Fall 2009-10

# UCLA Faculty Association Newsletter

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An Independent Membership Organization of Faculty at the University of California, Los Angeles
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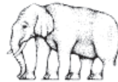
## The UC Retirement Plan (UCRP):

## Market Numbers & What They Show:

## The Elephant in the Room is Getting Bigger & Bigger



*June 30, 2009 YTD Fiscal Year*

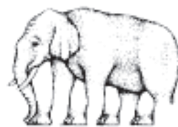
**The Market Funding Ratio is 70.9%.**

**The $13.263 Billion Unfunded Liability**

**Requires $1.5 Billion Annually to Amortize it over 15 Years.**

**The Annual Cost of Benefits is $1.3 Billion.**

**Thus, about $2.8 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**

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**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. 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. Actuarial numbers show that UCRP had a 95% funding ratio as of June 30, 2009. Market numbers reveal that the funding ratio has fallen to 70.9%. 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 June 30, 2009 was 2.3%. Not including the 2008-09 year losses, the annualized 9-year return was less than 5%.

Averaging numbers puts the estimate of the unfunded liability at $2.279 billion, but the market numbers show a $13.263 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 June 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 formulate a contribution policy that will, within three years, put UCRP on the road to full funding. If the path is travelled that we outline here, UCRP will return to full funding in 15 years at most.

## 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 year-end June 30, 2009. When the 3rd quarter investment information is available, the FA will update the numbers and send out an email report.

**Q Is UCRP in financial trouble today?**

**A** Yes. Liabilities exceed assets by $13.263 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, $1.5 billion dollars needs to be added to the contributions each

year for 15 years to amortize an unfunded liability of $13.623 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 now 16.91% of CC (16.91% of $7.7 billion) or $1.3 billion.

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 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 20.3% of CC or $1.56 billion. This figure assumes a 7.5% return, includes the Normal Cost, and amortizes the smoothed unfunded liability ($2.279 billion) at $258 million per year over 15 years.

But the market numbers call for a much higher contribution: 36.4% of CC or $2.8 billion. This figure also assumes a 7.5% return, includes the Normal Cost of 16.91%, but amortizes the market value unfunded liability ($13.263 billion) at $1.5 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 16.91% per year to cover the Normal Cost, and an even greater amount, 19.5%, to amortize the unfunded liability of $13.263 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 $2.7 billion; therefore, the UC Regents would have to contribute 15.3% (20.3%-5%) of CC ($2.7 B) or $412 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** $848.6 million per year or 31.4% (36.4%-5%) of CC of $2.7 B.

**Q How could UC pay even the contribution of $412 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 $412 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 ($2.7 billion) and the other agencies about 65% of CC ($5 billion) for a total retirement-covered payroll of $7.7 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.

Translated into the "smoothed" value of assets (aka actuarial value of assets), delay in waiting for the State to budget $412 million per year costs the Regents $763 million per year in other reimbursements.

Seen from the perspective of market numbers, delay in waiting for the State to budget $848.6 million costs the Regents $1.57 billion 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 15.3% (20.3%-5% employee contribution) of the contract and grant payroll when that cost was not factored into earlier research proposals that extend 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 that will include 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 15.3% 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 20.3% --closer to $36.4%. 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 market 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 $13.263 billion to return to full funding, the assets would have to increase more than 41%. In addition, through the course of a year, the fund would need to take in the Normal Cost (16.91%) or roughly $1.3 billion, pay out about $1.5 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 investment returns for the third quarter, 2009, are not available yet. We assume that they have dramatically improved, since both the Dow Jones Industrial Average and the Standard and Poors Index were up about 15% for the 3 month period ending Sept. 30, 2009.

**Q With an unfunded liability of $13.263 billion, and needed contributions of at least 20.3%, possibly approaching 36.4%, 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 note that even though market turmoil has increased the need for employer contributions, 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 Cash Out, January 20, 2009": **http://www.universityofcalifornia.edu/senate/reports/Lump%20Sum%20Cashouts%2022JAN09%20Final.pdf**

**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** For the current UC Budget, President Yudof will propose to begin contributions on April 15, 2010 at 6%, with 4% for the employer and 2% for the employee and ramp up slowly to the full cost. 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 meets the UCRP funding policy. The initial 4/2% plan might be OK to get contributions started, but is not enough to bring the plan back to financial health soon enough. 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. During all of these years of inadequate contributions, the unfunded liability would have risen higher and higher and the funding ratio fallen lower and lower.

The Regents should follow the funding policy they formulated for UCRP in September 2008, which requires more than three times what they are planning to put in. Contributions should:

(1) start on 4/15/10 at the level of 4% for the employer and 2% for employee

(2) increase on 7/1/10 to the level of the Normal Cost 16.91%

(3) rise on 7/1/11 to the Full Cost (NC+ amortize 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), May 13, 2009
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/portaldocs/ben/bendoc-post-emp-benefits.pdf; and
the many reports on UCRP and the UC Budget prepared by Charles Schwartz at http://socrates.berkeley.edu/~schwrtz/.

**THE CALCULATIONS:**

1. Review:
   The UCRP Numbers as of June 30, 2009
   The MVA = $32.309 billion
   The AVA = $43.294 billion (the MVA averaged over 5 years)
   The AAL= $45.572 billion (the AAL from 2008 of $42.577 billion, plus 7.5% return on assets, less the payout of benefits of roughly $1.5 billion, plus the Normal Cost of $1.3 billion).

   The Funding Ratio:
   The MVA/AAL (32.309/45.572) funding ratio was 70.9%.
   The AVA/AAL (43.294/45.572) funding ratio was 95%

   The Unfunded Liability:
   MVA - AAL was $13.263 billion ($32.309-$45.572)
   AVA - AAL was $2.279 billion ($43.294-$45.572)

2. The payment needed to amortize the actuarial shortfall over 15 years is 11.33% times the unfunded liability. That figure is (11.33% x $2.279) or $258.2 million.

3. The actuarial unfunded liability requires 3.35% of CC (.2582/7.7).

4. When the funding ratio is 100%, Employer and Employee Contributions as a percentage of CC should equal the Normal Cost, currently 16.91%.

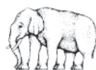
5. The Normal Cost (16.91%) plus the extra % of CC to amortize the unfunded liability (3.35%) total 20.26% CC.

6. If the market unfunded liability were to be amortized over 15 years, then (11.33% x $13.263) $1.503 B would have to be added to the contribution each year for fifteen years.

7. As a percentage of CC (1.503/7.7), this amounts to 19.516%.

8. The Total Contribution Based on the Market Estimates:
   16.91% to cover the Normal Cost +
   19.52% to amortize the unfunded liability and the shortfall in invest return
   36.43%
   36.43% of $7.7 billion = $2.8 billion.

9. The Total Contribution Based on the Actuarial Estimates:
   16.91% to cover the Normal Cost +
   3.35% to amortize the unfunded liability and the shortfall in invest return
   20.26%
   20.26% of $7.7 billion = $1.56 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

**In a follow up letter to the UC Regents, June 26, 2009, the FA calculated that it will cost UC about $533,33 a day for every day they delay resuming contributions to UCRP.**

## 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***

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

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

Application to

# JOIN THE UCLA FACULTY ASSOCIATION

**BENEFITS SALARIES**

**UC POLICIES LOBBYING**

The Faculty Association at UCLA is a voluntary, dues-supported organization of UCLA Academic Senate members, founded about 30 years ago, with an Executive Board, Bylaws, a dues structure, and a Research Director.
**Purposes:** The purpose of the FA is to influence the decisions of the University administration and the state legislature that affect faculty salaries, benefits, and working conditions broadly defined.
**Relation to the Academic Senate**: The FA at UCLA supports the Senate in all academic matters. Because it has no state funding the FA can & does engage in lobbying & other nonpartisan political activities on behalf of faculty.
**Membership**: The FA at UCLA membership is open to all faculty eligible for membership in the UCLA Academic Senate.

I wish to join the Faculty Association at UCLA. I agree to pay the following dues (choose one) by payroll deduction and to sign Form U669 below or by personal check. FA dues are tax deductible: either on Schedule A of your income tax to the extent that they and other profession-related and income-producing expenses exceed 2% of your adjusted gross income; or in some instances on Schedule C without the 2% limitation. Please check with your tax consultant. AAUP members may claim a 20% reduction in FA dues.
______$8.75 per/mo. for Assistant Professors and Acting Professors of Law
______$13.50 per/mo. for Associate Professors
______$18.00 per mo. for Full Professors
______Lecturers with security of employment, please designate the dues that most nearly approximates your salary range
______$40.00 per year for Emeriti (by check only)
______Recalled Faculty: 50% of the dues for their rank (for example, per year $42.00 for Assistant Professors; $63 for Associates; and $84 for professors (payable by check only)
_______50% discount for Second Member of a Family

**Mail Completed Forms to:**
FA at UCLA, P.O. Box 33336
Granada Hills, CA 91394

**Or Drop in Campus Mail to:**
Prof. Jonathan Post, UCLA FA Membership Chair
149 Humanities Bldg. 153005, UCLA

***Employee Organization Membership Payroll Deduction Authorization UPAY 669 (10/80)***

Organization name: *Faculty Association at UCLA* Initiation Fees 0 General Assessment 0 Campus UCLA

**Last Name__________________First Name________Middle Initial___ Dept. Employed at UC_______**

**Monthly Deduction: Dues_____Employee ID_______________Email Address_______________________**

**Title at UC_________ Date ____ Action on this Form to Become Effective on Pay Period Beginning___________**

I authorize the Regents of the University of California to withhold monthly or cease withholding from my earnings as an employee, membership dues, initiation fees, and general assessment as indicated above.I understand and agree to the arrangement whereby one total monthly deduction will be made by the University based upon the current rate of dues, initiation fees, and general assessments.

I also understand that changes in the rate of dues, initiation fees and general assessments may be made after notice to that effect is given to the University by the organization to which such authorized deductions are assigned and hereby expressly agree that pursuant to such notice the University may withhold from my earnings amounts either greater than or less than those shown above without obligation to inform me before doing so or to seek additional authorization from me for such withholdings. The University will remit the amount deducted to the official designated by the organization. This authorization shall remain in effect until revoked by me allowing up to 30 days time to change the payroll records in order to make effective this assignment or revocation thereof or until another employee organization becomes my exclusive representative.

It is understood that this authorization shall become void in the event the employee organization's eligibility for payroll deduction terminates for any reason. Upon termination of my employment with the University, this authorization will no longer be in effect. This authorization does not include dues, initiation fees and general assessments to cover any time prior to the payroll period in which the initial deduction is made. Payroll deductions including those legally required and those authorized by an employee are assigned priorities. In the event there are insufficient earnings to cover all required and authorized deductions, it is understood that deductions will be taken in the order assigned by the University and no adjustment will be made in a subsequent pay period for membership dues, initiation fees and general assessments.

**Employee Signature____________________________Date____________________**

For University Use Only Tran Code_______ Employee ID No________ Date____________ Element No._______ Bal CD__________ Amount_____