



**UCLA
Faculty
Association
Newsletter**

Fall/Winter 2009-10

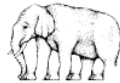
Nonprofit
US Postage Paid
Van Nuys, CA
Permit No. 173

An Independent Membership Organization of Faculty at the University of California, Los Angeles
P.O. Box 33336 Granada Hills, CA 91394-3336 Phone and FAX 818 341-8664 ucfa@earthlink.net
For more information, see the FA at UCLA Website at <http://www.uclafaculty.org>

The UC Retirement Plan (UCRP):

Market Numbers & What They Show:

The Elephant in the Room is Getting Bigger & Bigger



On September 30, 2009, UCRP Quarterly Investment Information Shows

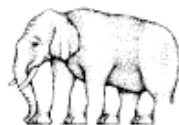
The Market Funding Ratio was 78%.

The \$10.19 Billion Unfunded Liability

Requires \$1.15 Billion Annually to Amortize it over 15 Years.

The Annual Cost of Benefits is \$1.34 Billion.

Thus, about \$2.49 Billion should be put into UCRP Annually.



Delaying the Resumption of Contributions Costs the Regents Double their own Contribution

Resuming Contributions at too Low a Level Increases Unfunded Liabilities, Will Cost Younger Employees Dearly, and Threatens the Future of UC



**UCLA FA
Executive Board
2009-10**

Chair, Dwight Read, anthro,
dread@anthro.ucla.edu

Treasurer, Sheila Greibach, comp.
sci_greibach@cs.ucla.edu

Michael Allen, English
mjballen@humnet.ucla.edu

Jean-François Blanchette, info.
studies_blanchette@ucla.edu

Stephen Cederbaum, psychia.
scederbaum@mednet.ucla.edu

Russell E. Christensen, dent-oral
rchristensen@dentistry.ucla.edu

Jody Kreiman, surgery-hd & nk
jkreiman@ucla.edu

Steven Lippman, management
steven.lippman@anderson.ucla.edu

Michael Lofchie, poli sci
mlofchie@polisci.ucla.edu

Daniel Mitchell, emer., mgmt
danieljbmitchell@gmail.com

Karen Orren, poli sci
orren@ucla.edu

Roger Waldinger, sociology
waldinge@soc.ucla.edu

Dan Atkinson, emeritus rep.
dea@ucla.edu

Susan Gallick,
Executive Director
ucfa@earthlink.net

Are you an FA member?
Is "member" on your mailing label?
If not, the FA newsletter is being mailed to you courtesy of your colleagues. Please join them and support the FA. **Application on p. 8.**

This is the third part in a series of Faculty Association newsletters on the UC Retirement Plan (UCRP). In the first part, the FA provided a primer on retirement terms, defining such basic building blocks of pension calculations as MVA (Market Value of Assets or the price at which the assets might be traded in the open market), AVA (Actuarial Value of Assets or the value of the assets after averaging market returns over a number of years), and AAL (Actuarial Accrued Liabilities or an estimate of the present value of all accrued pension benefits). These values allow one to calculate the funding ratio, which tells participants if the assets (stocks, securities, etc.) are sufficient to meet the liabilities (the amount that must be paid out to retirees, survivors, etc). In the second article, we examined the question of “Who Has to Pay the Retirement Contributions” for state-supported employees at UC, thus providing historical background on the complex issue of the State’s obligation to pay into UCRP after a 20 year contribution holiday. The bottom line: although the State should pay for the retirement contribution of state-supported employees at UC, the Regents have the ultimate, legal obligation to pay all the promised benefits. There is no backing out of this obligation. (FAwebsite: <http://www.uclafaculty.org/FASite/Newsletters.html>.)

In this article, we would like to update faculty on the current status of UCRP as of Sept. 30, 2009. To do that, we will rely on the market value of the assets. Market numbers are what they are; they have not been smoothed or averaged or manipulated in any way. Averaging over a period of time, like 5 years, smoothes out the effect of the ups and downs typical of market returns, which, in turn, ensures less volatility in setting the level of contributions over time. However, smoothing also masks the value of the market numbers.

In the case of UCRP, whose funding ratio has been declining for ten years, averaging the market numbers over a period of 5 years makes the financial condition of the fund appear better than it is. Averaged numbers show that UCRP had a 95% funding ratio as of Sept. 30, 2009, whereas market numbers for the same period reveal that the funding ratio has fallen to 78%. If the market continues to perform poorly over the next several years, then the actuarial numbers will drop and come closer to the market numbers.

The actuaries use an annual return of 7.5% on the UCRP portfolio of assets in all of their calculations. Over the long term, this has been a reasonable assumption, and the UCLA FA is not objecting to this number. But we want you to be aware that the annualized 10-year return on investments for UCRP on Sept. 30, 2009 was 3.9%. Not including the 2008-09 year losses, the annualized 10-year return was 5.66% as of June 30, 2008.

Averaging numbers puts the estimate of the unfunded liability at \$2.441 billion on Sept. 30, 2009, but the market numbers show a \$10.190 billion unfunded liability.

UCRP is not facing a small decline in assets that will soon be evened out by higher returns over the next few years. In 2008-09, the plan experienced a -18.81% return on investment that propelled it into a significant deficit funding position that will take years to correct. So the first big step is to see the market numbers and understand what they show about the financial condition of UCRP on Sept. 30, 2009. The FA is not suggesting that contributions be set using these market numbers; we are suggesting that market numbers should propel the UC Regents into action to implement the UCRP funding policy they passed in 2008 and put UCRP on the road to full funding within 3 years.

FACULTY ASSOCIATION

Q&A on the UCRP Funding Crisis

See “The Calculations” at the end of this article if you are interested in seeing how we arrived at the numbers. Market numbers are from the third quarter, Sept. 30, 2009.

Q Is UCRP in financial trouble today?

A Yes. Liabilities exceed assets by \$10.190 billion. This shortfall is called the unfunded liability.

Q Why has this crisis emerged so suddenly?

A Because the MVA fell 18.81% during 2008-09. Also, the UC Regents have been drawing down the funding surplus in UCRP for years to pay for such programs as VERIPs and CAP payments. Furthermore, neither employees nor employers have contributed to UCRP for a period of 20 years.

Q How does a retirement plan typically manage a single year loss of that magnitude?

A Contributions are increased. A portion of any unfunded liability is added to the contributions each year to bring the Plan back to full funding over a set period of years. In addition, the investment return on the shortfall must be factored into the size of the contribution. For example, the UC Funding Policy requires that the unfunded actuarial liability be amortized over 15 years. Given the assumed 7.5% annual return on assets, \$1.15 billion dollars needs to be added to the contributions each year for 15 years to amortize an unfunded liability of \$10.190 billion.

Q How will the Regents set the level of the contributions?

A The UCRP Funding policy calls for contributions to be set at the level of the Normal Cost plus any unfunded liability. The Normal Cost is an actuarial estimate of the cost to fund the benefits provided by the retirement system for the current year. The Normal Cost is expressed as a percentage of the payroll covered by retirement benefits—called the Covered Compensation or CC. The Normal Cost is not a smoothed or averaged number, but a complex actuarial figure based on estimates of mortality rates, demographics, salary increases, separation rates, the number of survivors, etc. and has been remarkably constant over the last 20 years. The Normal Cost is 17% of CC (17% of \$7.87 billion) or \$1.34 billion for 2009-10.

A retirement plan that has a 100% funding ratio still needs contributions in the amount of the Normal Cost so that the assets will equal the liabilities at the end of the plan year after the benefits have been paid out and assets have earned the predicted rate of return. A funding ratio of less than 100% signals the need for even higher contributions than the Normal Cost in order to bring assets back up to the level of all accrued liabilities.

Q When will contributions start?

A The Regents approved contributions to start on April 15, 2010.

Q What is the total contribution needed by UCRP when contributions start April 15, 2010?

A Using an average of the market value of assets over the last five years, UCRP needs 20.5% of CC or \$1.6 billion. This figure assumes a 7.5% return, includes the Normal Cost, and amortizes the smoothed, unfunded liability (\$2.441 billion) at \$277 M per year over 15 years.

But the market numbers call for a much higher contribution: 31.7% of CC or \$2.49 billion. This figure also assumes a 7.5% return, includes the Normal Cost of 17%, but amortizes the market value unfunded liability (\$10.190 billion) at \$1.15 billion per year over 15 years.

The FA does not suggest that anyone use the market numbers to calculate the actual contribution to UCRP, but the market numbers show that UCRP needs 17% per year to cover the Normal Cost, and an even greater amount, 14.7%, to amortize the unfunded liability of \$10.190 billion over 15 years.

Q How will the contribution be divided between employer and employee?

A The FA urges that the employee contribution be capped at 5% and the employer contribution be allowed to

adjust according to funding needs. Historically, the ratio has been close to 5:1. With a reduction in state funding, the Regents recently proposed that contributions begin with a 4% employer contribution and a 2% employee contribution. Without any state funding, the Regents provided for at least a 1:1 contribution ratio in the UCRP funding policy passed in September 2008. This ratio, if ever implemented, would constitute an adverse change of enormous proportion for the faculty and all employees.

A 5% employee contribution and an adjustable employer contribution bring UCRP policies in line with those of other state-supported enterprises, like CSU, that receive state support for the employer contribution.

Q What would the UC Regents have to contribute per year for state-supported employees if the contribution were set at the level called for by the smoothed market numbers?

A The portion of CC for state-supported employees is about \$2.75 billion; therefore, the UC Regents would have to contribute 15.5% (20.5%-5% employee contribution) of CC (\$2.75 B) or \$427 million dollars per year.

Q What would the UC Regents have to contribute per year for state-supported employees if the contribution were set at the level called for by the market numbers?

A \$735 M per year or 26.7% (31.7%-5%) of CC.

Q How could UC pay even the contribution of \$427 million arrived at by smoothing the market numbers when the budget for 2009-10 was cut by over \$800 million, faculty and other employees have been furloughed, and the outlook for next year remains grim?

Without state contributions, it is not at all clear how the UC Regents would pay for the yearly contribution of \$427 million. We have assumed in our calculations that UC employees provide 5% of the contribution. This is similar to the contribution rate for other state employees, which would place the onus on the State to provide the employer share of the UCRP contribution.

Q. Could the Regents delay payment for a few years or at least lower the payment until the budget crisis is over?

A Delay is costly because liabilities increase without any offsetting contributions. At UC, delay is particularly costly because of the reimbursement policy that was followed before contributions stopped in 1990 and presumably will hold when contributions resume. The Regents make the employer contribution for all employees covered by UCRP with the expectation that the State, the federal government, the UC Medical Centers, and all other independent enterprises will reimburse them for UCRP

contributions in proportion to their portion of the total CC. The State provides roughly 35% of CC (\$2.75 billion) and the other agencies about 65% of CC (\$5.12 billion) for a total retirement-covered payroll of \$7.87 billion.

So far, the Regents have been delaying the start of all contributions because the State has refused to budget the contribution amount for state-supported employees. While the Regents wait to recover 1/3 of the cost of retirement contributions from the State, they lose 2/3 of the total contribution they could be recovering from the other agencies that provide 65% of the CC but with no hopes to recover these lost contributions in the future.

Delay is costly whether amortizing the averaged or market value of the unfunded liability. If we take the contribution figure of 20.5% of CC, which does not recognize the market unfunded liability immediately, then delay in waiting for the State to budget \$427 million per year costs UC \$794 million per year in other reimbursements.

If we take the figure of 31.7% of CC, which recognizes the market unfunded liability immediately, then delay in waiting for the State to budget \$735 M costs the Regents \$1.36 B in reimbursements from the federal government, the UC Medical Centers, and other independent enterprises. During a holding pattern, not only do the employers not contribute, neither do the employees, which further increases the unfunded liabilities.

Q What about the hardship of extracting even 15.5% (20.5%-5% employee contribution) of the contract & grant payroll when that cost was not factored into earlier research proposals extending 3 or 4 years into the future? (For new grants, the amount of the employer contribution will be figured in, but not for the older ones.)

A That will be a hardship for a few years as the longer contract and grant periods wind down, but newer contracts and grants will have to account for the retirement contribution for those employees covered by outside funds. The UC Regents may have to forego some percentage of the reimbursements from contracts and grants in some situations. However, since the granting agencies are getting more research for the same amount of money on earlier grants than on ones including the retirement contribution, the administration could enter into negotiations with granting agencies on the grounds that the earlier grants should be augmented to cover UCRP contributions since the granting agency is otherwise getting a free-ride.

Q Could the UC Medical Centers afford to take 15.5% of their covered payroll to pay for the retirement benefits of their employees and stay in the black?

A That question points to the urgency of the present situation: fragile funding for all UC enterprises, instruction, medical centers, contracts and grants. It will not be easy

for any of the employers and employees at UC to pay for the cost of retirement in the current budget crisis, with budget cutbacks and furloughs, but it must be done. The market numbers point to the need for much higher contributions than the total of 20.5% --closer to \$31.7%. Unless the Regents act quickly and decisively to resume contributions and bring them to the level needed quickly, the alternative is an unfunded retirement liability that could grow according to the wonders of compounding and very quickly cripple the academic mission of the University and the academic hopes of its faculty.

Q If the UCRP crisis was caused by a drop in assets, won't the market come back up and fix the problem?

A No. Anyone who thinks the stock market will bail out UCRP is most certainly engaged in "faith-based budgeting." If UCRP needs \$10.190 billion to return to full funding, the assets would have to increase more than 28.5%. In addition, through the course of a year, the fund would need to take in the Normal Cost (17%) or roughly \$1.34 billion, pay out about \$1.67 billion and earn 7.5% on the assets just to stay even. These amounts far exceed what UCRP assets alone could be expected to earn.

The UCRP investment returns for the third quarter 2009 were 12.2%, down slightly from the second quarter returns of 13.38%. The increase in market returns since Sept. 30 (the S&P is up about 9.8% from 9/30 to 11/16) has further reduced the shortfall. Although the very recent trend is positive, the 5 year annualized return is 3.68% as of the end of the third quarter.

Q With an unfunded liability of \$10.190 billion, and needed contributions of at least 20.5%, possibly approaching 31.7%, are my retirement benefits safe?

A Yes. The UC Regents are legally obligated to pay all the benefits promised.

Q Should I consider taking a lump sum cash-out just to make sure I get all of my benefits?

A Everyone must weigh the pros and cons very carefully. The FA cannot give investment advice. We understand that UC has an iron-clad legal obligation to provide funding for UCRP. Anyone who takes a lump sum cash-out gives up the right to retiree health benefits, continued payment of benefits to a contingent annuitant like a spouse or domestic partner, and perhaps most importantly, takes on the obligation to invest the proceeds and accept the market risk. In actuality, it helps UCRP if employees take out their benefits as a lump sum because it reduces liabilities by more than assets. See the Senate Report "Market Turmoil and the UCRP Lump Sum Cashout, January 20, 2009": <http://www.universityofcalifornia.edu/senate/reports/Lump%20Sum%20C%20shouts%2022%20JAN09%20Final.pdf>

Q Will the Furlough/Salary Reduction Plan approved by the Regents in July 2009 affect the level of contributions?

A The Furlough/Salary Reduction Plan will have no effect on the calculation of member benefits or on the level of the contribution, but it will reduce the dollar amount of contributions coming into UCRP when they resume on April 15, 2010 because contribution percentages will be based on actual pay. For example, UCRP will receive about \$10 M less in funding between April 15 and Aug. 31, 2010 if contributions are set at 4% for employer and 2% for employee because of the furlough plan.

Q Who should be concerned about the increasing unfunded liability?

A Everyone. The Regents, who have a fixed legal obligation to retirees, may be compelled to allocate a higher and higher percentage of the university's operating funds to pay retiree benefits. This would reduce the funds they could allocate for teaching, research, salary improvements and the university's physical infrastructure. Some have estimated that if UC does not reverse the trend of allowing unfunded liabilities to increase, the employer share of the retirement contributions could go up beyond 50% of covered compensation.

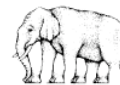
Q Why is the grim state of the retirement system, paradoxically, of greater interest to younger and mid-range faculty than senior faculty?

A Because the longer the UCRP system goes underfunded and if contributions are less than necessary to restore full funding, the unfunded liability increases according to the wonders of compounding. In this situation, the level of contributions that will be required in the future will climb higher and higher and the process of eliminating those who retire from making contributions says that the younger faculty will have to pick up the bill.

Q What is the best approach to begin contributions?

A In Feb. 2009, the Regents approved restarting contributions effective April 15, 2010, subject to collective bargaining, as applicable. The University will contribute 4% and employees 2%. The employee contribution would increase by 1% per year until it reached 5%, and the employer contribution would increase by 2% a year until it met the contribution level required by the UCRP funding policy. Following this plan, total contributions would add up to 6% for 2010-11, 9% for 2011-12, 12% for 2012-13, and 15% for 2013-14. Even after 5 years, contributions would still not equal the Normal Cost. The unfunded liabilities would have risen higher and higher and the funding ratio fallen lower and lower.

On June 3, 2009, the Academic Council asked President Yudof to follow the UCRP funding policy approved by the Regents in Sept. 2008, which calls for contributions of about 20.7% of CC by July 1, 2011.



By looking at the market numbers and what they reveal about the magnitude of the unfunded liabilities, roughly 29% of the Market Value of UCRP Assets on Sept. 30, 2009, the FA urges the Regents to

- (1) start contributions on 4/15/10 at the level of 4% for the employer and 2% for employee,
- (2) increase contributions on 7/1/10 to the level of the Normal Cost 17%,
- (3) and set contributions on 7/1/11 to equal the Full Cost according to the UCRP funding policy, including the Normal Cost and an amount to amortize any unfunded liability over 15 years.



Faculty must insist that the Regents be both prudent and smart. In a nutshell, prudence means restarting contributions at a significant level, at least the level of the Normal Cost by July 1, 2010. Smart means ensuring that the federal government, UC Medical Centers, and all other independent enterprises that support UC employees, reimburse the Regents for their share of the retirement costs. If worse comes to worst and the State refuses to reimburse the Regents for the UCRP contribution on behalf of state-supported employees, then the UC Regents must either take a big chunk of the operating budget to fund UCRP, issue an IOU or issue a pension bond of some sort. In any case, the amount owed, borrowed or raised will draw from non-state agencies more than double that amount. These additional reimbursements as well as the employee contributions will all increase the asset base earning investment returns. UCRP will then have the two streams of income that it needs: investment returns and contributions. If the Regents do not address these problems immediately, UCRP will soon require funding at a level that the University cannot sustain and fulfill its educational mission at the same time.

For more information on this problem, see the Report issued by the UC Task Force on Investment & Retirement (TFIR), 5/13/09 <http://www.universityofcalifornia.edu/senate/reports/mctoyudof.ucrpfunding.june09.pdf>; the Post-Employment Benefits Task Force (PEBTF) presentation at UCLA on October 14, 2009 <http://www.chr.ucla.edu/chr/portal/docs/ben/bendoc-post-emp-benefits.pdf>; and the many reports on UCRP and the UC Budget prepared by Charles Schwartz <http://socrates.berkeley.edu/~schwartz/>.

THE CALCULATIONS:

Review:

The UCRP Valuation Numbers as of June 30, 2009

The Covered Compensation (CC) is \$7.87 billion

The Normal Cost is 17% of CC is \$1.339 billion

The Actuarial Accrued Liabilities (AAL) \$45.161 billion

The UCRP Numbers as of September 30, 2009

The MVA = \$35.734 billion

The AVA = \$43.483 billion (the MVA averaged over 5 years)

The AAL = \$45.924 billion (the AAL from 6/30/09 of \$45.161 billion, plus $\frac{1}{4}$ of 7.5% return on assets, less the $\frac{1}{4}$ payout of benefits of roughly \$1.67 billion, plus $\frac{1}{4}$ the Normal Cost of \$1.34 billion).

The Funding Ratio:

The MVA/AAL (35.734/45.924) funding ratio was 77.8%.

The AVA/AAL (43.483/45.924) funding ratio was 95%

The Unfunded Liability:

MVA - AAL was \$10.190 billion (\$35,734-\$45.924)

AVA - AAL was \$2.441 billion (\$43.483-\$45.924)

1. The payment needed to amortize the shortfall over 15 years with an assumed return on assets of 7.5% is $11.33\% \times$ the unfunded liability. For the averaged AVA ($11.33\% \times \$2.441$) or \$276.6 million per year.
2. The averaged unfunded liability requires 3.51% of CC ($.2766/7.87$) per year.
3. When the funding ratio is 100%, Employer and Employee Contributions as a percentage of CC should equal the Normal Cost, currently 17%.
4. The Normal Cost (17%) plus the extra % of CC to amortize the unfunded liability (3.51%) total 20.51% CC.
5. If the market unfunded liability were to be amortized over 15 years, then ($11.33\% \times \$10,190$) \$1.155 B would have to be added to the contribution each year for fifteen years.
6. As a percentage of CC ($1.155/7.87$), this amounts to 14.67%.
7. The Total Contribution Based on the Market Numbers:
17.00% to cover the Normal Cost +
14.67% to amortize the unfunded liability and the shortfall in invest return
31.67% of \$7.87 billion = \$2.49 billion.
8. The Total Contribution Based on the Averaging the Market Numbers:
17% to cover the Normal Cost +
3.51% to amortize the unfunded liability and the shortfall in invest return
20.51% of \$7.87 billion = \$1.614 billion.





What Did the FA Do for Me in 2008-09?

FALL/WINTER, 2008

NEWSLETTER TOPIC: HOW IS UCRP FUNDED?

The FA at UCLA set up the basics of pension funding. The Q&A format was called "A Primer on UCRP Pension Contributions." The FA urged the UC Regents to

- Provide figures for MVA (Market Value of Assets) of UCRP on a quarterly basis.
- Make transparent all assumptions about calculating the AAL (Actuarial Accrued Liabilities), including salary growth, discount rate, and life expectancy.
- Assume conservative principles in calculating the Normal Cost.
- Retain the historical precedent of splitting employer & employee contributions on a 4 to 1 ratio.
- Adjust contributions annually to maintain a 100% funding ratio.
- Base the request for state contributions on the full Normal Cost.
- Require all UC employers & employees to make the same contribution as requested from the state and from state employees.
- Allow employees to take their contrib. from their DCP accounts if they wish.

www.uclafaculty.org/FASite/Newsletters.html

WINTER-SPRING, 2009

NEWSLETTER TOPIC: WHO HAS TO PAY CONTRIBUTIONS INTO UCRP?

In the Winter/Spring, the UCLA FA published a newsletter on the complex issue of who has to pay contributions into the UC retirement system. The Q&A format covered the current UC budget situation, CA's support of UCRP before the contribution holiday beginning in 1990, the politics of State support of UCRP today, finding the funds to pay the UCRP employee contribution, and the politics of the UC employer contribution.

www.uclafaculty.org/FASite/Newsletters.html

SPRING 2009

FA LETTERS TO THE REGENTS, SPRING 2009

OPEN LETTER TO THE UC REGENTS, JUNE 17, 2009

The UCLA FA requested that the Regents get more involved in the changes happening to the University. On June 19, this letter was cited on the front page of the San Francisco Chronicle and in the Assoc. Press, Los Angeles News.

http://www.uclafaculty.org/FASite/FA_at_UCLA.html .

During the Spring quarter, faculty from all of the UC campuses and from many departments and professional schools sent their responses to the proposed Furlough Plan to the UCLA FA website. In this way, faculty were able to see what others had written and decide how they should respond.

Check out the Faculty Association Website at www.uclafaculty.org and

the Faculty Association Blogsite at www.uclafacultyassociation.blogspot.com