

San José Federated Postemployment Healthcare Plan



5e

Assumptions for June 30, 2023 OPEB Actuarial Valuation

November 16, 2023

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Background

OPEB Assumptions

- Health Trend Assumptions
- Health Plan and Coverage Elections
- Administrative Expenses
- Discount Rate

Board Decisions

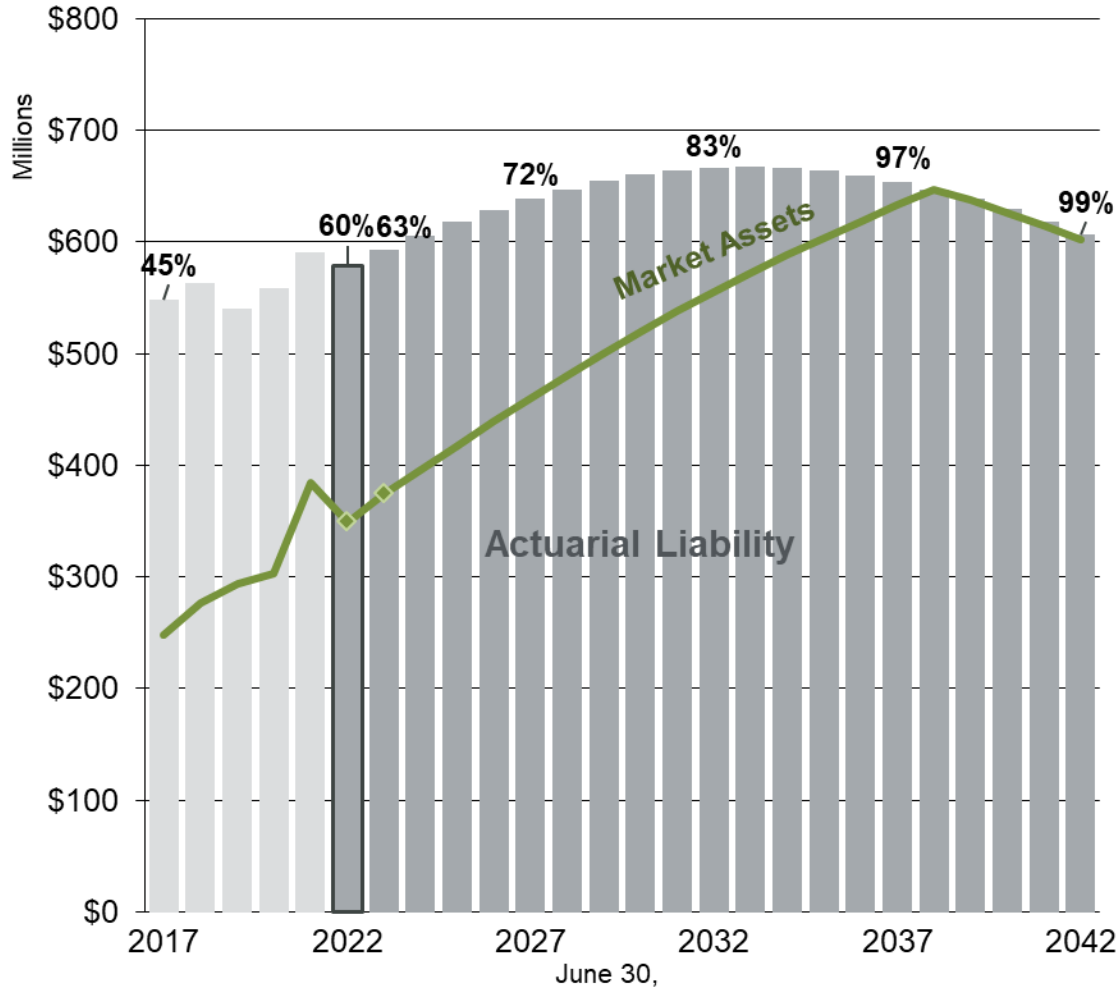


- OPEB plan is mostly closed
 - Only Tier 1 members who did not elect the VEBA can receive full benefits
 - Benefits for others who qualify for catastrophic disability
- Member contributions are fixed at 7.5% of pay
- City contributions are set by the Board
 - City can cap contributions at 14% of pay
- June 30, 2023 valuation
 - Develops City contribution for FYE 2025
 - Used as basis for GASB 74/75 reporting in September for FYE 2024

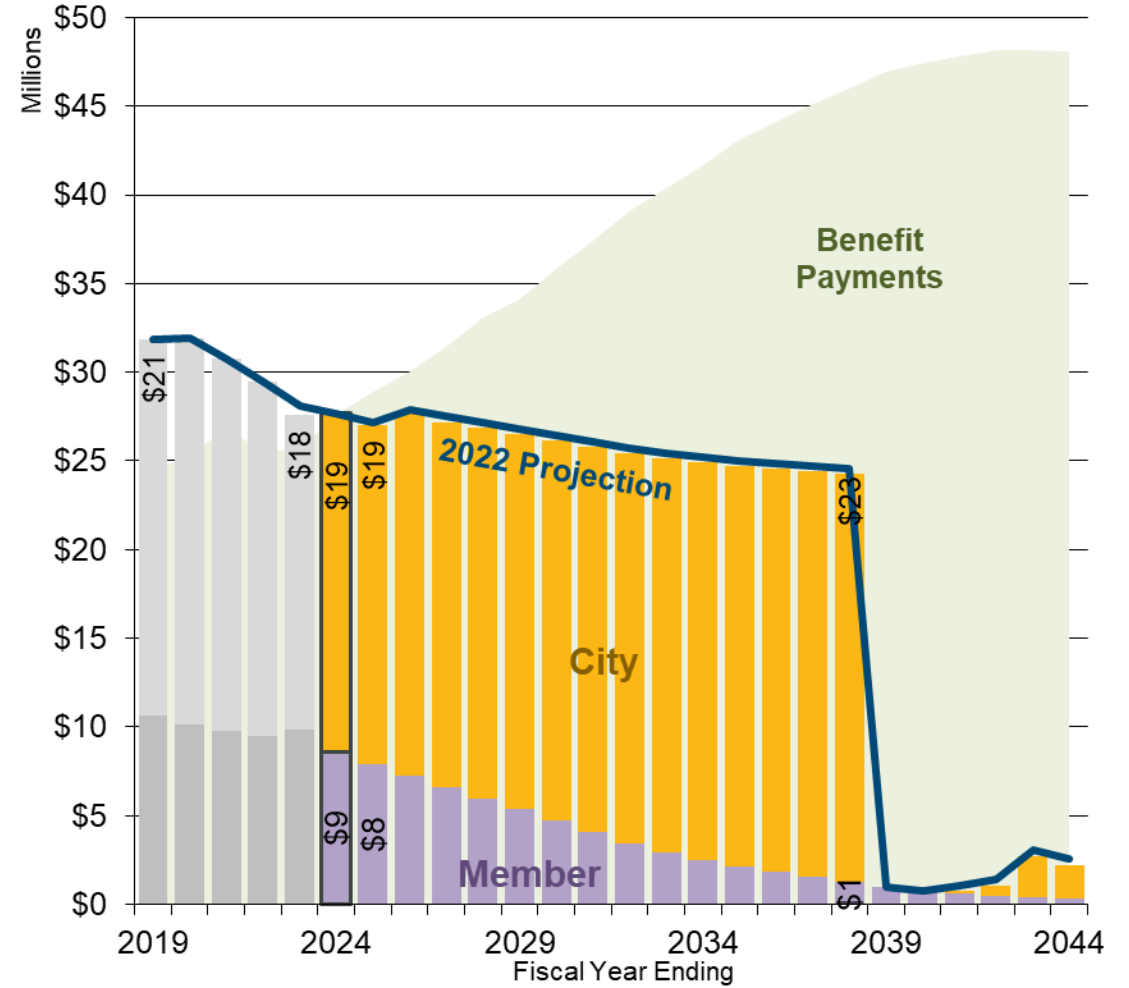
Projections – Updated for Investment Returns



Historical and Projected Assets and Liabilities



Historical and Projected Contribution Amounts



OPEB Assumptions





- Use same assumptions as pension plan where applicable
 - Economic assumptions: Price inflation, wage inflation
 - Demographic assumptions: Retirement rates, mortality, etc.
- Unique OPEB assumptions
 - Health care trend rates
 - Health plan elections and coverage tiers
 - In-Lieu elections
 - Administrative expenses
 - Expected return on assets

Overview of Proposed Changes



OPEB Assumption	Recommendation
Health care trend rates	<ul style="list-style-type: none">Update Getzen model parameters (details in appendix)<ul style="list-style-type: none">New short-term trends
Health/Dental plan elections	<ul style="list-style-type: none">Adjustments to reflect enrollment trends
Future retiree tier elections	<ul style="list-style-type: none">No change
In-Lieu election and coverage duration	<ul style="list-style-type: none">No change
In-Lieu credit tier	<ul style="list-style-type: none">Adjustments to reflect enrollment trends
Administrative expenses	<ul style="list-style-type: none">Update assumption to \$105 per member for FYE 2025
Discount rate	<ul style="list-style-type: none">No change

Other than the discount rate, analyses for items with no changes proposed are shown in the appendix

Changes in Explicit Subsidy



Maximum Annual Explicit Subsidy Premium for Lowest Cost Health Plan Offered to Active Employees

Year	Member Only	Member + Spouse	Member + Child(ren)	Member + Family	Approximate Increase
2018	\$4,916	\$9,833	\$8,604	\$14,749	-16.4%
2019	\$5,340	\$10,681	\$9,346	\$16,021	8.6%
2020	\$5,807	\$11,615	\$10,163	\$17,422	8.7%
2021	\$6,172	\$12,344	\$10,801	\$18,516	6.3%
2022	\$6,120	\$12,288	\$10,752	\$18,431	-0.8%
2023	\$6,508	\$13,017	\$11,389	\$19,525	5.9%
2024	\$7,162	\$14,324	\$12,534	\$21,486	10.0%

- Maximum explicit subsidy
 - Expected increase = 7.16%
 - Actual increase = 10.04%
 - All pre-Medicare plans receive maximum subsidy
- All Medicare-eligible plans have premiums below the maximum subsidy
 - Expected increase = 4.27%
 - Actual increase =
 - +16.3% for Kaiser (~43% of population)
 - +3.1% for Anthem PPO (~57% of population)

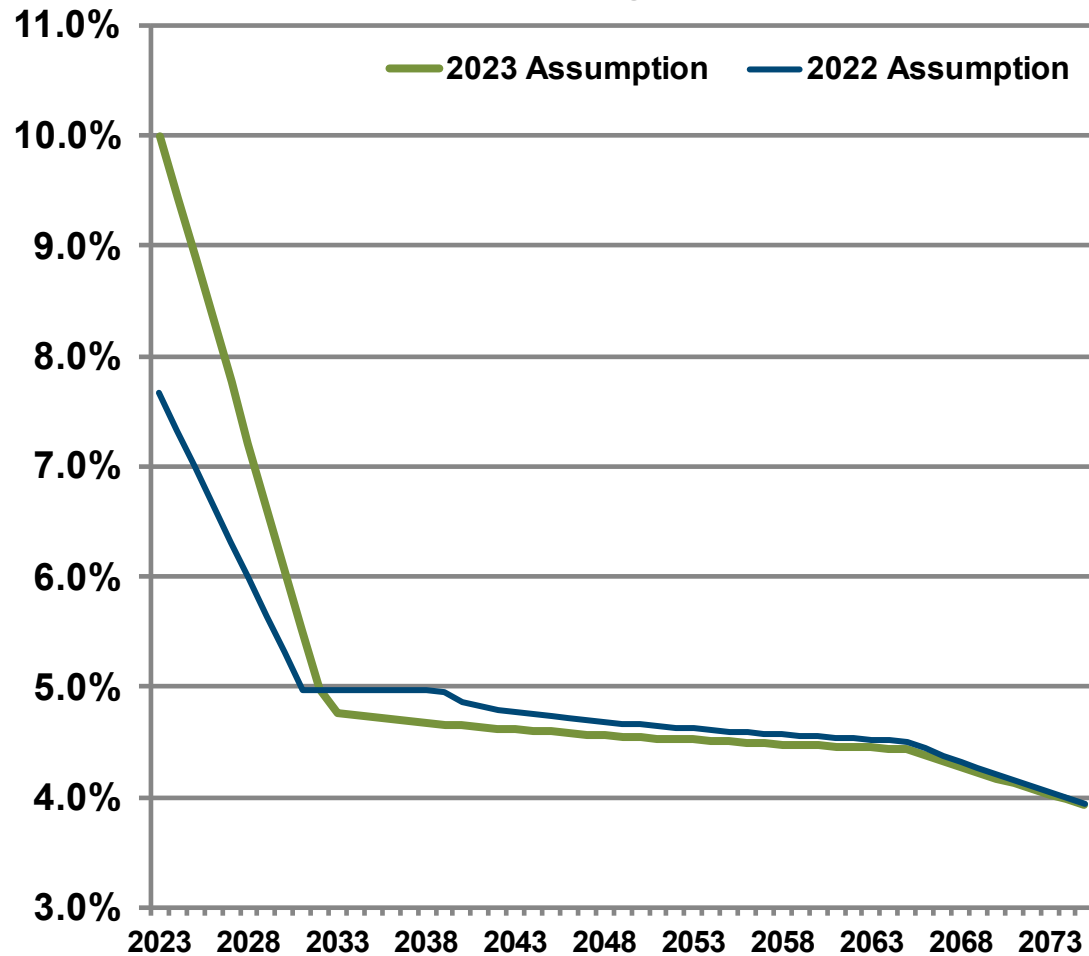


- Developed medical trend assumptions using 2023 Getzen model published by the Society of Actuaries
 - Initial trends reflect short-term expectations
 - Non-Medicare Eligible = 10.00%
 - Medicare Eligible = 6.00%
 - Adjusts linearly to long run trend of 4.97% in 2032
 - Nominal per capita GDP growth plus 1.0% excess medical cost growth
 - Grades down to nominal per capita GDP growth of 3.94% in 2075
- The trend for dental remains at 3.5% for all years

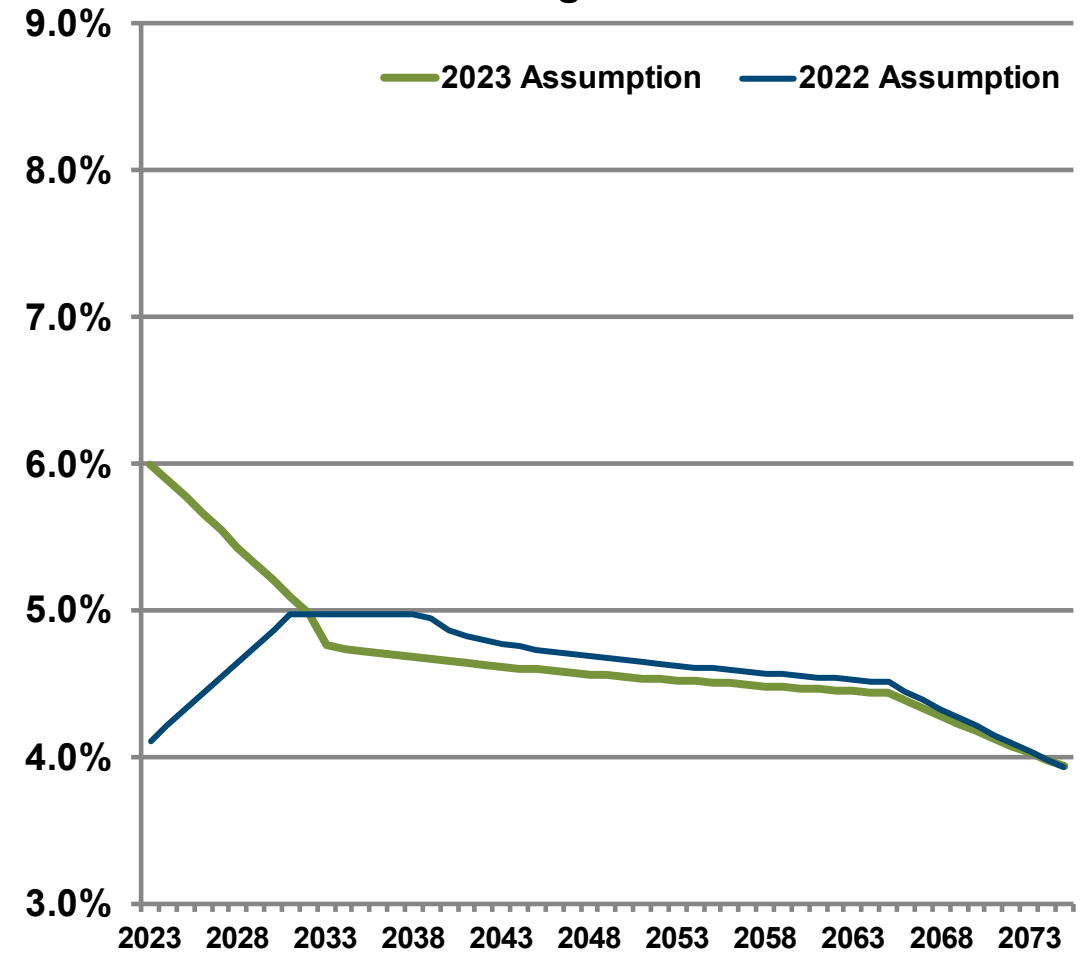
Comparison of Health Trend Rates



Non-Medicare Eligible Trend



Medicare Eligible Trend



Health/Dental Plan Elections



Assumed Plan Elections for Future Retirees*				
	Enrollment		Assumptions	
	Average	2023	Current	Proposed
Pre-Medicare Medical Plans				
Kaiser DHMO	9%	8%	10%	8%
Kaiser \$25 Co-pay	66%	66%	67%	67%
Kaiser HDHP	8%	9%	8%	8%
Anthem DHMO	1%	1%	1%	1%
Anthem Select \$20 Co-pay	6%	5%	5%	5%
Anthem Traditional \$20 Co-pay	2%	3%	1%	2%
Anthem HDHP PPO	4%	5%	3%	5%
Anthem Select PPO	3%	2%	4%	3%
Anthem Classic PPO	1%	1%	1%	1%
Medicare-Eligible Medical Plans				
Kaiser Senior Advantage	60%	61%	60%	61%
Anthem Medicare HMO	3%	1%	1%	0%
Anthem Medicare PPO	37%	38%	39%	39%
Dental Plans (All Retirees)				
Delta Dental PPO	98%	98%	98%	98%
DeltaCare HMO	2%	2%	2%	2%

* Eligible for coverage and elect coverage

- Historical trends and 2023 enrollment elections differed from the 2022 valuation assumptions slightly
 - The Anthem Traditional \$20 Co-pay, Anthem High Deductible PPO, and Kaiser Senior Advantage continued to attract more enrollment than anticipated
 - The Kaiser Deductible HMO and Anthem Select PPO continued decline in enrollment
 - Anthem Medicare HMO no longer available in 2024

In Lieu Coverage Credit Tier



- Measure F added an “In-Lieu” option
 - Retirees can waive health coverage for a credit equal to 25% of the explicit subsidy for the tier of coverage for which they qualify
 - Credit can be applied to pay future premiums
 - Now have 6 years of data

- In-Lieu Coverage Credit Tier
 - Five years of data
 - Trend toward fewer retiree only and family
 - Recommend updating pre-Medicare and Post-Medicare assumptions

Assumed In-Lieu Coverage Tier				
	Enrollment		Assumption	
	Average	2023	Current	Proposed
Pre-Medicare				
Retiree Only	33%	30%	32%	30%
Retiree + Spouse	25%	30%	26%	30%
Retiree + Family	42%	40%	42%	40%
Medicare Eligible				
Retiree Only	52%	46%	55%	50%
Retiree + Spouse	48%	54%	45%	50%

Administrative Expenses



- Current assumption would be \$106.09 per member for FYE 2025
 - Increases each year with assumed wage inflation
- Analysis adjusts historical administrative expenses to the current year with assumed wage inflation
 - Change in administrative expense allocation methodology beginning FYE 2020
 - Analysis ignores data prior to methodology change
- Average adjusted expense per member for last 4 years is \$99.33. Increasing average for expected wage inflation produces an estimate of \$105.38 per member for FYE 2025
- Proposed assumption = \$105 per member for FYE 2025 increasing with assumed future wage inflation

FYE	Adjusted Administrative Expenses	Members	Adjusted Expense / Member
2023	\$ 750,475	7,788	\$ 96.36
2022	787,591	7,542	104.43
2021	739,398	7,541	98.05
2020	749,623	7,613	98.47
2023 4-Year Average Adjusted Expense / Member			\$ 99.33
FYE 2025 Expense per Member			\$ 105.38

Expected Return on Assets



- Meketa provided forward-looking capital market assumptions for 2023
 - 10- and 20-year time horizons
- Horizon survey includes:
 - 10-year time horizon – 42 consultants
 - 20-year time horizon – 27 consultants
- Very significant increase in expectations this year
 - 150-200 bps for Meketa

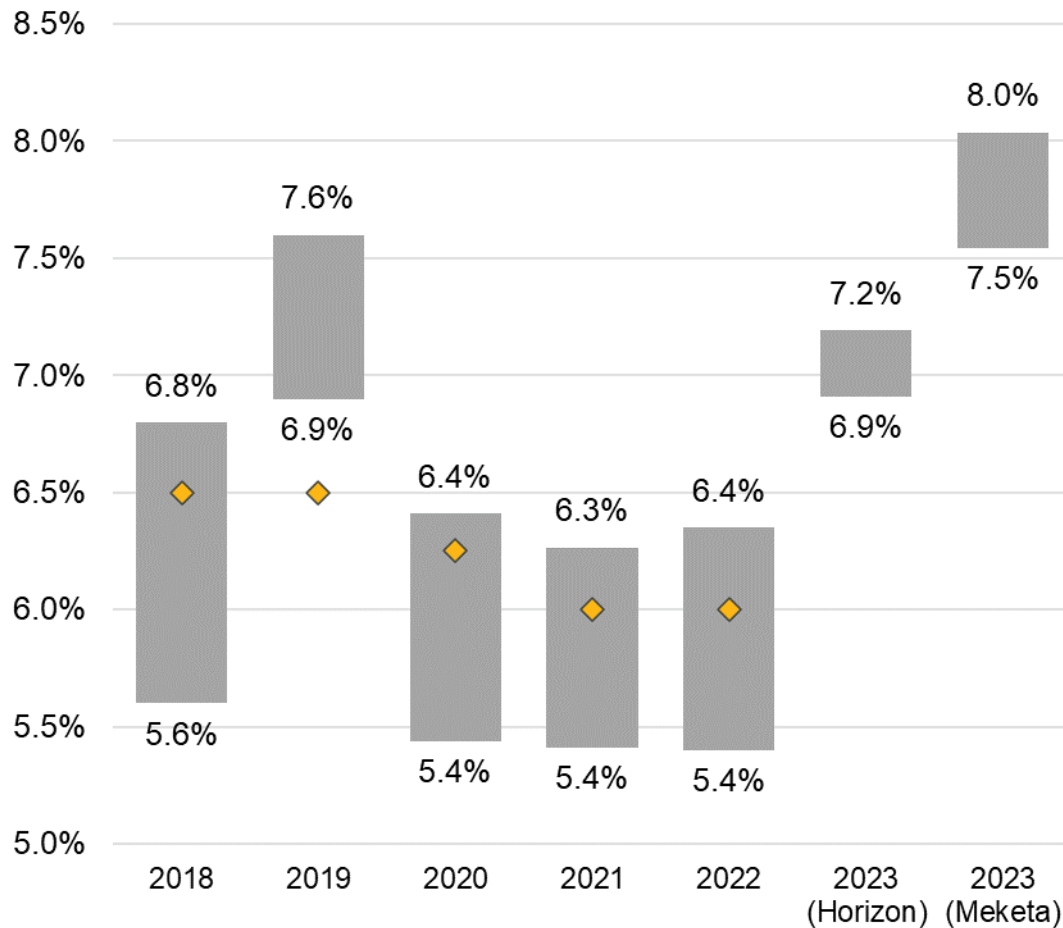
Expected Distribution of Average Annual Passive Returns				
Percentile	10-Year Timeframe Horizon		20-Year Timeframe Horizon	
	Survey	Meketa	Survey	Meketa
95th	13.2%	13.8%	11.6%	12.4%
75th	9.5%	10.1%	9.0%	9.8%
60th	7.9%	8.5%	7.9%	8.7%
55th	7.4%	8.0%	7.5%	8.4%
50th	6.9%	7.5%	7.2%	8.0%
45th	6.4%	7.1%	6.9%	7.7%
40th	6.0%	6.6%	6.5%	7.4%
25th	4.4%	5.1%	5.4%	6.3%
5th	1.0%	1.6%	2.9%	3.8%

Cheiron calculations based on capital market assumptions from the Horizon survey and from Meketa

Expected Return on Assets



Expected Return on Assets vs. Discount Rate
10 and 20-Year Time Horizons



- Capital market assumptions fluctuate
 - Interest rates
 - Valuations (P/E ratios)
- Discount rate typically falls between 10- and 20-year expectations
 - 10 years ~ 40% of the present value of benefits
 - 20 years ~ 70% of the present value of benefits
- Current discount rate of 6.00% is conservative based on 2023 capital market assumptions
 - Significant change from prior years

Discount Rate Considerations



- Is the increase in capital market assumptions temporary?
 - Primary driver of increased capital market assumptions is the rise in interest rates due to actions of the Federal Reserve
 - Not clear if/when rates may come down
- Very painful to reduce discount rate
 - Be cautious about increasing discount rate
 - Don't want to increase discount rate and then have to reverse course and reduce the discount rate again
- It is okay for the discount rate to be less than expected return
 - Greater probability of achieving the return
 - Provides margin against adverse experience
 - The reverse is not true – it is not okay for the expected return to be materially less than the discount rate
- We propose no change to the discount rate this year
 - If Board elects to increase the discount rate, small steps would be prudent



OPEB Assumption	Recommendation
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- The purpose of this presentation is to present recommended assumptions for the June 30, 2023 Valuation for the City of San José Federated Postemployment Healthcare Plan.
- This presentation was prepared exclusively for the Board of Administration for the purpose described herein. Other users of this presentation are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to any other user.
- In preparing our presentation, we relied on information (some oral and some written) supplied by the Plan. This information includes, but is not limited to, the plan provisions, employee data, and financial information. We performed an informal examination of the obvious characteristics of the data for reasonableness and consistency in accordance with Actuarial Standard of Practice No. 23.
- Cheiron utilizes ProVal actuarial valuation software leased from Winklevoss Technologies (WinTech) to calculate liabilities and project benefit payments. We have relied on WinTech as the developer of ProVal. We have a basic understanding of ProVal and have used ProVal in accordance with its original intended purpose. We have not identified any material inconsistencies in assumptions or output of ProVal that would affect this valuation.
- Health care trends for this valuation were developed using the Society of Actuaries (SOA) Long-Run Medical Cost Trend Model. The SOA Long-Run Medical Cost Trend Model and its baseline projection are based on an econometric analysis of historical U.S. medical expenditures and the judgments of experts in the field. The long-run baseline projection and input variables have been developed under the guidance of the SOA Project Oversight Group.

Certification (continued)



- We have relied on the Society of Actuaries as the developer of the Model. We have reviewed the Model and have a basic understanding of the Model and have used the Model in accordance with its original intended purpose. We have not identified any material inconsistencies in assumptions or output of the Model that would affect this valuation.
- This presentation has been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we collectively meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this presentation. This presentation does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

William R. Hallmark, ASA, EA, FCA, MAAA
Consulting Actuary

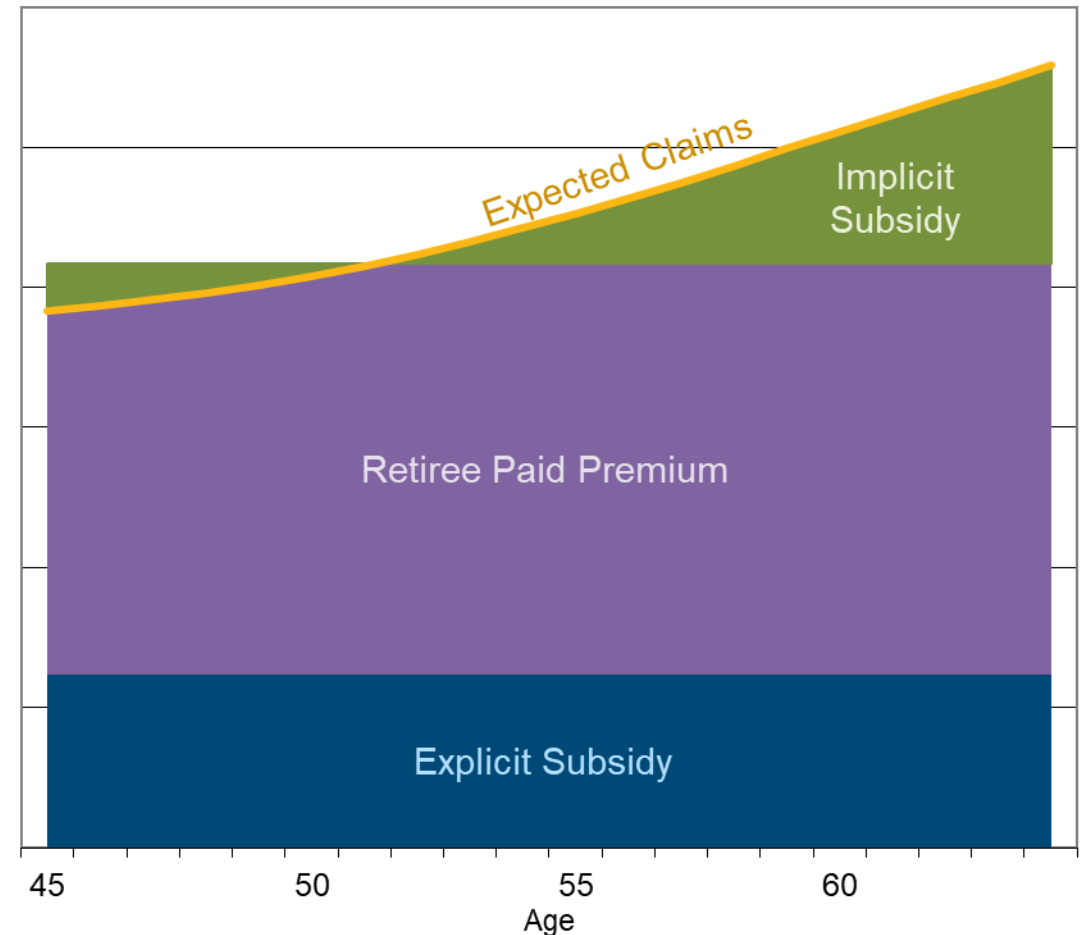
Michael W. Schionning, FSA, MAAA
Principal Consulting Actuary

Appendix – Two Types of Subsidies

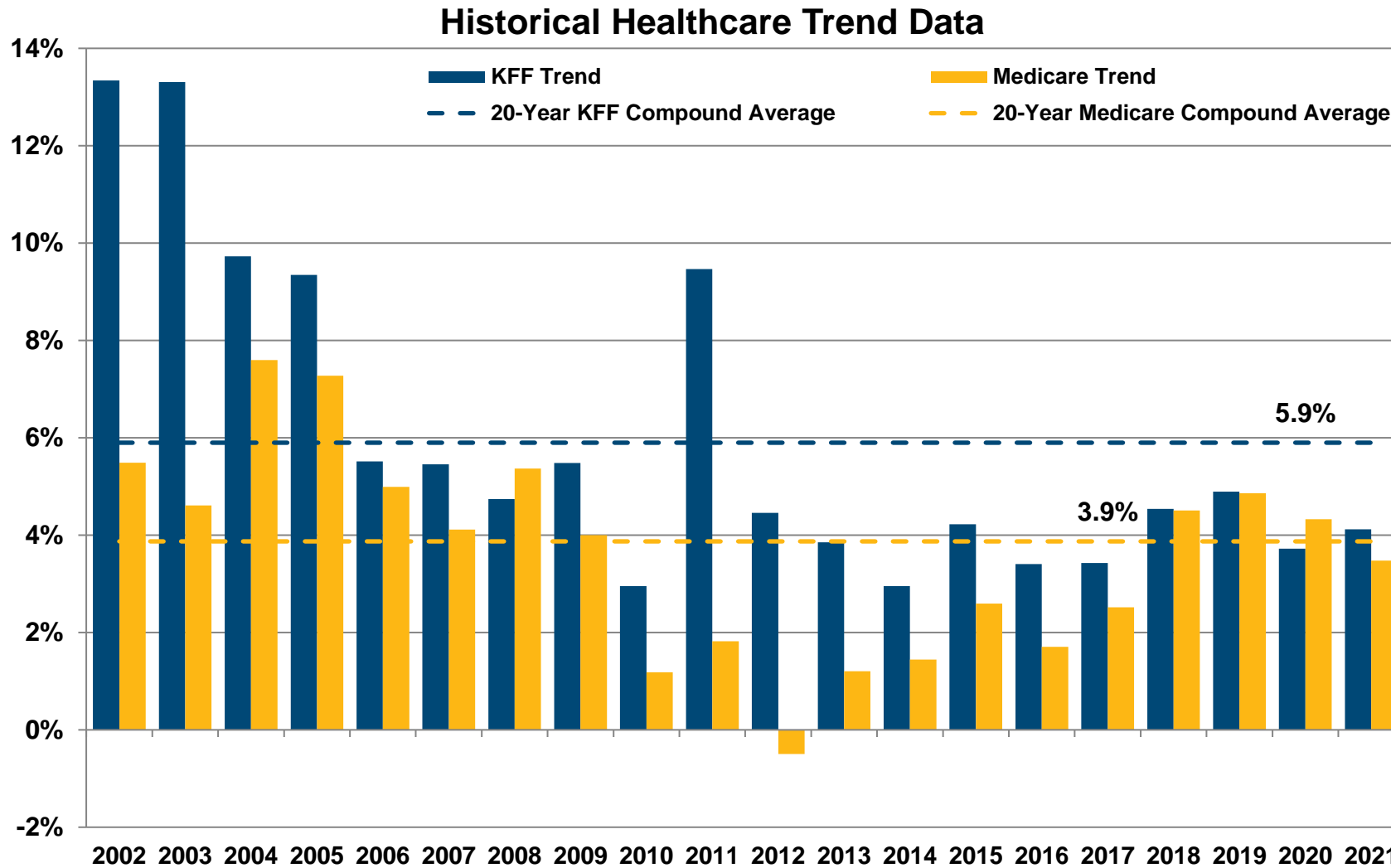


- Explicit subsidy – Pre-Funded
 - The plan pays the premium for health coverage selected by the retiree, up to 100% of the premium for the lowest cost plan offered to active employees
 - The explicit subsidy is the focus of our funding valuation
- Implicit subsidy – Pay-as-you-go
 - Difference between the expected claims cost and the total premium (retiree + plan)
 - Same premium is used for active employees and retirees not yet eligible for Medicare
 - Cost for a retiree generally exceeds the premium
 - City pays for the implicit subsidy on a pay-as-you-go basis through its premiums for active employees
 - Expected claim costs are developed using combined data for Federated and Police and Fire
 - Value is disclosed in the funding valuation and is a key part of required financial reporting

**Illustration of Pre-Medicare Subsidies
Anthem Select PPO Plan**



Appendix – Historical Healthcare Trend Rates



Appendix: Getzen Health Trend Model Parameters

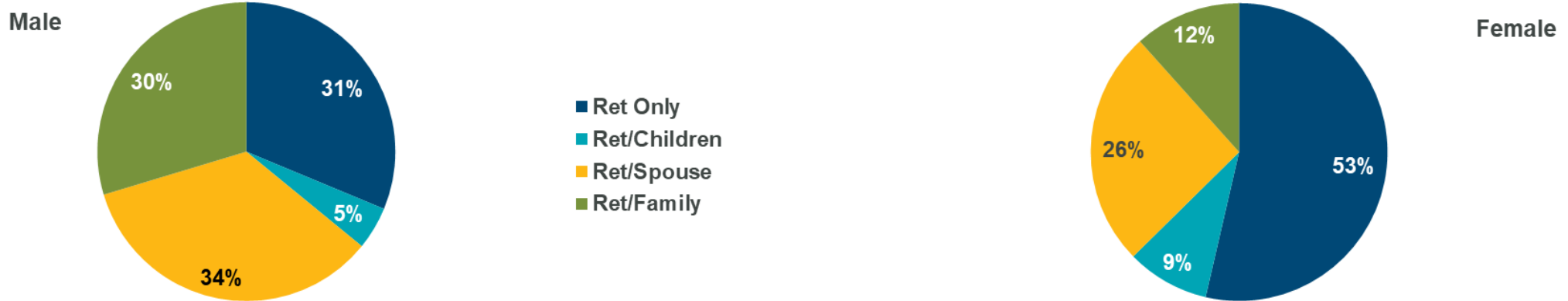


- Initial 2023 Trend Rate (Updated from prior valuation)
 - Non-Medicare Eligible = 10.00% in 2023, 9.44% in 2024
 - Medicare Eligible = 6.00% in 2023, 5.89% in 2023
- Linear decline to long run trend in 2032
- Long run trend = 4.97% (Same as Getzen baseline)
 - Inflation = 2.50%
 - Real GDP per capita = 1.4%
 - Excess medical cost growth = 1.0%
- Capacity constraints
 - Expected GDP Share in 2032 = 19.8%
 - Resistance point = 19.0%
 - Applies resistance to growth in health spending as a percentage of GDP starting in 2032
 - Year limited to GDP growth = 2075

Appendix – Future Retiree Tier Elections



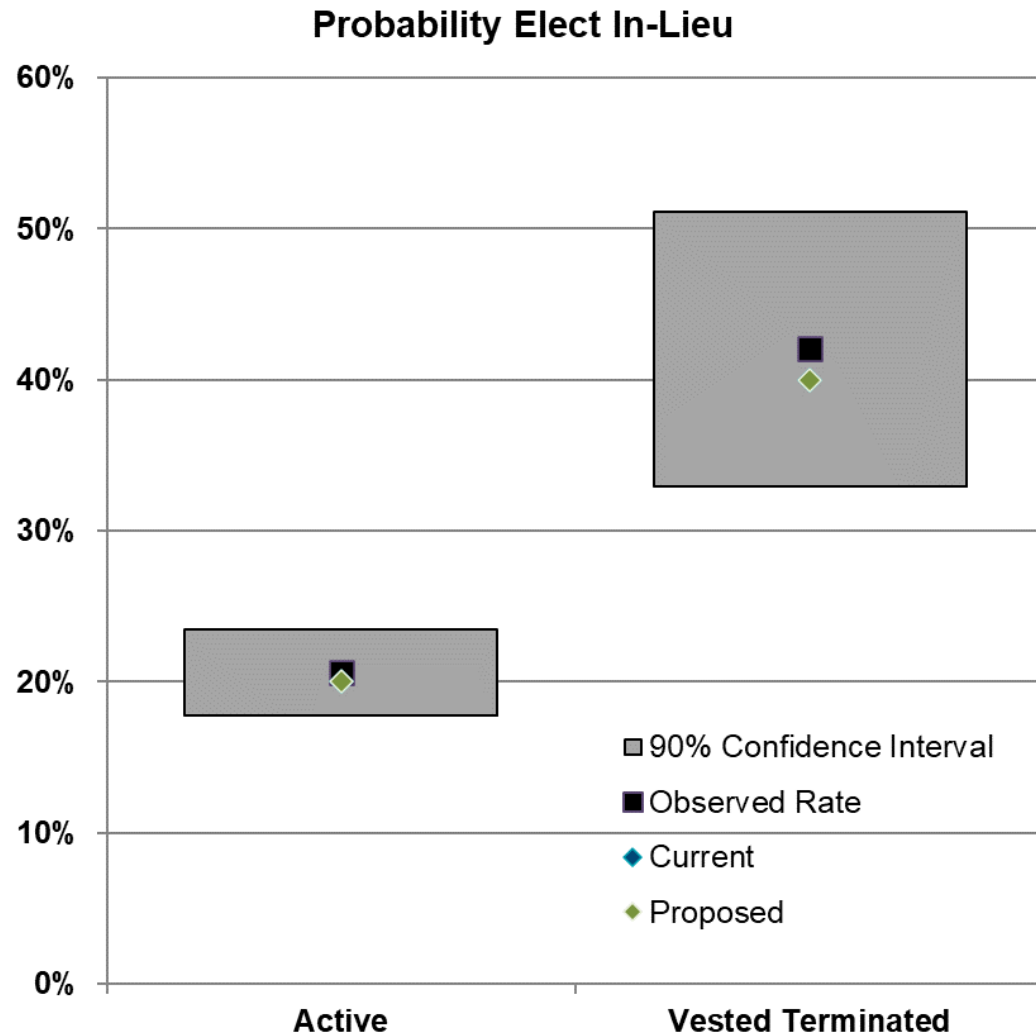
Actual 2023 Pre-Medicare Dependent Coverage Elections



Based on experience over the last 5 years, we recommend no adjustment

Assumed Future Retiree Tier Elections						
Coverage Tier	Male			Female		
	Pre-Medicare		Medicare	Pre-Medicare		Medicare
	Current	Proposed		Current	Proposed	
Retiree Only	31%	31%	35%	55%	55%	64%
Retiree and Children	4%	4%	0%	9%	9%	0%
Retiree and Spouse	37%	37%	65%	24%	24%	36%
Retiree and Family	28%	28%	0%	12%	12%	0%

Appendix – In Lieu Coverage Option



- Probability Elect In-Lieu Coverage
 - 20% of active members elect in-lieu coverage
 - 40% of vested terminated members elect in-lieu coverage
 - No change proposed
- Duration of In-Lieu Coverage
 - Assumption for how long members remain in-lieu before commencing health coverage and using in-lieu credits
 - Very little data on duration so far
 - Recommend continuing with current assumption of 5 years

Appendix – Meketa's CMAs



Capital Market Assumptions

Meketa's Assumptions					Horizon Survey Assumptions				
Asset Class	Allocation	Standard Deviation	Arithmetic Returns		Asset Class	Allocation	Standard Deviation	Arithmetic Returns	
			10-Year	20-Year				10-Year	20-Year
Short-term Investment Grade Bonds	6.0%	1.0%	3.81%	3.54%	US Corp Bonds - Core	20.0%	5.9%	4.88%	4.93%
Investment Grade Bonds	14.0%	4.0%	4.87%	4.76%					
Long-term Government Bonds	5.0%	12.0%	4.91%	5.62%	US Treasuries	5.0%	1.1%	3.39%	3.23%
US Equity	30.0%	18.0%	9.11%	10.10%	US Equity - Large Cap	30.0%	16.6%	8.19%	8.67%
Developed Market Equity (non-US)	16.0%	19.0%	11.53%	11.34%	Non-US Equity - Developed	16.0%	18.3%	9.05%	9.38%
Emerging Market Equity	12.0%	23.0%	12.36%	12.21%	Non-US Equity - Emerging	12.0%	23.9%	10.86%	11.39%
Core Private Real Estate	12.0%	12.0%	4.91%	7.09%	Real Estate	12.0%	16.7%	7.34%	7.48%
Commodities (naive)	5.0%	17.0%	7.49%	6.99%	Commodities	5.0%	18.0%	6.53%	6.55%
Inflation		3.0%	2.54%	2.63%	Inflation		1.9%	2.56%	2.47%



- Claims costs are developed by age for each health plan offered
- Aggregate claims costs reflect the average cost based on plan election assumptions as of 7/1/2023
- Claim costs will be developed using combined data for Federated and Police and Fire