

DRAFT #7a
THE STATE'S OBLIGATION TO RESUME CONTRIBUTIONS TO UCRP

EXECUTIVE SUMMARY

Because of a funding surplus, the University of California Retirement Plan (UCRP) has not required contributions for nearly 20 years. However, the steady decline of that surplus in recent years and an unfunded liability of \$10.19 billion as of Sept. 30, 2009 have added urgency to the need to resume contributions to cover both the Normal Cost of annual accrued liabilities and to amortize the unfunded liability. The UC Regents asked the State to resume contributions in 2009-10 and 2010-11, but it removed all allocations by the end of the budget process in 2009-10 and has not allocated any part of the amount requested for 2010-11. It appears as if the State is following the advice of the Legislative Analyst's Office (LAO), a bipartisan office that analyzes state budget issues. The LA has asserted that the State has no obligation to pay into UCRP because the Regents are autonomous and have full fiduciary responsibility for payment. However, the State could make contributions in the future if certain conditions are met—for example, if funds are available and if UC employees contribute their share.

We demonstrate in this White Paper that the State, like all the other sources of funding that cover employee compensation at UC, has an obligation to support retirement at the level established by UC actuaries and requested by the Regents. The reasons, although not complex, lie buried in California history. The Legislative Analyst's assertion of no obligation is a radical departure from the historical relationship between UC and the State.

The autonomy of the UC Regents never affected the State's obligation to support retirement because autonomy was conferred in 1879, long before the State began funding retirement benefits for any state employees in any plan. In 1879 California citizens approved the second state constitution. In Article 9, Sec. 9, the University of California is designated as a public trust, which conferred autonomy on the UC Regents and gave them the power to govern UC, manage its resources, and guide its academic development free from the interference of the state legislature. UC would still need to engage in the state budget allocation process, but Legislators were forbidden to use the funding process to harm the ability of the Regents to govern UC.

If autonomy were going to be raised as a reason for the State to stop retirement support for UC employees, it would have been raised in 1961 at the creation of a separate UC Plan. Before 1961, the State contributed to the retirement of state-supported UC employees whether they were in the UC Plan or the State Plan, CalPERS. At that time, most UC employees were enrolled in CalPERS, including all of the UC employees in the federal laboratories. Relatively few, only the faculty and some high-level administrators, were in the UC Plan. Moving all these employees over from CalPERS into the new UCRP and requiring all new employees to join the UC plan would have been the moment for the State to question its obligation to continue to fund retirement benefits for some UC employees for which it had neither fiduciary nor administrative responsibility.

But state support to UC retirement was seamless. After 1961, the State continued to contribute to the retirement benefits of state-supported UC employees who were now all in one plan. A

separate UC retirement plan did not affect the long-standing retirement contribution policy that existed before 1961 and continued for almost 30 years after 1961.

As a public trust, UC depended on shared responsibility not legal obligation among those who fund employee compensation. The UCRP contribution policy was layered. The Regents always made the full contribution for retirement for all UC employees regardless of the funding source or the retirement plan. Then, all sources of funding at UC, like the State, the federal government, and the UC Medical Centers, reimbursed the Regents for their share of the total retirement cost. Nothing changed after 1961 except that all UC employees were in one retirement plan. For each of the different UC funding sources, the obligation to reimburse the Regents remained the same before and after 1961 because it was not based on fiduciary relationships. Instead, the willingness to pay the amount set by the UC actuaries and requested by the Regents stemmed from a sense of shared responsibility to the University to ensure that all UC employees received the same level of retirement support for the same level of retirement benefits regardless of the funding source.

The Regents depend on everyone to follow the UCRP contribution policy once again. If any of the sources of retirement funding, like the federal government, informed the Regents that because it did not have the legal obligation to fund retirement it no longer would include that cost in its total grant allocations, then the results would be predictably dire. The public trust would begin to break down, and the University could no longer function as it once had. Similarly, without the willingness of the State to resume the UCRP contribution policy and to assume the same commitment now that it had to the University before 1990, UCRP is in dire straits. It no longer has a viable, reliable source of retirement funding for about 33% of its employees who are state-supported. If the UC Regents have to pick up this expense and cover it through reallocating other state funds and using some part of student tuition, it will affect the quality of the education that the University can offer as well as access to the residents of California.

INTRODUCTION

The Legislative Analyst's Office (LAO) has played an important role in California in providing an independent voice on fiscal matters. That voice has, until recently, also been one of experience. In the 67-year history of the office, there have only been five LAs, with the last one, Elizabeth Hill, serving for 22 years, but with the office even longer. The current LA, Mac Taylor, was appointed to the position in October 2008, but had served under Hill for many years. A newcomer to the LAO is Jason Dickerson, Director, State Administration, who has been in charge of higher education for three years. In correspondence with the UCLA FA Executive Board, Dickerson has asserted the position that the State has no obligation to pay the retirement benefit of state-supported employees at UC: "The state treasury, we believe, is not obligated to provide annual contributions to the UC retirement system. The Regents control the system's benefits and are the fiduciaries responsible for seeing that it is funded." Furthermore, he contends that UC's delay in resuming contributions for employees does not mean that the State should now pick up a disproportionately higher share of future UCRP costs; however, the State could appropriate funds in the future "to assist the Regents in making these contributions."

It appears to be the intention of a relatively new member of the LAO's office to undo state support for the retirement plan of the University of California. This change of position also comes at a time of economic upheaval. In 2008-09, the UCRP assets fell about 19% as of June 30, 2009. After almost two decades of a funding surplus, the market funding ratio of UCRP fell to 78% by Sept. 30, 2009, with an unfunded liability of \$10.19 billion. Even with an unfunded liability closer to the \$8 billion mark, contributions still need to resume to cover both the unfunded liability as well as the Normal Cost of additional benefits accrued annually. For 2009-10, the Normal Cost was 17% of a \$2.7 billion payroll or \$331 million for state-supported UC employees.

The LAO's position on the UC pension, however, seems to go beyond the misunderstanding of a junior employee. Emails involving LA Mac Taylor find him asserting that his office—in taking its position—is merely following guidelines set by the Legislature in February 2009. However, the emails and other LAO documents clearly indicate that it was the LA that first suggested to the Legislature (before February 2009) that it had no liability to the UC pension. The Legislature removed a proposed contribution by the State to the UC pension in the Governor's budget on advice from LA showing that the LA's policy is being followed by the Legislature rather than the reverse (<http://savingsucla.ning.com/profiles/blogs/email-exchange-with>).

The UCLA FA requested copies of documents from the LA relevant to the State's obligation to pay the retirement contribution of state-supported employees at UC and any related analyses of the UC retirement system, according to the rights granted in the Legislative Open Records Act (Govt. Code, Sec. 9070-9080). The LA received our request on Dec. 28, 2009 and the Chief Administrative Officer of the Joint Rules Committee responded on Jan. 19, 2010. He offered to send us copies of UC documents, including the UC Retirement Handbook, The UCRP: Annual Financial Reports for 2003-2005; Summary Plan descriptions for UCRP, the DC Plan, 403(b) Plan, 457 (b); and UCRP Valuation Reports from 2003-2008. At a minimum, this response suggests that the LA has not based his position on research, external policy studies or in-depth analyses of the UC retirement system. He points the FA to internal UC documents that have nothing to do with the State's obligation to UC.

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—over 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 180,000 employees 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 retirement contribution policy that emerged over time.

THE 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).

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.

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).

THE HISTORY OF CalSTRS

The oldest public retirement plan in California is CalSTRS (CA State Teachers Retirement System), created by law in 1913. This plan offered retirement benefits to certificated public school 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), with the funding mechanism expanded to include four sources: fixed member and school district contributions, investment earnings, and a fluctuating state appropriation, in the amount needed to meet actuarial funding requirements. The CalSTRS Retirement Board has exclusive control over the investment and administration of the retirement fund. (See Funding CalSTRS Benefits at http://calstrs.com/Legislation/funding_calstrs_benefits.pdf).

THE HISTORY OF CalPERS

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

However, if the State were to take on the obligation to fund these benefits, it would need to adopt and follow sound actuarial funding principles, sometimes called "prefunding." In 1927 legislation was enacted (Chapter 431, Statutes of 1927) to establish a Commission to study the feasibility of establishing a retirement system for state employees. In 1929, the California Commission on Pensions of State Employees issued their findings:

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 actuarial funding principles, like estimating the cost of the current service year, interest rate earned on investments, mortality rates, 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 (Chapter 700, Statutes of 1931) was enacted to establish the State Employees Retirement System (SERS), which has become the largest public retirement system in the world. A year later SERS was in operation, with the plan financed through contributions from the State, employees, and the investments of retirement assets; however, investments were limited to government and municipal bonds. The employee contribution rate was based on age at employment, but after 1970 it was changed to a fixed percentage of pay, with the percentage established by statute. The employer contribution fluctuated to fund the difference between promised pension benefits and the revenues generated by member contributions and investment earnings. The SERS Retirement Board had exclusive control over the investment and administration of the retirement fund.

The year 1939 is an important one in the history of retirement coverage in California because it expanded the role of the State Plan. In 1939 public agencies and classified school employees were allowed to contract with CalPERS for retirement benefits (Chapter 954, Statutes of 1939). The Legislature further expanded these provisions to include all public employees in 1967 (Chapter 1455, Statutes of 1967), at which time SERS became PERS (Public Employees Retirement System) in recognition of wider benefit coverage. The name change to California Public Employee Retirement System (CalPERS) in 1992 was made to differentiate it from other state retirement programs (Note: in order to avoid confusion, we will use the term CalPERS to denote both SERS and PERS).

After 1939 terminology became more important because it could signal the level of state sponsorship. The word “public” covers all state, county, city plans in California, but “state” is more restricted and covers only a few. CalSTRS is a state plan entitled to some state appropriation but not total state support. CalPERS contains both state plans with state support and public plans with no state support. Calling a retirement plan in California a “public plan” is neutral because it could refer to all plans, including independent ones not in CalPERS. Referring to a retirement plan as a “state plan” indicates entitlement to state funding.

THE HISTORY OF UCRP (UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM)

In looking back at UC history and the creation of a UC retirement plan, two early dates stand out: 1954 and 1983.

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.

In 1937, the Regents established pension coverage for all non-academic employees through CalPERS, which meant that by this date all UC employees had retirement coverage, and the

majority were in the state plan. UC employees in CalPERS, like those in the UC plan, had the employee contribution deducted from their salary, and the UC Regents covered the employer contribution. The UC employees who worked in the federal labs were also enrolled in CalPERS. (See the “Plan Progression,” UCRP annual Financial Report 2008-09 at <http://www.universityofcalifornia.edu/regents/regmeet/nov09/j1ucrp.pdf> .)

After 1937, the UC Regents would make the employer contribution for all the employees in both plans, and the State would reimburse the Regents for the faculty in PRAS and the state-supported UC employees in CalPERS. The Department of Energy (DOE) funded retirement for the federally supported employees at UC. The DOE allocated the total costs of retirement to the Regents for the UC employees they supported; these funds flowed to the Regents to reimburse them the appropriate amount of the federal allocation to PRAS and CalPERS (see the minutes for the legislative proposal to grant those UC employees in CalPERS who worked in federal labs the right to VERIP benefits at http://www.archive.org/stream/doenationallabor00unit/doenationallabor00unit_djvu.txt).

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 issues 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, from 1950 to 1954 brought the plight of the UC faculty to the attention of the Regents. Upon his retirement, 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 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 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 interest in making any changes to UC retirement benefits because the State provided a significant percentage of the funding. Before making their decision about what to do in 1954, the Regents hired the actuarial firm of Coates, Herfurth, and England to analyze their current financial condition. 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 nonacademic UC employees 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, that plan 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 university policy.

In April, 1961, based on consultation with the faculty, the Regents made their decision: they would maintain a UC retirement system, call it UCRP (University of California Retirement Plan), extend it to all the employees currently in the state plan--state funded, federally funded, privately funded--and to reject the still pending CA legislation that would have transferred PRAS into CalPERS. And most importantly, they would provide a benefit structure comparable to the one offered by CalPERS at less expense to the State and to UC employees.

When it was formulated, UCRP might be considered a hybrid plan. It was similar to CalSTRS in that the State has responsibility for funding state-supported employees but not for funding all employees. The UC Plan was also like CalPERS because the State's contribution to UCRP is set according to what UC actuaries and the UC funding policy say is required of the employer. The payment fluctuates only according to these parameters. The State did not provide assistance; it provided support in the amount of the employer contribution required by the actuaries and the funding policy. And UCRP was like the many public pension funds that joined CalPERS in 1939 in that they too depended on many different sources of funding, like local and municipal payroll taxes and revenues, to fund the total employer contribution. But UCRP was unique in its dependence on outside sources of funding to be willing to reimburse the Regents for their fair share of retirement costs without fiduciary responsibility, almost like repaying an unsecured loan.

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 created a 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 (See the Report on the Academic Council, Northern Section, Dec. 18, 1957).

The question was framed differently: could the Regents use their autonomy to the benefit of everyone--the University, its faculty and administrative officers, 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 if they asked the State to support UC employees in a separate UC retirement system it could not be more expensive than CalPERS.

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. 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. 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%.

1983-84

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. 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 from all other non-state sources, which would then flow into UCRP.

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 \$256 million in employer contributions toward UCRP.

In such a carefully interlinked system of payment followed by reimbursement, the consequences of nonpayment by any one party are severe, especially the State. 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.

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 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 employees 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.

How the State responded in the past to fiscal emergencies underscores its obligation to pay retirement benefits for state-supported employees at UC in the amount requested by the actuaries according to the requirements of the funding policy and not to offer only "assistance." In 1983-84, budget problems affected the ability of the State to pay the retirement benefits requested by CalPERS and UC. In 1983, the State did not give CalPERS its full contribution, an omission that forced the CalPERS 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.

The State had more options with the UC not because it had a different standing—autonomy-- but because it had more resources. After some discussion of how to make actuarial calculations for UCRP, the State and the Regents reached an agreement acknowledging the State’s liability to the UC pension 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.

THE UCRP FUNDING SURPLUS

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, but the Regents were conservative in their handling of the 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.

RESUMING CONTRIBUTIONS TO UCRP

The UC Regents have moved slowly to restart contributions, especially at a time of major economic turmoil. For the 2009-10 fiscal year, the Regents requested \$228 million from the State to resume contributions on July 1, 2010 at 9.5% of a \$2.4 billion state payroll. At first the

Governor approved this amount, but later reduced it to \$96 million, which would lower the contribution rate to 4% of payroll. Later, the Governor reduced the allocation to \$20 million.

After the Governor's reduction to \$20 million, LA Mac Taylor analyzed the budget situation in January of 2009. He rejected the Governor's proposal to increase General Fund appropriations to UC by even \$20 million. Instead, Taylor advised the Legislature to cut the \$20 million and noted that before the State resumes contributions, he wants to see UC employees resume contributions to cover approximately one-third of the total contributions needed to fund their pension benefits (http://www.lao.ca.gov/analysis_2009/highered/highered_anl09004008.aspx).

The LA's terminology in this January 2009 budget analysis further distanced UC's established claim to retirement support from the State. LA Taylor referred to UC as a "public employer," which provides its workers with a total compensation package. By contrast, Elizabeth Hill, the previous LA, referred to UC as a "state employer" in her 2007 study of "Public Employee Retirement Benefits, Background and Policy Principles." She listed the funding status of the public employee retirement plans by type in table 2. Under the category "State," where both UC and CSU are included, she listed their combined actuarial value of assets, liabilities, unfunded liabilities, and funded ratio. Hill did not include UC in the "Public Agency" category. Of the categories listed in Table 2, the State has obligations to pay appropriations for the "State" category and the "Schools" category, but not for the Public Agencies. Hill included UC in this analysis of state funding because of its funding entitlement in the past and its emerging need to resume contributions in the near future because of a decline in the funding surplus (<http://www.lao.ca.gov/laoapp/main.aspx>). See also the Post Employment Benefits Commission report for similar terminology for UC (To read this report, click on <http://www.pebc.ca.gov/> and click on "final report.").

The UC Regents in February of 2009 had a different response to the Governor's action to limit contributions to \$20 million. They were glad that the State made a contribution because it confirmed the State's willingness to resume contributions to UCRP. In response to this appropriation, the Regents met in February 2009 and voted to resume contributions to UCRP for all employees at UC and all funding sources, but they moved the start date forward to April 15, 2010 so that for three months at least employer contributions would resume at 4%. Later, the Legislature eliminated the \$20 million funding entirely, apparently following the advice of the LA.

The Regents' 2010-11 budget request fared no better. In the 2010-11 budget proposal, the Regents requested \$108.9 million from the State for retirement support, or 4% of UC's retirement-covered compensation of \$2.7 billion. The Governor's Proposed Budget for California does not contain any funding for retirement for state-supported employees at UC.

Beginning April 15, 2010, the Regents will resume the historical contribution policy to UCRP by paying the employer contribution and expecting reimbursements from all the funding sources—State, federal, private. Even though they plan to start with a total of 6% of covered compensation, 4% from employers and 2% from employees, they will soon need to increase the total amount to 17%, the Normal Cost, and higher than that to amortize the unfunded liability. Without state support, or an IOU in the amount funded by the State—4%--if only for a brief

period of time in the budget process, 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.

If the State abandons its responsibility to reimburse the Regents its share of the retirement benefits of state-supported employees at UC according to agreed upon actuarial principles and the UCRP funding policy, then it will be setting aside the historical contribution policy for UCRP in favor of establishing a new one dependent on many variables, including the availability of State funds. It substitutes a long-established contribution policy followed by all the other sources of outside funding at UC for an uncertain promise to offer assistance if funds are available. Given the magnitude of this change of policy and the financial implications to the University, the Legislature will have used the allocation process to impair the ability of the Regents to govern the university. The State will also have failed to support a public trust that depends on the commitment of all parties to meet their individual financial responsibilities.