ACADEMIC SENATE
BERKELEY
320 STEPHENS HALL
UNIVERSITY OF CALIFORNIA

February 5, 2016

J. DANIEL HARE, Chair
University of California Academic Senate

Subject: Response of the Berkeley Division of Academic Senate to the Retirement Options Task Force Report

Dear Dan,

At its January 25, 2016 meeting, the Divisional Council of the Berkeley Division of the Academic Senate (DIVCO) discussed the Report of the Retirement Options Task Force (ROTF), informed by the comments of the Division's Committee on Faculty Welfare (FWEL), its Committee on Budget and Interdepartmental Relations (BIR), and by comments submitted by individual faculty. The comments of FWEL and BIR are attached.

At the outset, DIVCO wishes to express its appreciation for the hard work of the ROTF and also for the great work you and Vice Chair Chalfant did in providing additional information and analysis.

Executive Summary
DIVCO's principal points are:

1. It is imprudent and potentially fiscally irresponsible to change a key component of remuneration without considering all components.
2. Assuming the University of California wishes to remain excellent, which means being competitive for top faculty, the proposed changes to the pension program will inevitably result in *raising* the University of California's *total* remuneration expense for faculty. Conversely, were total remuneration expense to stay flat or decline, the consequence would be an erosion in UC's competitiveness and consequent deterioration of the quality of education and research upon which the California people and economy depend.
3. In the long run, the proposed changes will have additional adverse consequences *vis-à-vis* the status quo, including the loss of both the "golden handcuffs" (*i.e.*, making it easier to retain faculty) and the "golden handshake" (*i.e.*, encouraging timely and predictable retirements).
4. If the current pension plan (the 2013 Tier) cannot be continued (as regrettably seems likely), DIVCO favors the following:
    a. Plan A should be adopted and the majority of DIVCO favor it being the default.

b. The Berkeley campus is ambivalent as to whether Plan B should be an option; it is judged to be the inferior plan except for those who will be UC employees for only a short period.
c. If Plan B is offered, employees who elect it should have the option to switch to Plan A. The case for having the option to switch at five years is sensible, but, additionally, assistant professors should have the option to switch at the time they receive tenure as well. If it is infeasible to have both options for any individual, then, for assistant professors, the option should only be exercisable at time of tenure.
d. The Unfunded Actuarial Accrued Liability (UAAL) surcharge should be on all covered compensation.
e. Because, in many instances, the defined contribution (DC) supplement will be paid too late in an individual's career to earn sufficient return (compounding), some contribution to the DC plan should occur before individuals hit the PEPRA cap. Plan A should be augmented or revised accordingly.

5. The Berkeley Division objects in the strongest possible terms to the lack of consultation prior to the tentative agreement to accept the PEPRA cap and the limited period for consultation subsequent to the release of the ROTF report. The processes that have led us to this point are wholly inconsistent with UC's norms of shared governance. With respect, the President should understand that such actions alienate the faculty, to the peril of the University, and erode their trust and confidence in her.

Additional Details

If the University of California is to continue to provide California with the kind of educated workforce and cutting-edge research that the state's 21st-century economy requires, then UC must be able to recruit and retain the best faculty; the faculty who not only help to fuel California's innovation-based economy through their research, but who also bring that research immediately into the classroom, along with their great depth of knowledge, thereby ensuring our students are at the forefront of their fields and, thus, more competitive for top jobs and top professional and graduate schools. Recruiting and retaining the best faculty means that UC will have to offer total remuneration that is competitive *vis-à-vis* other institutions.

Unfortunately, as has been well documented, UC's total remuneration seriously lags its competitors. This is especially a problem given the high cost of living in the areas in which so many UC campuses are located. It is incumbent upon UCOP and the Regents to address this problem unless they wish to see the world's greatest university system descend into mediocrity.

Against that background, it is difficult to comprehend why we should be contemplating replacing our current pension program with one that is inferior with respect to attracting and keeping the best faculty. To be sure, if there were simultaneously a credible plan to raise salaries and address other deficiencies in total remuneration, then one could contemplate changing the pension program; but there is no such overall plan at this time. It is, at best, imprudent to change one component of total remuneration in isolation; indeed, it is arguably irresponsible.

The Berkeley Division's view is that the most sensible course of action is for the Regents to delay accepting a change in the pension plan until the time that there is a full assessment of total faculty remuneration that can address the issue of overall competitiveness, as well as the overall expenses and liabilities associated with any remuneration strategy.

The Berkeley Division notes that if total remuneration is not to erode further, then the proposed change in the pension program will almost surely mean the University's compensation expenses will be greater than they would be under the current program. As the ROTF report observes, the amount of savings UC realizes from the new pension plan will be, at best, modest. But because the new plan will result in many faculty having a far lower replacement income in retirement than the current plan, shifts market risk from UC to the faculty, and shifts longevity risk from UC to faculty, the new plan is far less attractive than the current plan; hence, other parts of compensation will have to increase by a far greater amount than they would have otherwise to prevent any further erosion in total compensation. To reiterate, the Regents need a careful and comprehensive study of and strategy for *total* remuneration before making such a consequential decision for the University.

As noted in the ROTF report, it is likely that UCRP's investment portfolio will out perform the average faculty member's portfolio. Additionally, because an individual's risk considerations are different than UCRP's, a prudent individual will necessarily follow a more conservative investment strategy than UCRP, which further reduces replacement income at retirement. It is a well-known result in economics that an organization like UCRP can take advantage of the law of large numbers to absorb risk and, moreover, that efficiency dictates that the party better able to absorb risk should do so. All of this indicates that a well-managed defined-benefit program is a far more effective and efficient way of providing retirement income than a DC plan.

Long run, the change in the pension plan will generate other additional costs. Under the current plan, mid-career faculty are "golden handcuffed" to the University. This helps the University retain its best faculty against raids from other universities. Without those golden handcuffs, the amount of increased salary necessary to win such retention battles will be all the greater. At the end of one's career, the current plan is a "golden handshake": there is no financial incentive to remain on the faculty well into old age. In contrast, with DC plans, the incentives to continue to work can be great, especially if the market is experiencing a downturn. Beyond the academic and intellectual benefits of ensuring a constant refreshing of the faculty, there is a cost component: under our salary ladder, older faculty's compensation is significantly greater than younger faculty's. If we drive up the average age of the faculty steady state, we increase our wage bill steady state. Finally, many other institutions have found that they sometimes need to induce older faculty to retire by buying them out; the golden handshake avoids that quite costly problem (having, *e.g.*, to pay a faculty member an extra year of salary as a buyout at the end of her career—an action that, by the way, swamps the savings that abandoning the current plan yields).

Concerning the two plans put forward by the ROTF: as noted, there are many reasons to view a defined-benefit (DB) plan as superior to a DC plan. For this reason, DIVCO prefers Plan A to Plan B because Plan A retains a significant DB component (the 2016

Tier). Various analyses indicate that Plan A is better for individuals than Plan B, except for those individuals who will have very short careers at UC. Consequently, many on DIVCO favor making Plan A the default. There was, however, a minority view, summarized in the BIR report (see its point #4), that Plan B should be the default, at least for assistant professors.

If offered, some individuals will initially elect Plan B, especially if the length of their employment at UC is uncertain (*e.g.*, assistant professors). Because being in a better plan will help *vis-à-vis* retention (the "golden handcuffs") and the DB component helps somewhat with timely retirement (the "golden handshake"), it would be desirable to get long-term employees who initially elect Plan B into Plan A, which correspondingly makes providing an option to switch from B to A desirable. Because many assistant professors will not want to switch until they know whether they will earn tenure, we recommend that assistant professors be allowed to switch at the time of their tenure decision. If it is not feasible to have the switch be contingent on tenure, then the time at which an individual can switch should be close to the normative time for tenure (*e.g.*, in her or his sixth year of employment).

As discussed in the FWEL report (see its point #7) and also in the ROTF report, not applying a UAAL surcharge to all covered compensation is a false economy: it represents borrowing at a prohibitively high rate. We note that UCFW's TFIR also questions not applying the UAAL surcharge to all covered compensation.

A problem with the way in which the DC supplement under Plan A is structured is that contributions to the DC plan start only once an individual's salary exceeds the PEPRA cap. For many faculty members, this will occur in the second half of their career. Consequently, those contributions will be invested for a relatively short time before retirement, leaving a retirement account that is relatively small. For example, for the considered rates of return between 4.5 and 7.25%, a 30-year investment is worth between two to three times a 15-year investment. As the analyses in the ROTF, as well as your guide with Vice Chair Chalfant reveal, this means that, even under Plan A, many faculty will have a far lower replacement income in retirement than they would under the 2013 Tier. This can be partially ameliorated by having contributions made to the DC supplement from day one of employment. UCFW endorses a "retirement readiness" contribution to a supplemental DC plan on the order of 6% (3% employer and 3% employee) to commence at time of initial hire.

There are issues with an additional 3% employee contribution, given that many assistant professors are struggling to get into high-priced housing markets and often carry non-trivial amounts of student debt. But the 3% employer contribution or similar seems well worth exploring. Of course, this could make Plan A *more* expensive than the current pension plan if the 3% is on top of the 14% contribution to UCRP to fund the 2016 Tier component, which again calls into question the wisdom of abandoning the current plan. All of this suggests that, as UCFW observes, additional analysis is warranted and various modifications to Plan A should be considered. Yet another argument for why having the Regents make a final decision within a month or so is premature.

Shared Governance
The University of California has a long and proud tradition of shared governance. It is wholly inconsistent with that tradition that President Napolitano simply agreed with Governor Brown that the PEPRA limit would be applied to new hires without any review or input from the Academic Senate. The Berkeley Division has previously noted its dismay and disapproval of that decision by President Napolitano—a decision that has shaken many faculty members' confidence in her. The abbreviated review period for this critical and complex issue, especially given open questions about overall remuneration, is also wholly inconsistent with shared governance. Consultation without effective time for evaluation and analysis is not true consultation.

A Final Thought: Maintaining a Great University
It is easy in many instances to dismiss faculty complaints about changes to remuneration as their simply acting in their self-interest. That does not apply in this instance: no current faculty member is directly affected by this change; the pension plans of those currently employed will be unchanged. Moreover, if the faculty were motivated solely by self-interest, then they might even favor the deal the President struck: although a trivial fraction of what is needed to close the unfunded liability, $436 million is better than nothing. For existing faculty, anything that appears to shore up UCRP is in their narrow self-interest.

But the faculty care deeply about the future of a university to which many of them have devoted their entire careers. Making remuneration worse for *future hires* jeopardizes the excellence of the University. In the long run, California's economy is dependent on the highly skilled labor force and the direct and indirect spillovers (agglomeration economies) that come from having leading universities. Moreover, if the quality of UC slips, it will cease to be the amazing social mobility machine it is (and for which it was recently recognized by the *New York Times*); a second-rate system will not produce graduates with the depth of understanding and cutting-edge knowledge that will make them competitive for the best jobs or best graduate and professional schools.

The best and most economical way to preserve a University of California system that, through its excellence, keeps California prosperous is not to accept the PEPRA cap, but rather to preserve the 2013 Tier. Should that battle be lost, then we strongly urge President Napolitano to choose the options in the ROTF report that are most consistent with recruiting and retaining the best faculty. Furthermore, we strongly urge her to consider additional measures to make sure that our total remuneration package will permit us to recruit and retain the best.

On behalf of the Divisional Council,

Benjamin E. Hermalin
Chair, Berkeley Division of the Academic Senate
Schneider Distinguished Professor of Finance & Professor of Economics

Enclosures (2)

Cc: R. Jay Wallace, Chair, Committee on Budget and Interdepartmental Relations
Mark Gergen and Caroline Kane, Co-chairs, Committee on Faculty Welfare
Aimee Larsen, Manager, Committee on Budget and Interdepartmental Relations
Anita Ross, Senate Analyst, Committee on Faculty Welfare

University of California, Berkeley

COMMITTEE ON BUDGET AND
INTERDEPARTMENTAL RELATIONS

January 21, 2016

CHAIR BENJAMIN HERMALIN
BERKELEY DIVISION OF THE ACADEMIC SENATE

RE: Retirement Options Taskforce Proposals

Thank you for providing us with the opportunity to comment on the recommendations of the Retirement Options Task Force. We see two broad areas of possible concern related to the recommendations: the effect of any such plans on the financial stability of the University of California (UC) system and that of the UC Retirement Plan, and the effect on competitiveness in overall remuneration for newly hired faculty and in retaining faculty. We agree with the view of J. Daniel Hare and James A. Chalfant, Chair and Vice Chair, respectively, of the UC Academic Senate, who state that the financial stability of UC and UCRP is not likely to be significantly affected by the plans proposed. In any case, effects of this kind fall outside the purview of our committee. Thus we focus on the potential impact of the proposed plans on newly hired faculty, on overall remuneration, on readiness for retirement, and on the competitiveness of UC in recruiting and retaining faculty.

The issue of competitiveness is severe, and we have grave concerns about the effect of the proposed plans on the future quality of UC faculty. This effect is likely to be most acute at Berkeley, given the confluence on our campus of various factors, including extreme competition with other institutions, pre-existing shortcomings in salary and non-salary compensation relative to that of our competitors, and the inflexibility of existing policies for setting and adjusting salaries. We urge the Academic Senate leadership to stress the potential for irreparable damage to Berkeley posed by these changes, and the need for major changes in Berkeley's approach to determining salary and non-salary compensation in response, if we are to attempt to minimize this damage and maintain Berkeley's excellence.

More specifically, we would emphasize the following points.

1. The Task Force was given very tight constraints on possible plans. Given these constraints, it appears that there is no way to modify the details of the proposed plans that would result in significant improvement to the overall competitiveness of Berkeley in recruiting and retaining faculty. Thus working within these constraints, any changes designed to mitigate the potential damage to Berkeley will need to come from policies for salaries and other forms of compensation.

2. The proposed plans will weaken Berkeley's competitiveness in two distinct but related ways. The first is by significantly reducing the overall retirement benefits of newly hired

faculty relative to the current 2013 tier (which already represents a reduction in benefits compared to those accruing to faculty hired before July 1, 2013). The second is by eroding incentives for faculty to remain at Berkeley in the face of outside offers, an effect that will be particularly salient and strong for mid-career and senior-level faculty. These channels call for distinct but related responses.

a. We urge the Academic Senate leadership to move quickly to compile data comparing effects of the proposed plans on total remuneration, using Berkeley-specific competitors, such as the Comparison 8 universities (or ideally an expanded list weighted more toward Berkeley's private university competitors). Such data will be crucial for informing discussions about the impact of the new pension plans on Berkeley's competitiveness. We infer that this effect will be severe. UC already lags its competitors (in the Comparison 8) in overall compensation by 10%, based in part on retirement benefits given to newer faculty by the current 2013 tier (according to the 2014 total remuneration study). As the Task Force concedes, Plans A and B will significantly reduce benefits relative to the 2013 tier under every scenario presented.

b. We urge Academic Senate leadership to advocate plans for significant improvements in non-salary compensation at Berkeley, including housing supplements and tuition credits.

c. We urge Academic Senate leadership to advocate changes in policies for determining salaries for faculty at Berkeley, going forward. In many cases, it may be necessary to modify current policies for setting salaries at the time of appointment (by, for instance, approving 10% supplements over the salaries offered by peer institutions, rather than matching such salaries, as is our practice at present.) Further measures that might be necessary include significant modifications of the system-wide salary scales to increase step sizes, particularly for mid-career faculty (e.g. Associate Professor I - Professor VI), as well as improved, Berkeley-specific procedures for regular (and accurate) market-based adjustments, particularly in promotions and in cases for advancement across the thresholds at Professor, Step VI and at Professor, Step IX.

d. Finally, we note that defined contribution plans are often thought to incentivize faculty to remain in service longer than they otherwise might, in order to ensure adequate retirement benefits. Some of our private peers counter this tendency by offering large cash incentives to faculty to retire at an appropriate career stage. Under the new retirement benefit arrangements, Berkeley may need to consider similar programs to ensure its ability to renew the faculty ranks on a continuous basis.

3. The Task Force proposal calls for faculty to have a one-time option to revise their initial choice between Plans A and B after five years. A major rationale for offering an opportunity to switch is to allow faculty to opt into Plan A, which favors those expecting to hold a long-term position at Berkeley, once they have had enough time to reasonably

expect a long career here. Presumably Assistant Professors are a main target for this choice. In almost all cases, however, Assistant Professors will not be in a position to commit to a long career at Berkeley after only five years. We advise that the time at which this revision can be made be moved later to coincide better with the time at which most faculty hired initially as Assistant Professors can be expected to complete the tenure process. Five years is particularly short given that many Assistant Professors now take advantage of active service–modified duties status and tenure clock stoppages. Thus we advise moving the option to revise to eight to 10 years after appointment, or perhaps not specifying a time limit or otherwise offering a flexible option to change.

4. We recommend changing the default option from Plan A to Plan B. Plan A disadvantages Assistant Professors who might not receive tenure or younger faculty who for other reasons might not expect long service at Berkeley. These might also be the faculty least likely to evaluate and weigh retirement plans carefully, or even to make an initial choice. Thus setting Plan A as the default plan seems to benefit the university (through the forfeit of UC contributions should the faculty member resign within five years) at the expense of such faculty, and gives the appearance of exploitation.

These reflections capture our initial reactions to a complex set of proposals whose effects we are likely to be grappling with for many years to come. Given the potential magnitude of those effects, it is a matter of great regret to us that the basic parameters of the new retirement plans were fixed without consultation with the Academic Senate.

R. Jay Wallace

R. Jay Wallace
Chair

RJW/al

January 21, 2016

TO: BENJAMIN HERMALIN, CHAIR
BERKELEY DIVISION OF THE ACADEMIC SENATE

Re: Retirements Option Task Force Report

Dear Ben,

UC FWEL discussed the Retirement Options Task Force ("ROTF") Report at a January 19 meeting. We find much to object to in the Report. The process leading to the Report violates the principle of shared governance. The proposals provide inadequate retirement income security to faculty in Tier 2016. The system they propose replaces an efficient system for providing retirement income security with an inefficient system, creating new sources of cost not present under the existing system, and shifting risks that exist under any system from the University to employees. The reduction in the value of the pension benefit will significantly weaken Berkeley in recruiting and retention of faculty unless this reduction in total remuneration is offset by a significant increase in salary.

FWEL makes the following recommendations:

1) We think the process leading to the Report is a sufficiently egregious violation of the principle of shared governance to justify a general meeting of the Academic Senate to determine if the UC Berkeley Faculty as a collective body wants to officially express dissatisfaction over the process to the President.

2) While we expect it is too late to reverse the decision, if the decision to impose the PEPRA cap on the defined benefit ("DB") is open to being reversed, then it should be reversed. The Report makes it clear this was a mistake. Even in the most generous form, the new pension system provides less retirement income security to an employee whose compensation is subject to the cap at equal or greater cost to the employer. Much of the political impetus for the change has been organized around dealing with the unfunded liability, but the proposed changes actually reduce the contributions to be made by the University to address the unfunded liability, making the problem worse, unless the minority position reducing the level of the employer contribution to below 10 percent of covered compensation is adopted. The minority position on this point is untenable, for lowering the employer contribution makes the pension benefit even less competitive, and exacerbates the problem with the majority proposal, which is that it provides inadequate retirement income security to people in the 2016 Tier. Meanwhile the $436 million offered by the Governor is not guaranteed, and will cover only around four percent of the unfunded liability.

3) Turning to the proposals themselves, for most faculty members Plan A dominates Plan B by providing greater retirement income security. But the proposed supplement is inadequate to provide sufficient retirement income security. The

proposed supplement is a 10 percent employer contribution and 7 percent employee contribution for covered income above the PEPRA cap. Most junior faculty hired at Berkeley will be hired at a salary below the cap and then over their career their salary will rise to above the cap. Not making supplemental retirement contributions in a faculty member's early below-cap years makes it impossible for a faculty member to accumulate sufficient savings for retirement during his or her career to achieve income security in retirement. Under the old DB plan this was not an issue because the benefit was based on a faculty member's highest average compensation. To illustrate, persona "C" in the Report will have retirement income of around 50 percent to 60 percent of their highest average compensation under Plan A, as compared to just below 80 percent under Tier 2013, assuming they start at age 36 and retire at age 70. Only 30 percent of their retirement income is secure in the 2016 Tier DB plan. The balance of their retirement income is subject to market risk and annuity risk under the supplemental DC plan.

New faculty hires at Berkeley already find it difficult to afford a home in the Bay Area. Under this proposal, in addition to having a large mortgage and little savings, new faculty also will face the prospect of having an insecure income on retirement that is a fraction of their salary at retirement. Many senior faculty who face an insecure financial future should they retire are likely to choose to continue to work, occupying a position that could be occupied by a younger person. Once they do retire they are unlikely to be able to afford to remain part of this community. These changes—senior faculty defer retirement, and when they do retire they no longer participate in our community—will change Berkeley for the worse in fundamental respects. Meanwhile, Berkeley falls further behind its competitors in the compensation it can offer new faculty.

It is absolutely essential that some mechanism be created to make an additional employer supplemental contribution for junior faculty, whose current salaries are below the PEPRA cap, to provide income security in retirement comparable to income security now provided to faculty. Hopefully this mechanism will be designed in a way that raises the cost of leaving Berkeley at mid-career while encouraging retirement at end of career.

More than a sufficient balance in a retirement account is necessary to provide a secure retirement. It is also essential that UCRP be tasked to work with other financial intermediaries and providers of financial products to create a product as comparable as possible to a DB plan in protecting an employee from investment risk and annuity risk while providing returns comparable to the returns earned by UCRP. There is no such product today.

4) FWEL had mixed views on whether Plan B should be retained as an option. We recognize Plan B is not targeted at Berkeley faculty. Most faculty who come here hope to spend their career here. Certainly, this is something we as a University want to encourage. Moreover, allowing the option creates complexity for new hires and invites regret over the option selected. And we note that allowing the

option increases plan costs. If getting rid of Plan B could be a source of savings that could be used to enhance the supplemental benefit, then everyone on the committee would favor this instead. But we recognize employees who do not plan to work at the University for the five-year vesting period will benefit from having this option. And the option may help to recruit new faculty who do not trust the University to keep its pension promise, or who have an optimistic view about their ability as an investor.

5) We strongly agree with the position that the default should be Plan A for Plan A provides better income security for most employees.

6) We agree with the decision to allow an employee who chooses Plan B a one-time option to switch to Plan A. We understand the reason for making this option available after five years of employment to be that this is when the right to a pension vests under Plan A. For faculty it might seem more appropriate to make the option available after seven or eight years, not five years, so the option coincides with the tenure decision. But a faculty member who is not confident he or she will get tenure might still want to exercise the option after five years. A simple example will illustrate why. Assume an employee with $100,000 covered compensation who plans to retire at age 65. To keep it simple, assume the employee plans to work at the University for one more year. If the employee chooses to be covered by Plan A for year six, then they will get a right to a $2,500 annual pension, adjusted for inflation, to start at age 65. If the employee chooses to remain in Plan B, then they will get $17,000 in a tax-deferred account. The small annuity may well be more valuable than the money in a tax-deferred account. Thus we would like to keep this option open after five years. But we also understood many faculty members who select Plan B may not appreciate the value of a small annuity, and will not think about exercising the option until they get tenure. We propose providing an option in year five and then again in the tenure year. If this is determined to be too costly administratively or financially, then we would set the option in the tenure year on the view this is when most faculty are likely to make the decision to switch.

7) We strongly agree with the minority position in the Report that the UAAL surcharge should be on all covered compensation. The majority proposal not to impose the UAAL surcharge on covered compensation in excess of the PEPRA cap is inexplicable other than as a way to produce a plan that reduces benefits costs to campuses without a further reduction in the value of the benefit offered to employees in the Tier 2016. These are false savings. As the Report notes, this is basically a decision to borrow money that is not paid to reduce the deficit at 7.25 percent.