

## **Questions and Answers about the Health Sciences Retirement Proposal Initially Posted January 2004**

In order to help faculty and administrators understand the various features of the Proposal and related issues, we are establishing a Question & Answer page. One or more individuals have asked the following questions and we are posting these in hopes that others will benefit from answers to questions posed by their colleagues. This page will be periodically updated if we continue to receive questions that might be interest to others.

The Q/A's are broken into two sections. The first section contains some relatively basic questions/answers that hopefully address some key points. The second section contains some additional information that we realize may not interest all readers, but hopefully will be of use to some.

If you have any additional questions, please contact Robert Semple (email: Robert.Semple@ucop.edu phone: (510) 987-0598 about UCRP or the Defined Contribution Plan. If you have any questions about Health Sciences Compensation Plan policy, please contact Jill Slocum (email Jill.Slocum@ucop.edu phone: (510) 987-9482).

### **I. Some recurring basic questions:**

**1. Question:** *Is the purpose of the proposal to establish a new employer-paid Defined Contribution Plan?*

**Answer:** Yes, the current proposal is being offered to determine whether or not it is desirable to establish an employer-paid Defined Contribution Plan. The proposal is to establish:

- An annual Defined Contribution (DC) Plan employer contribution of 7% will be provided on all Y & Z compensation, up to the tax limits (see Attachment III). The employer-paid contribution to a Defined Contribution Plan would be charged to the same fund sources that pay the additional negotiated Y & Z compensation. Participation would be mandatory (i.e., there is no "opting-out" of the contributions), and health sciences faculty would have a choice of funds in which to invest the DC Plan contributions.

**2. Question:** *Is it necessary for the proposed mandatory contribution rate to be set at 7%, or could it be set at a different rate? Is it possible that the rate could be adjusted in the future? Would it be permissible to set up a variable contribution rate for the proposed new Defined Contribution Plan and/or is it possible for the contributions to be made on an optional basis by employees, APU's departments or schools?*

**Answer:** The proposal is to establish a mandatory Defined Contribution Plan contribution of 7% on salary above the amount of covered compensation. This is the amount that was recommended after the informal review process. However, during the informal review period, we had feedback from many of the campuses that at this time a mandatory 7% contribution is too high. Consequently as part of the formal review, we are asking for feedback about the optimal required contribution rate. While it is not possible to have a variable contribution rate by individual, department, school or campus, it is possible to set a uniform required contribution rate at a lower amount. We have been advised that it would likely not be permissible to charge contracts and grants more than 7%, so a higher amount has not generally been considered a viable alternative. It is important to note that it would be possible for the amount of the set contribution rate for the program to be adjusted in the future.

**3. Question:** *There is still confusion about the differences in the various components of health sciences faculty total negotiated salary as well as what is covered by the basic UCRP Plan and what would be covered under the proposed Defined Contribution Plan. Please give some examples of how retirement would be calculated under this proposal.*

**Answer:** The following examples show how salary components would be covered under the existing UCRP Defined Benefit and the proposed new Defined Contribution Plan.

### **Health Sciences Proposal**

Health Sciences compensation consists of 3 components; “X,” “Y,” and “Z”

- “X” = “base salary” - Only X is considered UCRP Covered Compensation
  - The amount of X is based upon a faculty member’s rank, step and applicable Health Sciences Compensation Plan (HSCP) salary scale (ranging from scale 0 to 9).
- “Y” = negotiated additional compensation - - Currently, there is no retirement coverage on Y pay
- “Z” = additional incentive compensation - - Currently, there is no retirement coverage on Z pay

#### **Example if proposed option was adopted:**

- A health sciences faculty member earns a total annual income (X, Y & Z pay) of \$220,000
- The faculty member has a rank of full **professor (step V)** and belongs to an APU currently on HSCP **scale 2**.
- Under the proposal, there are two applicable annual IRS tax limits for UCRP members hired after 6/30/94: one limit of \$200,000 applicable on X compensation for UCRP purposes and a separate \$200,000 limit on Y & Z compensation for defined contribution plan purposes.

\$20k	\$40k	\$60k	\$80k	\$100k	\$120k	\$140k
\$160k	\$180k	\$200k	\$220k			
+.....+	+.....+	+.....+	+.....+	+.....+	+.....+	+.....+

**Amount of "X" pay counted as UCRP Covered Compensation**  
 The annual X pay for a full professor at step V on HSCP scale 2 would be **\$128,900**

\$20k	\$40k	\$60k	\$80k	\$100k	\$120k	\$140k
\$160k	\$180k	\$200k	\$220k			
+.....+	+.....+	+.....+	+.....+	+.....+	+.....+	+.....+

**Y & Z pay eligible for annual DC Plan contributions = \$91,100**  
**\$91,100 X .07% = \$6,377 contribution**

- Thus, under the proposal, there would be retirement coverage on the faculty member's entire \$220,000.

**4. Question:** *Will there be, or can there be, a vesting period for the new DC plan?*

**Answer:** Vesting will be immediate.

**5. Question:** *How portable is the proposed Defined Contribution Plan?*

**Answer:** The Defined Contribution Plan contributions would be vested immediately so they would be completely portable upon separation from UC employment. However, we have discussed capturing the necessary payroll information once annually so it is possible that someone would have to wait for a while to receive a disbursement. This kind of detail, i.e. how disbursements would be handled, hasn't been worked out yet.

**6. Question:** *Can you clarify what fund source would be charged for the proposed new Defined Contribution Plan contributions? Would the new Defined Contribution Plan affect salary?*

**Answer:** The new Defined Contribution Plan benefit would be charged to the same salary source that pays for the Y & Z salary. Some faculty and administrators have expressed the concern that this plan is likely to adversely affect the salary of those faculty who receive all or part of their Y&Z salary from clinical income because the same funds that are used to provide salary would need to be used to pay the Defined Contribution Plan contribution.

**7. Question:** *The 7% Defined Contribution Plan is described as being mandatory on Y & Z salaries. Why is that necessary?*

**Answer:** In order for the Defined Contribution Plan to qualify as an employer tax-deferred plan and in order to have the capability of charging employer contributions to contracts and grants, it must be established as a mandatory plan.

**8. Question:** *Many are concerned about all potential benefit costs for compensation plan faculty. What other related factors might we want to consider for the costs of the various retirement benefits?*

**Answer:** Understandably faculty and administrators want to take all possible expenditures into account. However at this time no one knows when required contributions to the basic UCRP Defined Benefit Plan will be required on salary scales up to and including Scale 3 will again be required. Similarly at this time, we only know that reserve fund contributions on Salary Scales 4 and above are suspended through June 2004. Since this is a proposal for a new long-term retirement plan, reviewers should consider that there might again be at minimum a required contribution to the basic UCRP Defined Benefit Plan in the relatively near future. Some campuses also are considering the cost of the 415(m) restoration plan when deciding the relative merits of the new Defined Contribution Plan.

**9. Question:** *Is there a possibility of establishing a new voluntary plan that would allow employees the option of contributing to a new additional tax-deferred plan? If so, is this a different option from this current proposal for a new employer-paid Defined Contribution Plan? How would this be different from the current 403(b) Plan?*

**Answer:** UC is considering establishing a new voluntary employee paid tax-deferred savings plan that is similar to the current 403(b) Plan. However, this is a completely separate option from the current proposed Defined Contribution Plan for Health Sciences Faculty. Please see the following for more information.

#### **457(b) PLANS – A Brief Description**

UC is currently researching the cost and feasibility of establishing a 457 retirement plan with the hopes of making it available to UC employees through an outside vendor. Since a 457 plan would represent not only an additional retirement plan but also a new “type” of plan for UC, implementation and administrative complexities must be carefully assessed. Although UC is moving forward with this project, the ongoing budgetary crisis in the State of California and its subsequent impact on UC could potentially delay its implementation.

## **Background Information**

- 457(b) plans are deferred compensation plans that may be offered by governmental employers in addition to 403(b) plans.
- Prior to the passage of EGTRRA in 2001 the contribution limits for 403(b) plans and 457(b) plans were coordinated, which meant that if participants had contributed the maximum allowed under a 403(b) plan they could not contribute to a 457(b) plan or vice versa.
- As a result of EGTRRA the contribution limits for 403(b) plans and 457(b) plans are separate, which means participants now may contribute the maximum amount allowed under both plans.
- If UC were to offer a 457(b) plan in addition to the 403(b) Plan, the potential amount that employees could save for retirement on a tax-deferred basis would be doubled, as shown in the table below.

<b>403(b) and 457(b) Annual Contribution Limits</b>				
<u>Year</u>	<u>Age at year end</u>	<u>403(b) Limit</u>	<u>457(b) Limit</u>	<u>Total</u>
2004	under 50	\$13,000	\$13,000	\$26,000
	50 and over	\$16,000	\$16,000	\$32,000
2005	under 50	\$14,000	\$14,000	\$28,000
	50 and over	\$18,000	\$18,000	\$36,000
2006	under 50	\$15,000	\$15,000	\$30,000
	50 and over	\$20,000	\$20,000	\$40,000

For years after 2006 the limits will be adjusted for cost-of-living increases in \$500 increments. In 2010 the limits revert to the 2001 amount of \$10,500 for all participants unless new limits are adopted.

It is possible under both types of plans for eligible participants to make catch-up contributions that are in addition to the amounts shown above.

## **II. Some additional information:**

**10. Question:** *If the new plan is implemented, a department may want to consider reducing the scale it is currently on to scale 3. What, if any, assistance or information can be provided to departments to understand the implications of such a decision for their faculty and the department?*

**Answer:** It would be difficult to provide an analysis is would be useful across departments. There are a myriad of arguments for the relative merits of a Defined Contribution Plan benefit as opposed to a Defined Benefit Plan benefit since the factors are of course complex. For example, faculty who do not intend to remain at UC for a long time would presumably favor a Defined Contribution Plan. There is also of course

a wide difference of opinion on which kind of plan is more desirable which can largely be influenced by how people like to manage their investments. When the stock market was doing well, many people would more likely have been attracted to a DC Plan. Once the market started to lose value, the Defined Benefit Plan naturally started to look better.

The following are some additional considerations:

There is no simple analysis to guide departments and their faculty on whether it is advisable to reduce Scale 3. In addition to the above issues, there are also other important factors that come in to play, such as:

- How long will the Health Sciences Reserve Fund contributions continue to be suspended? (unknown)
- When will contributions to UCRP resume? (unknown)
- How much Y & Z pay above base does the average health sciences faculty member in the department accrue each year? (variable by department and over time)

What is the average age & length of service for each health sciences faculty member in the department? When do they plan on retiring? (variable by department and over time)

**11. Question:** *Does the whole system have to agree to this proposal, or could one campus implement it alone or with a couple other campuses?*

**Answer:** While in theory it might be possible to set this up the kind of Defined Contribution Plan on some campuses but not others, there would be significant problems and such a proposal is not likely to be approved. It would be very hard to justify why we would offer this kind of retirement program to some health science faculty and not others. We would also have to research the effect of setting this up at some but not all campuses since it is possible that there would be an adverse effect on the taxability of the benefit and the ability to charge the contributions to contracts and grants.

Additionally we need to do everything possible to make this an administratively viable program. For example, systemwide communications and payroll programming complexities are important considerations and unfortunately greater flexibility inevitably increases the complexity and expense of such a program.

**12. Question:** *Does the current proposal include any changes in the existing structure of base salary or covered compensation for the basic UCRP Defined Benefit Plan and the*

*existing Academic Program Unit structure? Does this proposal include any changes to the required contributions to the UCRP Defined Benefit Plan?*

**Answer:** Under this proposal, there is no change at all in the existing APU structure and current UCRP Defined Benefit Plan covered compensation. The only change is the proposed addition of a Defined Contribution Plan on salary in excess of covered compensation. Under the proposal there is no change in the reserve fund contributions, as in the reserve fund contributions will continue to be assessed for faculty who are on salary scales 4.0 and above. However at this time the reserve fund contributions are suspended through June 2004.

**13. Question:** *As part of this proposal, are there any changes in the existing policy regarding Health Science Reserve Fund contributions on salary scales 4 and above?*

**Answer:** There are no proposed changes in how the reserve fund charges would be assessed or used under the current proposal on salary scales 4 and above.

**14. Question:** *There has been some confusion about how the Defined Contribution benefits would be funded. How would the funding for these contributions be determined?*

The proposed 7% Defined Contribution Plan benefit would be charged to the same salary source that pays the “Y” and “Z” salary. For example if the “Y” and “Z” pay was fully funded by departmental clinical funds, the “employer-paid” Defined Contribution Plan benefit would also be charged to the same clinical funds. Conversely, if the “Y” and “Z” pay were funded by a combination of grants and/or consulting fees, those fund sources would be charged for the Defined Contribution Plan benefit.

Some faculty and administrators have raised the concern that since the Defined Contribution Plan benefit for clinical faculty would often come from the same fund source that pay clinical faculty salaries, any new expense for a mandatory Defined Contribution Plan benefit would result in a corresponding decrease in salaries, because for some clinical faculty there is only one pool of funds available for salary and benefits. Consequently in departments where faculty generate the clinical income that is used for the Y and Z components of salaries (and benefits), some people feel that faculty may prefer to maximize the use of the voluntary 403(b) tax deferred plans on their own rather than have a mandatory “employer-paid” plan for everyone. This is clearly a matter of personal opinion.

**15. Question:** *Would the new proposed Defined Contribution Plan have any effect on the funding of the existing UCRP Defined Benefit Plan or the potential timing of the resumption of required employer and/or employer contributions to the UCRP Defined Benefit Plan?*

**Answer:** This proposal has no effect whatsoever on the funding of the UCRP Defined Benefit Plan retirement plan. There is no cost to UCRP for this proposed Defined Contribution Plan contribution. However, some clinical departments are looking ahead to the time when there may again be required contributions to the UCRP. Departments with faculty who receive “X” or base salary funded by clinical funds would have to cover basic DBP required contributions from these same clinical funds.

**16. Question:** *There seem to be tax-sheltering advantages to the Defined Contribution Plan proposal. Is that right? Is it true that contributions to the Defined Contribution Plan would not change the maximum 403(b) contributions?*

**Answer:** Yes, the Defined Contribution Plan proposal would create new tax deferred accounts for eligible faculty. There are separate limits for the proposed Defined Contribution Plan and the 403(b) accounts. This would also be true for the tax-deferred 457 Plan that is being considered.

**17. Question:** *Some faculty think this new proposal represents a shift in retirement income financing from the university to the faculty. This perspective seems to ignore that it has been the success of the UCRP's investment strategies of the past that have allowed the plan to be financed by internally generated income. The University per se is not the funder of the retirement plan. If the UCRP has to begin requiring contributions from faculty and employees, it will do so across the board. This action will occur for reasons that have nothing to do with the Defined Contribution Plan proposal. Is that correct?*

**Answer:** We have been fortunate to have had a period of over ten years when there have been no required employer or employee contributions to the basic general fund for our UCRP Defined Benefit Plan. Funding for the UCRP Defined Benefit Plan is totally separate from the funding of this proposed Defined Contribution Plan and that contributions to this proposed new DC Plan will have no effect on the funding of the UCRP basic DB Plan.