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David Brownstone

UC Academic Senate Task Force on Investments and Retirements (TFIR)

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The views expressed here are my own and are not endorsed by TFIR or the UC Academic Senate unless otherwise indicated

Investment Basics

- Nobody can “beat the market” over times relevant for retirement planning. See A Random Walk Down Wall Street by Burton Malkiel
- The best way to deal with investment uncertainty is diversification.
- Above imply that you should only invest in broad-based index funds. Note currently only 60% of the world equity market is in the U.S.
- Any investment that promises high returns is either very risky or a scam (see FTX and Bernie Madoff)
- Almost any broad-based mutual fund or ETF will get similar long-run returns, so you should choose one with the lowest fees.
- Narrow specialized funds are attempts to beat the market and will almost certainly fail. They certainly charge higher fees.

- The only assets that have substantial real returns are equities and corporate bonds – gold, treasury bills, and residential real estate earn much less.

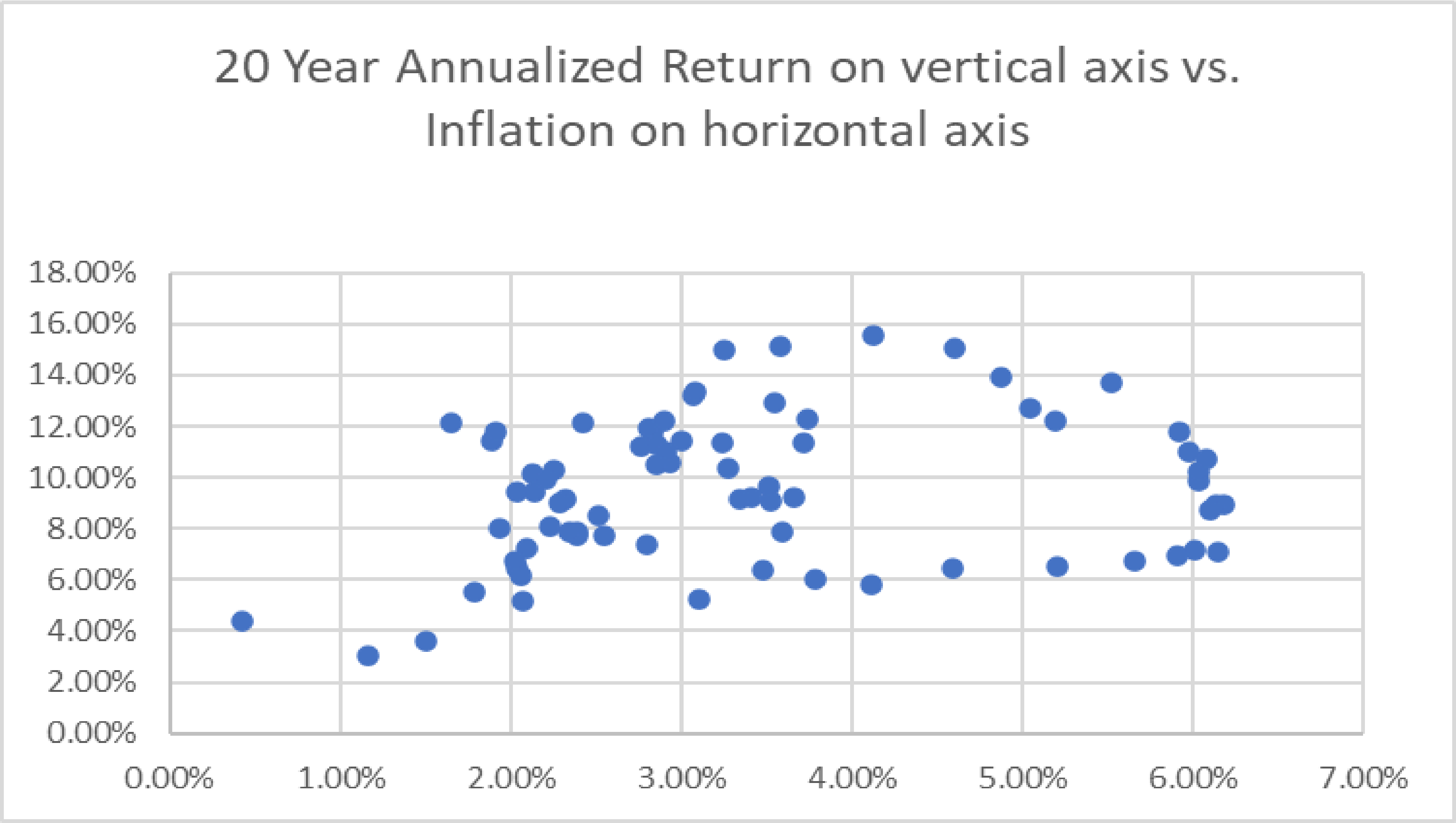
Value of $100 invested in 1928 at end of 2023 and annualized returns

	S&P 500	3 Mo Tbill	10 Yr Tbill	Baa Bonds	Homes	Gold	Inflation (TIPS)
End Value	$ 787,018	$ 2,249	$ 7,278	$49,525	$ 5,360	$10,042	$1,651
1928-2023	9.80%	3.30%	4.57%	6.68%	4.23%	4.92%	2.96%
1974-2023	11.10%	4.30%	6.12%	8.49%	5.40%	6.01%	3.87%
2014-2023	11.91%	1.27%	1.46%	4.32%	6.99%	5.58%	2.43%

Source: https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

What is the current financial status of the UC Retirement Plan, and how might this impact faculty and staff planning for retirement?

- UCRP is fine, and in any case it is the Regents' problem, not ours!
- Regents voted to increase employer contributions beginning July 1, 2024.
- Regents are using quite conservative assumptions for investment returns and inflation (6.75% and 2.5%), so it is likely that actual UCRP returns will be better than expected.
- UCRP annualized nominal returns 1991 – 2022 are 8.05%, and returns to 75% S&P 500, 25% US bonds are 8.09%
- It is extremely unlikely that UC will fail to meet pension obligations, but quite likely that the value of retiree health benefits will substantially decline.



Each dot is 20-year return and inflation starting at different years from 1928 through 2002

How does the university retirement system integrate with external retirement savings plans, and what are the tax implications for faculty and staff during and post-retirement?

- The UC Retirement Savings Plan provides low-cost funds that are appropriate for retirement savings.
- Default Target Date funds are fine for those who do not expect to get a large pension (plus Social Security), but too conservative for those who can easily live off their pension and Social Security income.
- The UC Domestic and International Equity Index funds are good, but they exclude fossil fuels. A good alternative is the Vanguard Total World Index fund ETF (VT) that you can purchase through the Fidelity Netbenefits Brokerage Link.

Roth versus tax-deferred savings

- Recent tax law changes require non-spouse beneficiaries to withdraw tax-deferred balances over 10 years. For substantial balances (after a lump-sum cashout for example) the tax bill could be as high as 40%.
- Low-wage employees should almost certainly save 100% in Roth accounts.
- Tax deferred accounts only good if you expect your tax rate to be lower in retirement – but this is not usually the case for long-term employees with large pensions, 403B/457, and social security income.
- The decision to convert existing pre-tax balances to Roth is complex, but most with current high balances and no Roth balances should likely convert at least some. Roth Conversions typically require paying additional quarterly tax to avoid IRS penalties.

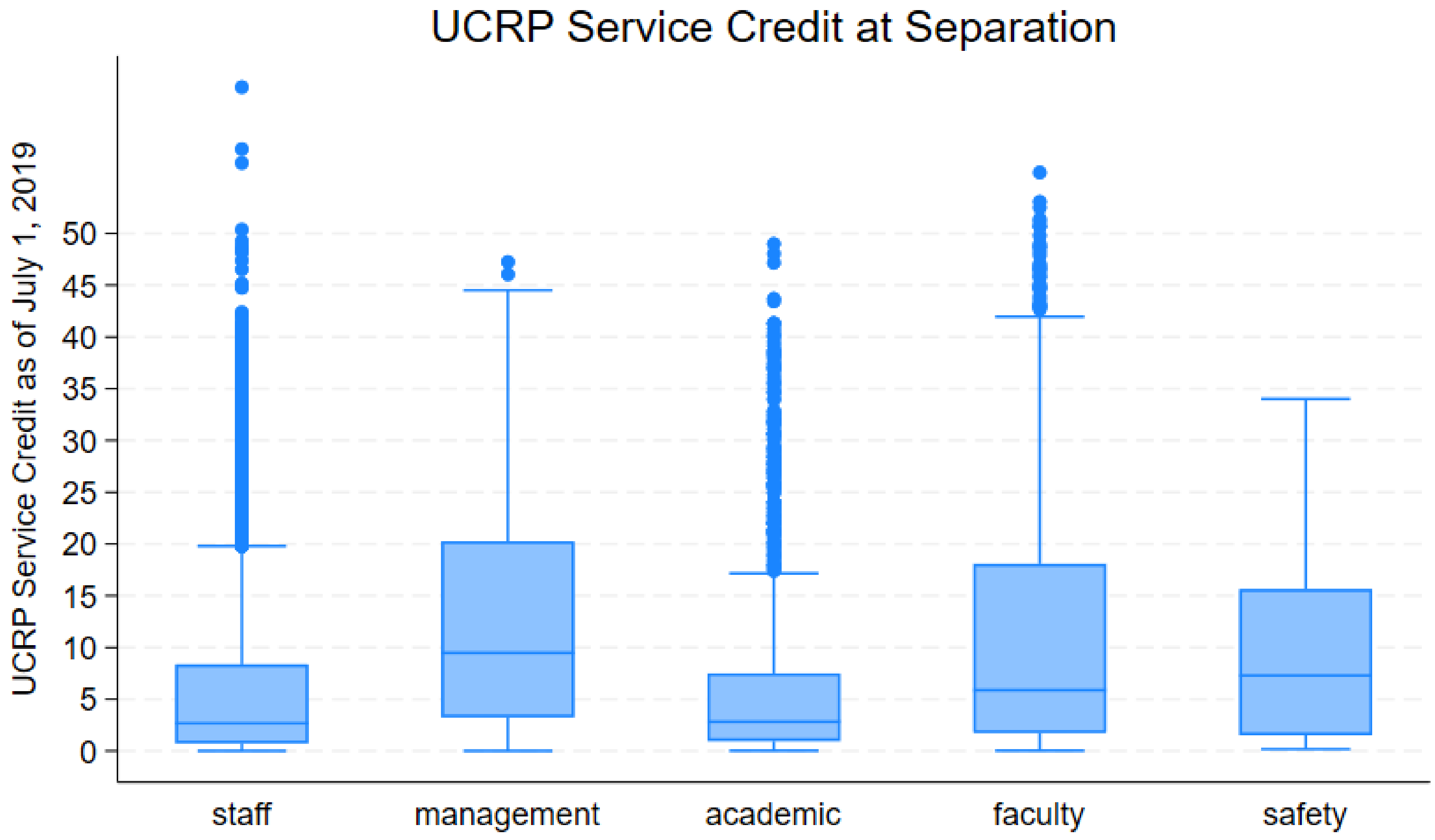
Lump-Sum Cashout (only for 1976 Tier)

- Provides a useful benefit for a small (but substantial) number of retirees. (see Pension Experience Study: https://regents.universityofcalifornia.edu/regmeet/july23/f4attach2.pdf Section 4h)
- Particularly useful for those expecting to: die "soon," not need health insurance, and/or expect to leave a substantial inheritance. Relatively common for one spouse in a couple with 2 long-term UC employees.
- Lump-sum cashout typically provides more protection against inflation and higher remainder values than the pension, though this depends critically on the individual's choices. Annuitization via commercially available products, for instance, would not likely do as well.
- May also be useful for those needing to go on Medicaid to afford long-term care.

Pension versus Savings Choice in 2016 Tier

see https://senate.universityofcalifornia.edu/resources/retirement-choice-model.html

- The 2016 tier consists of two plans, a traditional DC plan and a DB plan supplemented with a different DC benefit
- New employees have 90 days after initial hire to choose, and TFIR has been concerned that the default (pension choice) is wrong for most people and that employees are not getting sufficient education and advice.
- Based on TFIR's analysis, the Academic Council asked President Drake to change the default from pension to savings. In June 2023 President Drake responded by declining to make that change.
- TFIR recently obtained data on years of service credit at separation from UC and found that 75% of employees who separated during FY 2018-22 had fewer than 11.3 years of service credit. 55% had less than 5 years service credit.


UCRP Service Credit at Separation
UCRP Service Credit as of July 1, 2019
0
5
10
15
20
25
30
35
40
45
50
staff
management
academic
faculty
safety

Second Choice is the best option for new employees

- For the more than 75% of employees who leave with less than about 11 years of service credit, the value of their pension will be much lower than the value of the extra contributions to their tax-deferred savings (403b).
- Once it is clear that an employee will stay for at least 20 years, then opting for switching to Pension Choice during the 5-10 year window after initial hire (Second Choice) is optimal.
- These conclusions require that tax-deferred savings balances are invested to earn a sufficient real rate of return.

UC Employee Investment Advice

- Put at least 80% into indexed equity funds. This is the best hedge against inflation and the incomplete inflation indexing of UC pensions. This also makes the "4% rule" work.
- Expected pension and Social Security payouts should be treated like treasury bonds. This implies multiply expected annual payments by about 25 to get equivalent asset values. Those expecting substantial UC pensions should have almost all of their retirement savings invested in equities. Target-date funds are too conservative for people with large pensions – but fine for Savings Choice.
- Delay taking Social Security until age 70
- Put investments like bonds or REITs that generate taxable income into Roth (or at least tax-deferred) accounts.

RASC and Fidelity Expertise

- Most Fidelity UC advisors are OK, but they are incentivized to sell expensive Fidelity managed accounts.
- RASC has just hired about 10 retirement counselors. All (?) are Certified Financial Planners and they have training on the details of UCRP. They should be your first choice for advice, but they are likely to get overbooked and may try to steer you back to Fidelity.
- Neither Fidelity or RASC counselors are fiduciaries, but the RASC counselors have no obvious conflicts of interest.