

TFIR Response to PEB Task Force Report

September 7, 2010

The Academic Senate has been unwavering in its position that the single most important determinant of the University's excellence is the quality of its workforce: hiring the best faculty and staff, and maintaining the highest quality workforce, depends in large measure on offering competitive total remuneration during recruitment and retention. We believe, therefore, that it is both necessary and appropriate to view the recommendations of the PEB Task Force through the prism of total remuneration, and to evaluate their impact on the quality of the faculty and staff that the University wishes to attract.

- I. We support the majority of the recommendations of the Task Force. These include all of those pertaining to Retiree Health (#12-#19, 25) and those aimed at placing UCRP on a firmer financial footing (#1, 20, 24). We also concur with several modifications of the pension plan that are common to all the Options under discussion. We note, however, that these changes represent a reduction in Total Remuneration and our support for them is based on stated Senate and Regental policy to provide competitive total remuneration.
- II. We oppose any New Tier that substantially decreases total remuneration, placing the University in an uncompetitive position to recruit and retain talented faculty and staff. As currently formulated, all three Options mentioned in the Executive Summary represent significant decreases in the competitiveness of Total Remuneration and therefore cannot be supported as they currently stand.
- III. Of the three Options mentioned in the Executive Summary, Option A is categorically unacceptable, because, with a long term employer normal cost of only 7.3%, it would *be uncompetitive even if the gap between UC salaries and market comparators' were closed*. Option A could therefore only be part of a competitive total remuneration package if salaries and other benefits were substantially *above what UC's competitors pay*, a hypothetical scenario we consider too unlikely to be taken seriously. Moreover, such inadequate pension benefits would completely undermine the role that a defined-benefit plan plays in retention of mid-career employees, and in encouraging retirement near a targeted age. Finally, Option A would represent such a stark contrast to the current pension benefit that serious morale problems, due to treating two groups of employees so differently in determining their pension benefits, would be likely.
- IV. Either Option B or C, each with long term employer normal cost of 9%, *could* be part of a competitive total remuneration package which includes increases in salaries to competitive levels. We emphasize, however, that there is no proposal on the table that represents such a competitive package; there is only a proposal to reduce pension benefits. Without a credible, linked proposal for

both salaries and pensions, based on appropriate Total Remuneration analysis, we cannot support abandoning the status quo plan.

If, and only if, the commitment is made to a simultaneous salary increase, we could support either Option B or Option C. We see Option C as being more transparent to communicate to employees; possibly more likely to be favored by staff, whose advice on it has not yet been sought; and perhaps less complex to implement. Since Option C was included in the PEB reports only in reference to the dissenting statement, the inference might be drawn that it is supported by the Academic Senate participants, and/or that it is competitive. This point is worth restating here, as TFIR's recommendation: Option C is *not competitive* without salary increases, and we do not support it as is. We agree with the dissenting statement that the option should not be removed from consideration before it can even be considered by employees who would experience different outcomes under B or C. (See Addendum 1 for further discussion of the 3 Options)

- V. We oppose adoption of any pension plan, including Options B and C, which is said to be competitive based only on hypothetical salary increases. We urge that the President and the Regents formulate and implement a serious and committed plan to raise UC salaries to competitive levels over the next four years simultaneously with the implementation of a new Tier. We strongly advise that UCFW recommend to the Academic Council that the Senate withhold endorsement of any pension plan that undermines our competitiveness, and voice its strong opposition to any further declines in total remuneration, even temporary ones.
- VI. If current employees are given the choice for their future service credit, between joining the New Tier or remaining in UCRP, we oppose an employee contribution of greater than 7% for the current UCRP. We believe that exceeding this level of employee contribution fundamentally changes the terms of the Plan, and could have the effect of forcing employees to choose the new plan. Such an outcome could be interpreted as a challenge to the California Vested Rights Doctrine.¹ As in item III, any increase in the employee contribution percentage, above the current redirection of the DCP contribution, must be offset by increased salaries, to avoid further erosion of total remuneration. Both the New Tier and UCRP at 7% employee contribution represent a reduction in competitiveness. However, the recommendations in the Task force Report have been made without an analysis of the

¹ Historically, employee contributions to UCRP for employees enrolled in Social Security have never exceeded 3% of covered compensation below, and 5% above, the Social Security Wage Base, less \$19 per month. The California Supreme Court invalidated a plan to increase the employee contribution from 2% to 10% for Long Beach police and firefighters, writing that "The provision raising the rate of an employee's contribution to the city pension fund from 2 percent of his salary to 10 percent obviously constitutes a substantial increase in the cost of pension protection to the employee without any corresponding increase in the amount of the benefit payments he will be entitled to receive upon his retirement." *Allen v. City of Long Beach*, (1955) 45 Cal. 2nd 128, 130.

likely behavior of the current workforce, regarding choice and without an analysis of UC's competitiveness. We see no basis for setting contribution percentages without such modeling, except when it is driven solely by the desire to cut costs.

- VII. The Senate will vigorously oppose attempts to undermine the studies of Total Remuneration and to discredit their results through spurious claims of uncompensated investment risk for the employer.

In Summary:

1. The quality of the University depends on the quality of its faculty and staff, which in turn depends on competitive total remuneration. Post-employment benefits should be structured to achieve this aim and to provide incentives for retention and renewal.
2. Retirement Option A is unacceptable as uncompetitive. Retirement Option B can be made competitive if combined with competitive salaries. Option C deserves more consideration as providing desirable incentives for retention and retirement along with a uniform structure easing comprehension and implementation. Options A, B, and C have identical costs through 2021.
3. The employee cost for those who wish to keep their future service in the current plan should not be so high as to force their "choice" of the New Tier.
4. TFIR categorically reject attempts to undermine the University's Total Remuneration study using fallacious arguments regarding uncompensated employer risk.

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Addendum 1: THE OPTIONS

History: The idea of a pension plan integrated with Social Security was initially put forward by the consultants from Hewitt. Senate members of the Pension and Finance work Groups refined the concept, including further integration with proposals for Retiree Health (many of which were later adopted by that work group). This plan (see Addendum 2) was approved for bringing to the Task Force by TFIR and UCFW but was never endorsed by either committee. Indeed, the document stated “...*this new alternative—which TFIR and UCFW recommend studying, but which neither committee has endorsed—links the options for pensions and retiree health to provide incentives to retire later for both current and new employees*”. A key point that partially survived the PEB process was TFIR’s recommendation to consider behavioral change under proposals for both pensions and retiree health jointly, rather than designing plans in isolation. Unfortunately, the features of the TFIR Integrated plan were so changed by the Pensions Work Group that it was disowned by the Senate participants and eventually morphed into Option A. When this option proved to be dramatically uncompetitive, the “Conclave”, a small group of individuals from the administration and Senate, was formed to discuss additional options with employer normal costs of 9% rather than the 7.3% in Option A. This led to the somewhat less uncompetitive Option B. In addition, while integration with Social Security was a necessity when employer normal cost was limited to 7.3%, with 9% employer normal cost, it became feasible to design a non-integrated plan. Thus Senate participants proposed putting Option C on the table, since it would represent a modified UCRP, with an employer normal cost identical to that of Option B. Administration participants suggested also modeling a lower-cost version of Option C, with a maximum age-factor of 2.25% (instead of C’s 2.5%). Since such an option would be even more uncompetitive than Option C, it received no support from the Steering Committee. Hence, this cheaper version of Option C should be considered defunct. That leaves two integrated plans—Options A and B—and Option C, which could be thought of as “UCRP lite”.

Options A and B are integrated with Social Security, and are intended to provide total retirement income (UCRP plus Social Security) as a roughly level percentage of HAPC across all income levels. To achieve this, the employee contribution and the age factor are different when applied to income below and above Social Security Covered Compensation (SSCC). SSCC is an average of the social security wage base for the preceding 35 years; it is currently about \$60,000 and rises over time according to a formula. Roughly speaking, SSCC rises along with average U.S. wages.

Option A uses an age factor of 1.5 percent below SSCC and 3.0 percent above SSCC to determine the pension benefit; the overall age factor on all covered compensation is capped at 2.5 percent. The employee contribution rate is 3.5 percent below SSCC and 9.5 percent above SSCC. The long-term employer normal cost is estimated to

be 7.3 percent. Some members of the Task Force favor this plan, in the light of the gravity of the budget situation, but see NOTE below. Others believe that implementing that plan would cause unacceptable damage to the quality of the University, due to the fact that the plan is not competitive with the pension plans of our competitors. The reduction in benefits under this option particularly affects lower and middle income workers.

Option B uses an age factor of 2.0 percent below SSCC and 3.0 percent above SSCC to determine the pension benefit; the overall age factor on all covered compensation is capped at 2.5 percent. The employee contribution rate is 4.0 percent below SSCC and 8.2 percent above SSCC. The long-term employer normal cost is estimated to be 9.0 percent. Some members of the Task Force feel that this plan is too expensive. Others point out that this plan is significantly cheaper than the current UCRP terms, and that it is an acceptable option for new employees, providing a reasonably competitive plan (provided that cash compensation is raised to a competitive level) that will provide a secure retirement after a full career at UC.

Option C is not integrated with Social Security, but instead is a modification the current UCRP provisions. All employees, regardless of income levels, would receive a maximum age factor of 2.5%, as in the current Plan. However, eligibility would shift by five years, so that the 2.5% maximum age factor pertains to retirement at age 65 or later. The employee contribution is estimated to be approximately 6.1% and the long term employer normal cost is 9%, the same as Option B.

NOTE: Because the New Tier will apply only to newly hired employees and those current employees who choose it, it is likely that the majority of employees will be under the current tier for the next decade. As a consequence, changes in the design of the new tier designed to reduce the University's pension obligations will save the University very little in the first decade. Moreover, as a result of certain financial steps being taken, differences in the long term employer cost for the three options, whether 7.3% as for A or 9.0% for B and C, *will have no impact on the University's operating budget until 2021*. Therefore, even the lower Normal Cost of Option A does not save the University any money for a decade. After that time, it simply postpones the *decrease* in operating budget charges to address the unfunded liability in the 2020s and 2030s. By providing a more competitive retirement benefit, Options B and C will permit the University to achieve competitive Total Remuneration with lower cash salaries than would be required if Option A were adopted. To summarize, Option A reduces operating costs only after 2021; at least some of the savings are illusory since in the meantime higher salaries will have to be paid while UC's excellence is placed at serious risk.

TFIR Response to Task Force Report

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Addendum 2: TFIR CONCEPT, Introductory Page

Inducing significantly later retirement ages could lower both actuarial accrued liability and normal cost for both Retiree Health and UCRP, while ensuring that employees can comfortably retire after a full career at UC. A design alternative that considers these two post-employment benefits jointly, keeps both current and new employees in UCRP, and changes retirement incentives could outperform the other options, which are currently being studied in isolation from one another. This alternative has the potential to achieve reductions in actuarial accrued liability and normal cost that are comparable to the reductions from other options, while replacing a greater share of employment income in retirement; preserving the benefits of a DB plan in managing the recruitment, retention, and renewal of the UC workforce; avoiding the creation of an “orphan” plan; and retaining the largest possible payroll base for amortizing the unfunded liability for pensions and retiree health. Specifically, this new alternative—which TFIR and UCFW recommend studying, but which neither committee has endorsed—links the options for pensions and retiree health to provide incentives to retire later for both current and new employees. It would ensure that employees can retire with a comfortable income and secure health benefits after a full career, while reducing the costs borne by employees and the various UC fund sources.

TFIR and UCFW recommend that the Post-Employment Benefits workgroups develop this alternative along with the other options under consideration, and evaluate each of the options based on the entire charge to the Task Force, rather than on cost alone. In particular, since substantial cost reductions follow from behavioral change, the options should be evaluated based on how they will affect retirement ages and other relevant behavior. Evaluating plans based on current workforce behavior does permit a ranking by cost reductions achieved, but if the plans differ in their behavioral effects, the ranking could change. The same is true, of course, if the plans differ in how they deal with the current unfunded liabilities, which reinforces the need to move beyond comparisons based only on estimated normal cost based on the current workforce.

This alternative is comprised of a series of linked plan design changes that will be less effective if adopted in a piecemeal manner. For example, the focus on income replacement as the standard for a new defined-benefit formula, with genuine coordination with Social Security, rests on simultaneously protecting employees from significant erosion of purchasing power from inflation; in order for the employee to be able to rely on a pension that doesn't fully replace income initially, this alternative approach matches a contractual guarantee of the *ad hoc* COLAs to coordination with Social Security.