(Nov. 1997)

INVESTMENT AVERSE/INVESTMENT SAVVY FACULTY TELL ALL

Susan Gallick, Ph.D., Executive Director, FA at UCLA

Last May, just before summer vacation, the Faculty Association at UCLA conducted a survey to find out what faculty know about retirement investing at UC and what they would like to see changed. We sent out just over 4,000 questionnaires (there were seven different versions of the questionnaire randomly distributed) to all the Senate faculty at UCLA, UCSD, UCSC, UCR, and to FA members only at UCB. About 5% of the faculty turned in the questionnaires (the grand prize winner was from UCLA, and five additional winners from UCSC and UCSD as well as UCLA). Professor Shlomo Benartzi, AGSM, UCLA, helped us construct the questionnaire and provided the lottery funding; in addition he collected the data, tabulated the results, and helped analyze the findings.

We knew that many people in general and perhaps faculty in particular are investment-averse; investing is a subject to avoid if possible. Thus we expected a subset of the faculty inherently more interested in the subject to take the time to answer the questionnaire. But from the responses, it seems as if the questionnaire respondents divided into two distinct groups: one interested in and knowledgeable about investing and another much less interested in investing but interested enough in the lottery to participate. (For those who wish to see a detailed tabulation of the responses, please check out the new Faculty Association webpage at http:/home.pacbell.net/ucfa.)

QUESTIONNAIRE HIGHLIGHTS

ONLY ABOUT HALF OF THE FACULTY RESPONDING KNOW WHAT THE MANDATORY DIRECT CONTRIBUTION PLAN (DCP) DEFAULT IS-UC SAVINGS Nearly every employer who handles mandatory investment accounts for employees must have a default-an investment choice that the employer selects for employees who do not make a choice for themselves. Sometimes this default is necessary when employers change the investment options that they offer their employees, in which case employees must switch out of some accounts and into others by a certain date. Other times a default is necessary when the employer creates special mandatory investment accounts for its employees, who have a choice about how to invest the money. If for a variety of reasons employees do not make an investment choice, the employer must make it for them and be able to justify that choice.

UC employees have been lucky enough since Nov. 1990 not to have to contribute each month to their retirement plan because the UCRP pension fund is currently funded at actuarially acceptable levels. For as long as these monthly diverted into pre-tax Mandatory Defined Contribution Plan (Mandatory DCP) investment accounts for each employee. If employees do not specify an investment choice for these accounts, the University must make it for them. At UC, these monthly contributions are a condition of employment: a mechanism must be in place to take out a defined amount of money each month from each employee's salary and put it into an account: in either the UCRP or the Mandatory DCP. The amount varies according to membership status in UCRP; for example, for those with Social Security it ranges from 2%-4% of gross monthly pay minus $19 a month. Although the University has created a Task Force to study the current funding position of UCRP, they have mentioned informally to the Faculty Associations that they do not anticipate a change in the Mandatory DCP policy for the next five years.

Lack of interest in the default selection may be attributed to what some faculty perceive as a relatively small monthly amount to worry about (for example, a faculty member making $60,000 a year would put in about $100 a month). It's true that this is a relatively small amount compared to what some faculty put into their voluntary DCP accounts, particularly the 403b accounts ($606 a month on average, with a median of $750 for those answering our survey). Also faculty may not want to get too committed to an investment decision that might stop suddenly if contributions to UCRP became necessary. While it lasts, many faculty are happy to let UC invest Mandatory DCP contributions for them just as it does for the assets in the larger pension plan. After all, some people reason, if UCRP assets are doing so well that no further contributions are needed, why would they want to try to do better with the returns in their individual accounts?

The answer might be instructive: the default option for employees is quite different from the investment strategy followed by the University for the UCRP money. University fund managers would not consider a long-term investment for UCRP pension funds in fixed income assets like UC Savings (almost entirely in US treasury notes with maturity dates typically between 1 and 3 years). The term "fixed income" generally refers to cash, bonds, money market, US Treasury securities; "stocks" or "equities" to ownership of shares in a company. Therefore, the University does not make a default investment choice for employees that is similar to the investment choice it makes for UCRP funds. Both the investments and the returns are different. For example, looking at fiscal 1994-95, the assets in the UCRP retirement pension fund were balanced between 76.6% equities and 22.8% fixed income (all bonds) and earned 26.2%, while UC Savings (96% in US Treasury securities and 4% in federal agencies) earned 6.8%.

Also, $100 a month put into an investment account is not as insignificant as some might think. Going back ten years from June 30, 1995, UCRP funds earned 14.3%, and UC Savings earned roughly 8.6%. (Notice that the ten-year average return for UCRP is quite a bit lower than for the year 1994-95, while the UC Savings is slightly higher; such a difference demonstrates generally how the long-term ups and downs of equities match up

against a fixed income investment.) Assuming that employees could have directed a Mandatory DCP monthly contribution of $100 to a portfolio allocation roughly the same as UCRP's for ten years (with a return of 14.3% compounded monthly) beginning in June of 1985, the amount would have grown to $26,379 by June 1995; those in a default position in UC Savings (8.6% compounded monthly) for that same time period would have only $18,920-a $7,459 dollar difference.

ABOUT 77% OF FACULTY ANSWERING THE SURVEY DID NOT KNOW WHAT ASSETS WERE INCLUDED IN UC SAVINGS About 30.2% admitted that they did not have any idea of what was in UC Savings and about 47% thought stocks, mutual funds, cash, and other investments were included in UC Savings. Only 22.1% knew that UC Savings consists almost entirely of US Treasury securities.

If the faculty in general find the Mandatory DCP-Default concept confusing and off-putting, they find the word "Savings" to be attractive and reassuring. The semantics of "Savings" may have more influence on investing habits at UC than would a more descriptive title like "UC US Treasuries." Also the word "Savings" reminds one of the choices offered in banks between spending money-checking accounts-and saving money-savings passbook accounts. Since so many faculty thought UC Savings included stocks, bonds, and mutual funds, the term "UC Savings" may be reassuring to UC investors but it is misleading as well.

68% OF THE FACULTY RESPONDING THINK THE DEFAULT SHOULD BE BASED ON A PORTFOLIO BALANCE BETWEEN EQUITIES AND FIXED INCOME Many faculty believe strongly that when people are faced with an investment choice they should always think in terms of portfolio balance. Over 68% of the faculty who answered the questionnaire felt that the default choice should be a portfolio allocation based on years to retirement or balanced with 50% equities and 50% fixed income. Diversified port-folio configurations are popular investment choices in universities and businesses today and often recommended by financial planners who tend to stay away from fixed income investments for the long term. Although the principal may be safe, the loss to inflation could offset any gains or in some cases result in losses in terms of real dollars.

Changing the Mandatory DCP default is also supported by an analysis of faculty risk tolerance shown in answers to Question A on the questionnaire. Faculty were asked to look at a graph which compared the returns of two funds, A and B, and allocate their retirement funds between these two accounts. A, based roughly on the historic returns of the stock market, had higher but more volatile returns than the steady but lower B fund. Even if one lowered the historic rate of return of the stock market, and thus depressed the returns of A versus B, faculty still invested a greater percentage of their retirement portfolio in A than B.

MORE THAN 75% OF THE FACULTY RESPONDING INVEST IN 403b ACCOUNTS One of the reasons the FA at UCLA decided to conduct an investment survey was to provide information about faculty investment practices to the Office of the

President. Currently OP does not have the systems capability to separate out the investment practices of its different groups of employees. They know only that systemwide about 25% of employees invest about $361 per month in 403b accounts. Our resp-onses showed that a group of faculty, average agebout 42, showed a high degree of willingness to invest almost the max allowed in 403b accounts--$750/mo. In the near future, the yearly maximum may go up to $10,000 from $9,000.

Of those faculty who purposely divide their 403b contributions between fixed income investments and stocks, 50% did not know their overall portfolio asset allocation. The 50% who did know had an average portfolio allocation of 65.8% in stocks and 34.2% in fixed income-slightly more conservative (a lower percentage in equities) than the UCRP balance in 1995 which had 76.6% in equities.

MANY FACULTY FAVOR ADDING THE VANGUARD FAMILY OF FUNDS
Over 50% of the faculty responding to the questionnaire would like to see more pre-tax investment options at UC (about 25% didn't know what the current options are and 23% would not like to see more options). About 12% of faculty would like to see Vanguard, but T. Rowe Price and Janus were also mentioned by name. They would also like to be able to choose index funds to increase the diversity of their portfolios, which may be one reason why they favored Vanguard. Vanguard is currently a popular retirement investment choice among faculty in major universities and businesses because of its index funds, low expense ratios, and the generally high performance levels of its funds.

Although it appears that UC employees in general favor the UC Savings fund for their 403b investments (assets in the six UC- managed funds in June 1996 are roughly 49% in Savings, 36% in Equity, 9% in the Bond Fund), faculty answering the FA questionnaire selected UC Equity first (29.5%) Fidelity second (18%), the little understood UC Savings about as often as UC Bonds -12.1%. Overall, the UC Equity and UC Bond funds have done quite well. (Check out the UC Treasurer's website for percentile rankings for the UC funds compared to the Morningstar's database of 7,367 open-ended mutual funds-www.ucop.edu/treasurer/ranking.html.) Each year more and more investors choose Fidelity over UC-managed funds. In June 1995, there were about $24.5M in transfers to Fidelity from UC funds; in June 1996 that number increased about 23% to $30M. Of those faculty in Fidelity right now who answered our questionnaire, they select most often Contra (7.4%), Magellan (6.6%), and Growth Company (6.3%).

INFORMATION/COMMUNICATION About 43% of the faculty responding would like UC to provide at least weekly net asset values of the UC Equity Fund, but even more (73.4%) would like more general investment information on the internet. In particular, they mentioned projected inflation adjusted income from DCP/DBP at retirement, age to retirement portfolio suggestions, effect of leaving UC System, and mutual fund options.

From our responses, it appears as if many faculty would like to have the same information about UC-managed funds readily available on the internet that exists for outside funds. Then they could make some basic comparisons more easily than they can right now. For UC Equity a website report might include a profile of the portfolio,

including the largest holdings, the proportion of the portfolio in large-cap and mid-cap stocks, the division of the portfolio by market sector, a description of the venture capital operation, information about the foreign investments (which seem to be directed towards China), information on risk, expense ratios, the most significant changes in portfolio holdings in the past year; and something about the managers who are picking the stocks. These reader-friendly internet reports would allow an investor to compare the UC-managed portfolio more easily with other growth funds. Some of this information exists on the UC Treasurer's webpage-www. ucop.edu/treasurer. Faculty will find under "Regents Portfolios" info on the holdings of the UC-managed funds.

Just over 62% of those faculty answering the questionnaire want more information about their own portfolio. Many faculty find it frustrating to gain current information about their UC holdings from UC Benefits, bencom or bencom.fone. For example, the Semi-Annual UC Benefits statement doesn't specify clearly transfer of funds. Consequently, faculty are never sure if recent statements include updated information about their own transactions or not. This delay can be confusing and misleading: someone who has moved money out of a UC-managed fund into a Fidelity fund, for example, could have a double entry: the funds are still included in the UC Benefits statements weeks or months after the withdrawal has been made and yet the Fidelity statement clearly shows the transfer of the funds into the designated account. Even movement between UC- managed funds is not clearly indicated on the UC Benefits statements. The current formats of the bencom website and bencom.fone also seem time-consuming, frustrating, and counterintuitive, especially when compared to the portfolio information available by many outside funds.

CONCLUSION Many universities and companies started retirement investing accounts when few employees participated or participated in a relatively minor way. Ten years ago there were 2,300 mutual funds; now there are roughly 6,700. In 1991 mutual funds assets were about $800 billion. In 1994, they rose to $1.6 trillion, including both equity and bond funds, and by 1995, the number grew to $2.6 trillion. Todayfinancial marketplace, especially in retirement investing in mutual funds, many employers are choosing outside fund managers who will offer separate accounts for employees. Such arrangements are generally less expensive than investing through retail mutual funds. In general, employers are restructuring their retirement investment benefits to reduce their own liability, to offer employees more choice and control in managing their investments, to educate employees about the investment options open to them, to increase the portability of benefits, and finally to allow an increasingly sophisticated and professional investment marketplace to do what it does best.

At some point in the near future the University will have to reevaluate its commitment to UC-managed funds for retirement investing. If UC decides to compete with outside managed funds, it will need enhanced computer systems capabilities within the Benefits Office to increase the participation rate in the UC managed 403b funds and to be able to offer the information that investors seek. The Regents will also have to decide whether to increase the number of outside fund families made available to 403b investors at UC, a move which would reduce participation rates in UC-managed funds. The UC Regents

will be facing many decisions concerning retirement investment benefits within this fiscal year. Before they take action, we would urge a thorough study of future trends in retirement investing in the university environment. It's a good time for the University to listen to what faculty and financial experts are saying.

NOTE In our last Faculty Association Newsletter we discussed some of the basics of retirement investing. (For those who missed it, you can read it on the FA website at www.home.pacbell.net/ucfa.) There are several reasons why UC faculty might consider the advantages of diversification and balanced retirement portfolios, especially for the long term. UC employees have a defined benefit retirement plan where the employer assumes all the risk for the investment pool. The employee's monthly retirement pension will be calculated by a formula based on highest income for three years and length of service credit, not on the returns of the stock market or the investment decisions made years ago. Also tenure gives faculty employment security beyond that which most employees in other professions enjoy.Despite retirement pension security and job security, our questionnaire suggests that many faculty are still quite conservative or even indifferent about their long-term investments in 403b accounts and that many do not know the shape of their overall retirement portfolio or where their Mandatory defined contributions go each month.

Some Suggestions for the "Investment-Averse":
Attend a seminar in financial planning offered by UC, Fidelity, or one of the other large mutual fund families like Vanguard. Read the "Makeover" in the Business Section of the LA Times every Tuesday. Financial planners examine what people at different ages, stages of life, and professions are doing, not doing and could be doing with their money. Case studies like these provide interesting reading and may illustrate some current principles of portfolio asset allocation.

Yet, those who invest in stocks, whether they are risk averse or risk tolerant, must be prepared for market volatility, especially in the short term. The Dow Jones industrial average fell 554 points or 7.18% on the day before this newsletter went to press.
Go Back to Table of Contents.

COLA DELAYS SAVE UC MONEY

On September 24, 1997, the Council of UC Faculty Associations received University notice that COLA increases for 1997-98 would be delayed one month-from October 1 to November 1. The reason for this delay is a $12 million one-time undesignated budget cut. This sounded like a four month delay not a one month delay; therefore, the Faculty Associations decided to do some research on the history of COLA delays. Here is what we found for the last ten years:

Faculty COLA	COLA	Began	Delay
1988-89 COLA	3%	6/1/89	11 months

1989-90 COLA	4.7%	1/1/90	6 months
1990-91 COLA	4.8%	1/1/91	6 months
1991-92 COLA	0%		
1992-93 COLA	0%		
1993-94 COLA/Cut	-3.5%	7/1/93	no delay
1994-95 COLA	3%	1/1/95	6 months
1995-96 COLA	3%	10/1/95	3 months
1996-97 COLA	5%	10/1/96	3 months
1997-98 COLA	5%	11/1/97	4 months

For the last two years, October has been the start date for COLAs. For three of the last ten years, COLAs were delayed six months. One year, 1988-89, the COLA was delayed 11 months. The only time in the last ten years that a salary change occurred at the beginning of the fiscal year was in July 1993 when all employees took a pay reduction of 3.5%.

It appears that what was once a temporary method of budget savings has become common practice each year. If October is now the regular date for COLAs to begin, when will the start time switch permanently to November? The Faculty Associations have asked the Office of the President to clarify the legal basis the University has for withholding COLAs, or any other portion of faculty salaries, to meet other budgetary needs.