.4% of covered compensation. This level of contribution on a covered payroll of \$7.9 B would have yielded about \$1.6 B in total contributions.

The Regents requested 4% of UC's state-covered payroll of \$2.7 B or \$108.9 M. Of this amount, \$95.7 M would come from the State and \$13.2 M from UC General Funds. UC employees would pay 2%.

The Governor's Proposed Budget for California did not allocate any funding for retirement for state-supported employees at UC for 2010-11.

For 2010-11, the actuarial recommended contribution (ARC) was 20.4% of covered compensation or about \$1.6 B; the actual amount contributed will be 6% or \$474 M (6% x \$7.9 B), leaving about \$1.13 B unfunded.

2011-2022

UC plans to ramp up the contributions starting 7/1/2011: employer contributions would rise 2% per year until they reach the amount required by the actuary under the September 2008 funding policy, and employee contributions would rise by 1% per year until they reach 5% of covered compensation, the same level that state miscellaneous employees pay who are covered by CalPERS. It would take until 2022 for the total UCRP contribution to reach the contribution level recommended by the actuaries.

Lost Contributions Turn into Future Retirement Debt

Net Pension Obligations (NPO)

Government employers must fund their employee retirement plans at the level set by the actuary. According to Governmental Accounting Standards Board (GASB) 25 and 27, which governmental public pension plans like UCRP must follow, employers must account for the part of the ARC that they did not collect in contributions. The underfunded amount becomes a Net Pension Obligation (NPO) Bond that must be amortized in future years. In addition to amortizing these NPOs, employers are required to pay one year's interest on the balance every year at the same rate as the assumed rate of return on retirement assets, currently 7.5% at UC. These

increases are often added to employer contributions. The unfunded contribution for UCRP for 2009-10 was \$750 M; increased in 2010-11 by \$1.13 B to total roughly \$1.88 B by 7/31/2011.

These accounting rules highlight the problem of underfunding a public retirement plan. They also point directly to the future problem that the State of California is creating for itself in not funding UCRP at the level of the actuarial required contribution. CA retirement law, outlined in PERL, requires that the State Legislature fund the actuarial amount requested by all the state and public agency retirement plans. The State will eventually have to pay more in the future for deferring current contributions now. A dollar deferred in 2011 would require \$4.25 to be contributed if the deferral were made up in 2031, including 20 years of earnings at the assumed 7.5% rate of return (see the UC TFIR report, updated Feb. 9, 2010, at www.universityofcalifornia.edu/senate/reports/HP2MGY_UCRPFunding_030310.pdf).

The State's deferral tactic is particularly costly in the case of UCRP because of the historic contribution policy: the State sets the level of contribution for all other funding sources. If the State does not begin the process, then the other funding sources do not contribute. The contributions of the federal government can never be recovered (with some exceptions involving the UC labs). In most governmental pension plans, the employer tacks on increased amounts to the contributions to amortize both the NPO and the interest cost, but this cannot be done for the federal government. Under OMB (Office of Management and Budget) Circular A-21 Appendix A: once the actuaries make their calculations and the employer knows the percentage of covered payroll necessary to fully fund the plan, but does not collect that amount from all plan participants within 6 months after the end of the fiscal year, the employer cannot go back to the feds some time in the future and ask for higher retirement contributions to make up for earlier underfunding.

In the case of UC, by not paying the retirement contribution for the state-supported employees at UC now, the State assumes the further risk of liability for all retirement payments not made by the federal government. By not paying \$96 M in 20010-11, UC failed to collect roughly another \$96 M from the federal government and \$96 M from the other UC funding sources. By the State not paying its share to UCRP now, the State will assume three times that liability in the future.

Pension Obligation Bonds

Without State contributions for UCRP, the Regents will have to fund the state's share of the UCRP retirement contribution. They will have to look to other funding sources, like increasing student fees, extending the duration and increasing the size of the furloughs, large-scale layoffs or cultivating private funding. Another option would be massive downsizing, which would affect access, already a politically sensitive issue.

Under the circumstances, the most prudent choice for the UC Regents would be to take out Pension Obligation Bonds each year in the amount of the actuarial recommended contribution that is attributed to the State. This amount, based on a State-supported payroll of roughly \$2.7 B, would be substantially less than an NPO, which would be the total amount of the contributions not collected, based on a covered payroll of roughly \$7.9B. For example, for the 2009-10 fiscal year, the NPO would be \$750 M, the amount of the actuaries required contribution not funded,

but a POB would be only \$256.5 M (9.5% x \$2.7 B)—just the State’s share of the total contributions.

The POB is lower than the NPO because a bond set at the State contribution level would call forth the contributions from all of the other UC funding sources as well as employee contributions. A POB or an IOU from the State would open the floodgate to other contributions. These UC funding sources will pay at the same level as the State pays, but they will not pay more. Zero contributions from the State means zero for everyone else. The State’s failure to understand the long-term ramifications of the 2 for 1 contribution process at UC lies at the heart of its mounting liability problem with respect to UCRP. Major studies of the State liability include the entire amount of UCRP unfunded liability, not just the amount attributed to the State’s share.

Not only would it be less expensive to pay interest on POBs (at roughly 6%) over NPOs (at 7.5%), since 2/3 of the total contributions would then flow into UCRP, the effective rate of interest would be well below 6%.

The State has shown a willingness in the past to issue POBs when it could not make the full actuarial required contribution to other state retirement plans. The PEBC study of retirement liability found the total unfunded liability to be \$63.5 B in 2005, but this figure did not include pension obligation bond debt which was approximately \$10 B at that time.

Uncompetitive UC Faculty Salaries

Any cuts in University funding, including retirement funding, affects faculty salaries, which in turn affects recruitment and retention and ultimately UC’s reputation as a world class university. In a recent update of the Comparison 8 and UC average salaries, average UC salaries now fall below the Comparison 8 combined average (comparison 8 is comprised of 4 private universities, Harvard, Princeton, MIT, and Stanford, and 4 public universities, U of Virginia, U of Illinois, Urbana, U Michigan, Ann Arbor, and the U of New York, at Buffalo). The original idea of the Comparison 8 was to adjust UC salaries every year so that the average fell in the middle, between the 4 Privates and the 4 Publics. With the 2009-10 average of the Comparison 4 privates at \$147,724 and the Comparison 4 publics at \$104,984, the middle would be about \$126,354, but the UC average is below that at about \$112,862.

Perhaps even more significant is the downward trend in UC average academic salaries. Between 2008-09 and 2009-10, the average Comparison 4 privates rose from \$146,207 to \$147,724, the Comparison 4 publics rose from \$103,627 to \$104,984, but the average UC salary dropped from \$113,226 to \$112,862, due to the furlough. The lag is now 11.2% to return UC average salaries to the middle position. See www.universityofcalifornia.edu/regents/regmeet/mar09/j1attach.pdf. These figures mean that UC is falling behind in recruitment and retention of faculty who move among these top public and private institutions.

Deep Budget Cuts Move UC Closer to Privatization

The State's failure to support UCRP will give UC a different kind of "special" status: UC professors will be the only state-supported teachers whose retirement is not funded by the State.

Beginning April 15, 2010, the Regents will resume contributions to UCRP. Even though they plan to start with 6% of covered compensation, 4% from the Regents and 2% from employees, they will soon need to increase that amount to 17%, the Normal Cost, and higher than that to amortize the unfunded liability. Without state support, or an IOU from the State, the Regents will be forced to reallocate other state funding as well as use student tuition to make up for the loss of state support for retirement—with all of the expected negative political fallout.

Without pension support from the State, the Regents will also be forced to look to private sources to fund the core mission of the University. Tuition will increase and fewer California residents will be able to afford a UC education. If this chain of events occurs, the Legislature will have used the historic state allocation process to impair the ability of the Regents to govern the university, and the State will have failed to support a public trust that it created and nourished over the years, which helped it to grow into a world-class public university.

APPENDIX

Table 1
UCRP Assets, Investment Returns, Funded Ratio

FY ending June 30	Assets MVA in millions	Funded Ratio AVA/AAL	Funded Ratio MVA/AAL	Employee Contrib in millions	Employer Contrib in millions
1979	\$1,483				
1980	\$1,763	80.7%		\$41	\$193
1981	\$2,106	N/A		\$49	\$229
1982	\$2,495	85.2%		\$52	\$248
1983	\$2,956	88.8%		\$33	\$256
1984	\$3,967	89.4%		\$42	\$249
1985	\$5,402	95.1%		\$56	\$187
1986	\$7,771	99.8%		\$62	\$262
1987	\$9,831	111.2%		\$68	\$262
1988	\$9,313	128.1%		\$72	\$258
1989	\$10,896	143.2%		\$80	\$211
1990	\$12,463	161.4%		\$87	\$162
1991	\$13,422	150.3%		\$42	\$47
1992	\$15,203	121.1%		\$0	\$0
1993	\$17,371	109.4%		\$0	\$0
1994	\$16,299	108.1%		\$0	\$0
1995	\$19,912	106.6%		\$0	\$0
1996	\$23,603	110.1%		\$0	\$0
1997	\$28,970	118.7%		\$0	\$0
1998	\$34,531	131.6%		\$0	\$0
1999	\$37,930	144.8%		\$0	\$0
2000	\$41,914	153.8%		\$0	\$0
2001	\$38,699	147.7%	140.7%	\$0	\$0
2002	\$34,292	138.4%	113.9%	\$0	\$0
2003	\$35,241	125.7%	106.8%	\$0	\$0
2004	\$39,289	117.9%	112.1%	\$0	\$0
2005	\$41,970	110.3%	111.9%	\$0	\$0
2006	\$43,387	104.1%	116.5%	\$0	\$0
2007	\$47,954	104.8%	119.0%	\$0	\$0
2008	\$42,031	94.8%	98.7%	\$0	\$0
2009	\$32,309	94.8%	70.9%	\$0	\$0

NOTE: the Employer contribution given here reflects the total contribution from all sources: the State, the federal government, contracts and grants, and the UC Medical Centers. These figures reflect only the Basic plan support, not all UCRS. Data on University of California Retirement Plan, collected from UCRP Annual Reports 1980 – 2007 by Charles Schwartz, UCB, 10/31/2008. See his website at <http://socrates.berkeley.edu/~schwartz/>.

Table 2

**UCRP: The University Plan & CalPERS
Contributions as a % of State Covered Compensation**

year at 6/30	UCRP State, Misc., Tier 1				CalPERS State Misc., Tier 1			fiscal Yr end
	State Contrib	Employee Contrib	Salary Increase	Invest. Returns Fiscal	State Contribution	Employee contrib.	Salary Increase %	
1980	14.91%	3%	9.8%	10.60%	19.24%	5%	9.8%	7.91%
1981	14.91	3	6	14.60	19.563	5	6	8.72
1982	14.97	3	0	-4.60	13.56	5	0	9.58
1983	14.97	3	7	52.10	18.26	5	6	10.56
1984	14.97	2	9	-5.48	17.6	5	10	-3.10
1985	8.06	1.7	9.5	32.07	17.6	5	10.5	35.4
1986	11.3	2	5	38.60	15.45	5	6.8	24.6
1987	10.3	2	5.6	23.50	15.2	5	6.9	13.8
1988	8.59	2	3	-7.43	13.464	5	4.7	3.9
1989	5.92	2	4.7	16.82	13.224	5	4.8	15.7
1990	4.03	2	4.8	13.70	12.88	5	4.9	9.7
1991	-5	0	0	9.33	11.80%	5	0	6.5
1992	-2.5	0	0	15.30	10.30%	5	0	12.5
1993	0	0	0	17.10	9.90%	5	3	14.5
1994	-5.26	0	3	-2.80	9.90%	5	0	2
1995	-2.67	0	3	26.20	12.4	5	2.5	16.3
1996	0	0	5	21.20	13.1	5	4	15.3
1997	0	0	5	25.80	12.7	5	4	20.10
1998	0	0	4.5	21.80	8.5	5	5.7	19.5
1999	0	0	2.9	12.20	1.5	5	6	12.5
2000	0	0	3	12.80	0	5	6	10.5
2001	-3	0	0.5	-5.60	4.2	5	2	-7.23
2002	-5	0	0.5	-9.20	7.4	5	2	-5.97
2003	0	0	0	5.60	14.8	5	0.8	3.9
2004	0	0	0	14.34	17	5	0	16.7
2005	0	0	2	10.30	15.9	5	3.5	12.7
2006	0	0	2	7.10	17	5	4	12.3
2007	0	0	2.5	18.83	16.6	5	7.3	19.1
2008	0	0	0	-5.74	16.6	5	2	-2.62
2009	0	0	0	18.81%	16.9	5	0	-23.4

Note: This information was gathered from a variety of sources: Understanding CalPERS: An Overview of the CA Public Employment Retirement system, Investments, www.calpers.ca.gov/msspublication/pdf/xjnbzroGKb575_pub-36-2006.5.1.pdf. Annual Facts at a Glance: Investment.