

Office of the President**TO THE MEMBERS OF THE COMMITTEE ON FINANCE:****DISCUSSION ITEM***For Meeting of November 17, 2005***THE UNIVERSITY OF CALIFORNIA RETIREMENT PLAN/UC-PERS PLUS 5 PLAN – ANNUAL ACTUARIAL VALUATION****EXECUTIVE SUMMARY**

Each year, in accordance with actuarial reporting requirements of the Internal Revenue Code (IRC), the Plan's Consulting Actuary performs an actuarial valuation of the University of California Retirement Plan (UCRP or Plan) and the UC-PERS Voluntary Early Retirement Incentive Program (PERS Plus 5 Plan). The purpose of the annual valuation is to disclose a plan's funded position as of the beginning of the current plan year, analyze the preceding year's experience, and recommend contribution rates for the upcoming calendar year.

- Issues:
- The June 30, 2005 market value of assets of UCRP was \$41.9 billion, up from \$39.2 billion for the prior year, reflecting a 10.3 percent investment return.
 - Benefit disbursements from UCRP during the 2004-2005 Plan Year were \$1.2 billion compared to \$1.1 billion for the prior year.
 - The actuarial (smoothed) value of assets of UCRP earned 2.7 percent compared to the expected total return of 7.5 percent.
 - The July 1, 2005 actuarial accrued liability for UCRP grew to \$37.3 billion from \$35 billion for the prior year.
 - The Plan's funded ratio on an actuarial value of assets basis decreased from 118 percent as of July 1, 2004 to 110 percent as of July 1, 2005; however, the valuation results show that UCRP assets are sufficient to maintain a zero percent of payroll contribution rate for the 2006 calendar year.
 - The UCRP normal cost for the 2005-2006 Plan year is \$1.25 billion or 15.34 percent of the \$8.15 billion covered payroll at July 1, 2005.
 - Stochastic funding projections show a very high likelihood that UCRP will become less than fully funded within the next few years.

Future Action:

- The Regents have formed a Retirement Benefits Task Force to address the strategic positioning of the University's retirement programs as part of the competitive total remuneration offered to faculty and staff. The Task Force is expected to consider long-term strategies for resuming contributions to UCRP, potential retirement plan design changes for new employees, and related issues for retiree health coverage.
- Information will be presented to The Regents during this year.

BACKGROUND

Each year, in accordance with actuarial reporting requirements of the Internal Revenue Code (IRC) and the provisions of the University of California Retirement Plan (UCRP or Plan), the Plan's Consulting Actuary, currently The Segal Company (PowerPoint presentation attached), performs an actuarial valuation of the Plan to disclose the Plan's funded position as of the beginning of the current Plan Year, analyze the preceding year's experience, and recommend contribution rates for the upcoming calendar year. The results of the actuarial valuation as of July 1, 2005 are summarized and presented in the Executive Summary section of the actuarial valuation report (UCRP Executive Summary attached).

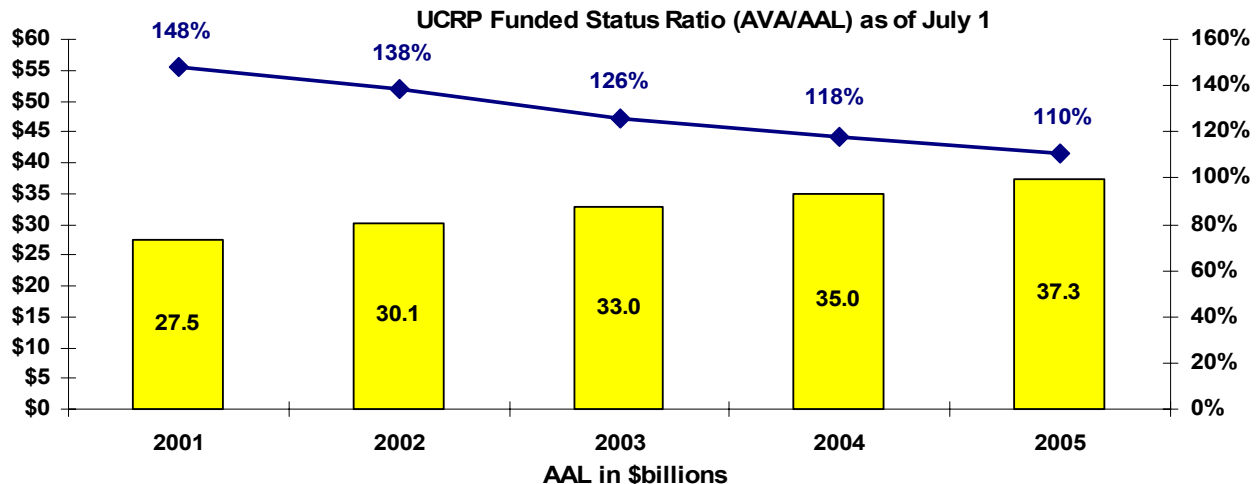
UCRP Valuation Results

The Plan's Consulting Actuary continues to recommend a zero percent payroll contribution rate for the 2006 calendar year since the July 1, 2005 actuarial valuation results show that the value of Plan assets continues to exceed Plan liabilities by a sufficient amount. This recommendation is in line with the full funding limitation described in IRC §412(c)(7)(A), as adopted by The Regents in 1990, based on amendments to IRC §412 through that date. Under Regents' policy, the University will suspend contributions when the smaller of the market value or the actuarial value of Plan assets exceeds the lesser of 1) the actuarial accrued liability including normal cost, or 2) 150 percent of the current liability including current liability normal cost.

As of June 30, 2005, the market value of assets of UCRP, after subtracting benefit claims currently payable and other current payables of the Plan, was \$41.9 billion as compared to \$39.2 billion as of the end of the prior Plan Year. During the 2004-2005 Plan Year, the Plan experienced a 10.3 percent investment return on the market value of Plan assets.

When determining the Plan's funded status ratio, the Plan's actuarial accrued liability is compared to the actuarial (smoothed) value of assets. The "smoothing" method reduces the impact of market volatility by recognizing, in each year, only 20 percent of the investment gains and losses in each of the preceding five years. As of June 30, 2005, this five-year period includes three years of investment returns which were less favorable than the Plan's assumed 7.5 percent earnings rate. The result is a 2.7 percent investment return for the 2004-2005 Plan Year on an actuarial value of assets basis.

The Plan's surplus, the excess of the actuarial (smoothed) value of assets over the actuarial accrued liability, decreased during the 2004-2005 Plan Year primarily because the liability grew at approximately the rate expected, but the smoothed value of assets earned 2.7 percent compared to the expected actuarial total return of 7.5 percent. This resulted in an actuarial loss, despite a market value return of 10.3 percent for the Plan year. The following chart shows the recent history of the Plan's actuarial accrued liability (AAL) growth along with decreases in the funded status ratio on an actuarial value of assets (AVA) basis.



The Plan’s actuarial accrued liability increased from \$35.0 billion as of July 1, 2004 to \$37.3 billion as of July 1, 2005. The Plan’s funded ratio decreased from 118 percent as of July 1, 2004 to 110 percent as of July 1, 2005 as a result of the investment loss on the smoothed (actuarial) value of assets and the fact that no contributions are being made to offset the Plan’s normal cost. The “normal cost” of the Plan, as defined under ERISA §3(28), is the annual amount, expressed as a percent of payroll (the “normal cost rate”) that must be accrued over the total career of each employee to provide fully for future UCRP benefits, measured as of the valuation date. Under the entry age normal method, as a percentage of covered payroll, the UCRP normal cost payable at the beginning of the 2005-2006 Plan Year is 15.34 percent or \$1.25 billion.

There were no changes in assumptions reflected in the July 1, 2005 calculations of actuarial accrued liability and normal cost; however, the normal cost rate reflects the first of three expected gradual increases. These increases occur as the temporary three-year reduction in the salary increase assumption that models the effect of current budgetary constraints is phased out. There will be gradual increases in the normal cost rate in the next two valuations as the remaining temporary reduction in the salary increase assumptions is phased out.

Evaluation of Sustainability of UCRP Funded Status

While the current valuation reflects that the Plan remains over 100 percent funded on both a market value of assets basis (112 percent) and an actuarial value of assets basis (110 percent) and that no University or Member contributions for the 2006 calendar year are required, it is clear from an actuarial standpoint that the current “contribution holiday” cannot be sustained. The funded ratio is expected to continue to decline unless contributions are restarted or extraordinary market gains were to occur.

The Regents have formed a Retirement Benefits Task Force to address the strategic positioning of the University’s retirement programs as part of the competitive total remuneration offered to faculty and staff. The Task Force is expected to consider long-term strategies for resuming contributions to UCRP, potential retirement plan design changes for new employees, and related issues for retiree health coverage. UC HR/Benefits has retained Mercer Human Resource Consulting as the lead consultant for advising the University in this process. Potential design options will be discussed at future Regents meetings. The University will take appropriate action concerning proposed changes

that may trigger notice, consultation, and meeting and conferring obligations under the Higher Education Employer–Employee Relations Act.

More detailed schedules and descriptions related to the UCRP actuarial valuation are included in the UCRP Valuation Results, Supplemental Information and Reporting Information sections of the actuarial report as of July 1, 2005 (UCRP Valuation Results attached; Attachments 1, 2, 3, 4).

The schedule on the following page shows actuarial valuation highlights.

Los Alamos National Laboratory Transfer of Assets and Liabilities

The University of California contract to manage the Los Alamos National Laboratory (LANL) is scheduled to expire May 31, 2006. Although, through a limited liability corporation with its industrial partners, UC has bid to retain management of LANL, regardless of who wins the competition for this contract, assets and liabilities will be transferred from the UCRP to the successor contractor's defined benefit plan for the LANL employees who transfer their participation to the new plan. Prior to such transfer, the necessary and advisable rulings on the plans and proposed transactions will be obtained from the appropriate regulatory agencies.

The amount of assets and liabilities to be transferred to the successor contractor's defined benefit plan will not be known until the transition process is completed, including approval from regulatory agencies and final decisions from LANL employees regarding continuation of employment at LANL under the new contractor. The Regents will be advised as this process progresses.

UNIVERSITY OF CALIFORNIA RETIREMENT PLAN

Actuarial Valuation Highlights

(Dollars in 000,000's)

Valuation Date	7/1/1996	7/1/1997	7/1/1998	7/1/1999	7/1/2000	7/1/2001	7/1/2002	7/1/2003	7/1/2004 ¹	7/1/2005
Asset Information										
(1) Plan Assets at Fair Market Value (MV)	\$23,737	\$29,120	\$34,633	\$38,099	\$42,071	\$38,870	\$34,442	\$35,327	\$39,216	\$41,858
(2) Actuarial Value of Assets (AVA) ²	19,736	22,851	27,132	32,090	37,026	40,554	41,649	41,429	41,293	41,085
(3) Assets ³	19,736	22,851	27,132	32,090	37,026	38,870	34,442	35,327	39,216	41,085
Actuarial Valuation Results – Contribution Basis										
(4) Normal Cost (Beginning of Plan Year)	624	662	699	761	849	975	1,095	1,177	1,179	1,250
(5) % Payroll (Beginning of Plan Year)	13.86%	13.90%	14.09%	14.24%	14.38%	14.91%	15.15%	15.22%	15.04%	15.34%
(6) Actuarial Accrued Liability (AAL: Entry Age) ⁴	17,925	19,257	20,617	22,157	24,067	27,451	30,100	32,955	35,034	37,252
(7) Actuarial Value of Assets in Excess of AAL	1,811	3,594	6,515	9,933	12,959	13,103	11,549	8,474	6,259	3,832
(8) Assets in Excess of Liabilities for Full Funding Limitation ⁵ Purposes	1,187	2,932	5,816	9,172	12,110	10,444	3,247	1,195	3,003	2,582

¹ Liabilities and costs reflect the economic and demographic assumptions adopted 7/1/2004.

² Actuarial Value of Assets: Adjusted market value method – the expected market value plus investment gains/losses amortized over a five year period.

³ Assets are defined as the smaller of market value and actuarial value.

⁴ AAL: The actuarial accrued liability based on the funding method used to value the Plan. The actuarial present value of plan benefits and expenses allocated to years prior to the valuation date.

⁵ Full Funding Limitation (FFL): The purpose of the FFL is to compare assets and liabilities to determine the need for a contribution. The FFL is calculated according to the IRC §412(c)(7)(A) (as adopted by the Regents in 1990 based on amendments to Section 412 through that date) as the lesser of market value of assets or actuarial value of assets less the smaller of (a) the actuarial accrued liability plus normal cost, or (b) 150% of the current liability, as defined in the IRC, plus current liability normal cost.

ACCOUNTING BASIS: Prior to 1997, the government accounting standard, GASB 5, provides that the liabilities, or obligation, for accounting purposes be based on the projected unit credit actuarial cost method. Beginning in 1997, GASB 25 replaced GASB 5. The GASB obligations are now based on the entry age actuarial cost method, which is the same cost method used to measure the AAL.

UC-PERS VOLUNTARY EARLY RETIREMENT INCENTIVE PROGRAM (PERS PLUS 5 PLAN) – ACTUARIAL VALUATION (UC PERS Plus 5 Plan attached)

On October 18, 1990, The Regents approved an early retirement incentive program for University employees who were covered under the California Public Employees' Retirement System (CalPERS) pension plan. The most tax-effective method to provide this group with a benefit generally comparable to the incentive offered to UCRP Members was to establish a "frozen" defined benefit plan under IRC §401(a).

The PERS Plus 5 Plan required campus and laboratory locations to fund their individual liabilities over no longer than five years. The PERS Plus 5 Plan is a standard terminal funding arrangement under a wasting trust, which, in this instance, is obligated to make fixed lifetime payments under either a single- or joint-survivor benefit structure. The assets must remain in the Trust until all benefit obligations have been satisfied. The assets are commingled with UCRP assets for maximum investment return without the loads, fees, or industry risk attached to an insurance contract. Market, rather than smoothed, value of assets is used for actuarial purposes.

In Revenue Ruling 89-87, the Internal Revenue Service clarified that a wasting trust is subject to the standard pension qualification, funding, and reporting requirements, inclusive of an actuarial review under IRC §6059. As such, the PERS Plus 5 Plan's Consulting Actuary reviews the Trust's fiscal position and funding status annually to assure that the PERS Plus 5 Plan is adequately funded.

As of July 1, 2005, the net assets of the wasting trust were \$77.8 million and the actuarial accrued liability was \$45.8 million. The surplus grew by approximately \$3.7 million since benefit disbursements and expenses were offset by investment performance that was more favorable than assumed (10.3 percent investment return versus the assumed 7.5 percent investment return).

As of July 1, 2005, there were 786 participants and beneficiaries in the PERS Plus 5 Plan, down from 798 as of July 1, 2004.