

# San José Federated Postemployment Healthcare Plan

## Assumptions for June 30, 2024 OPEB Actuarial Valuation

November 21, 2024

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## Background

## OPEB Assumptions

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

## Board Decisions

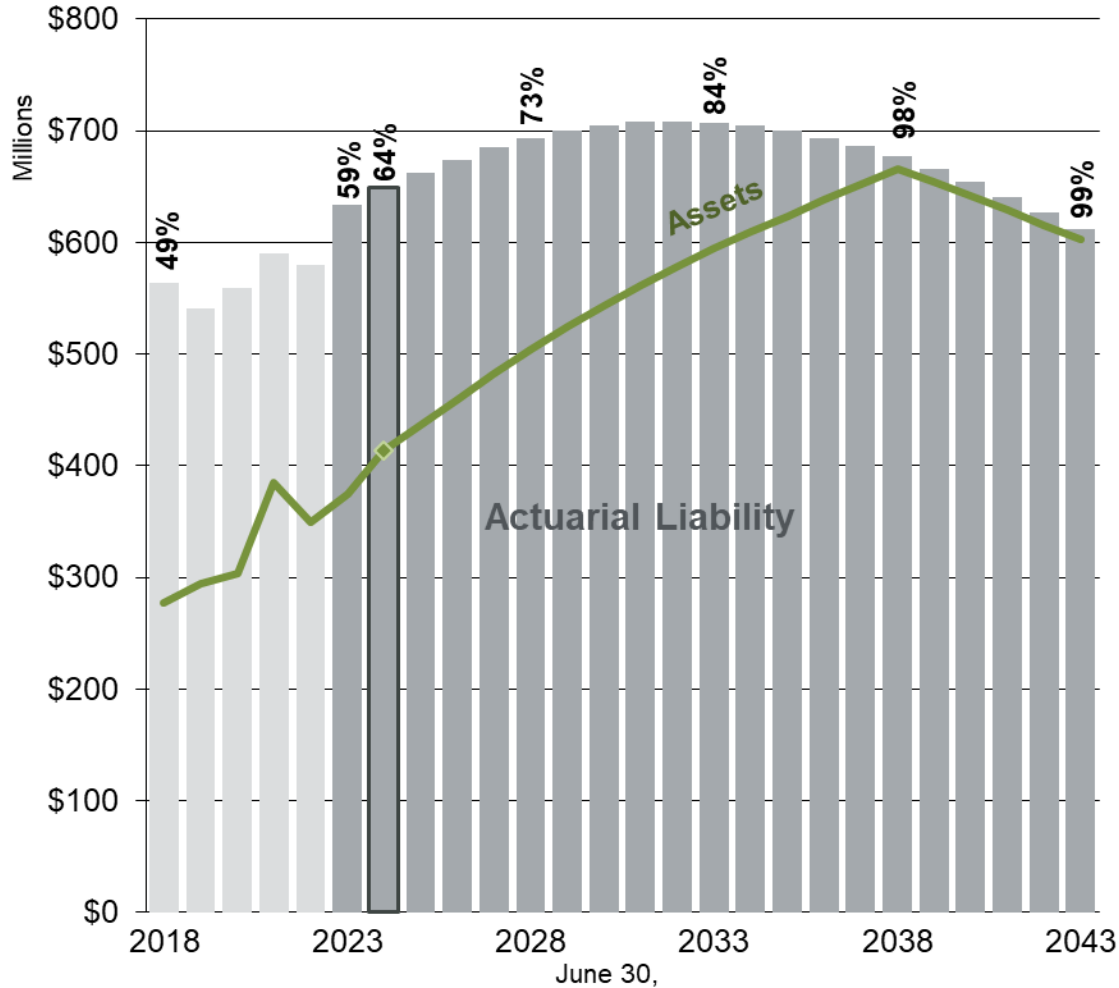


- OPEB plan is mostly closed
  - Only Tier 1 members who did not elect the VEBA can receive full benefits
  - Benefits for others who qualify for catastrophic disability
- Member contributions are fixed at 7.5% of pay
- City contributions are set by the Board
  - City can cap contributions at 14% of pay
- June 30, 2024 valuation
  - Develops City contribution for FYE 2026
  - Used as basis for GASB 74/75 reporting in September for FYE 2025

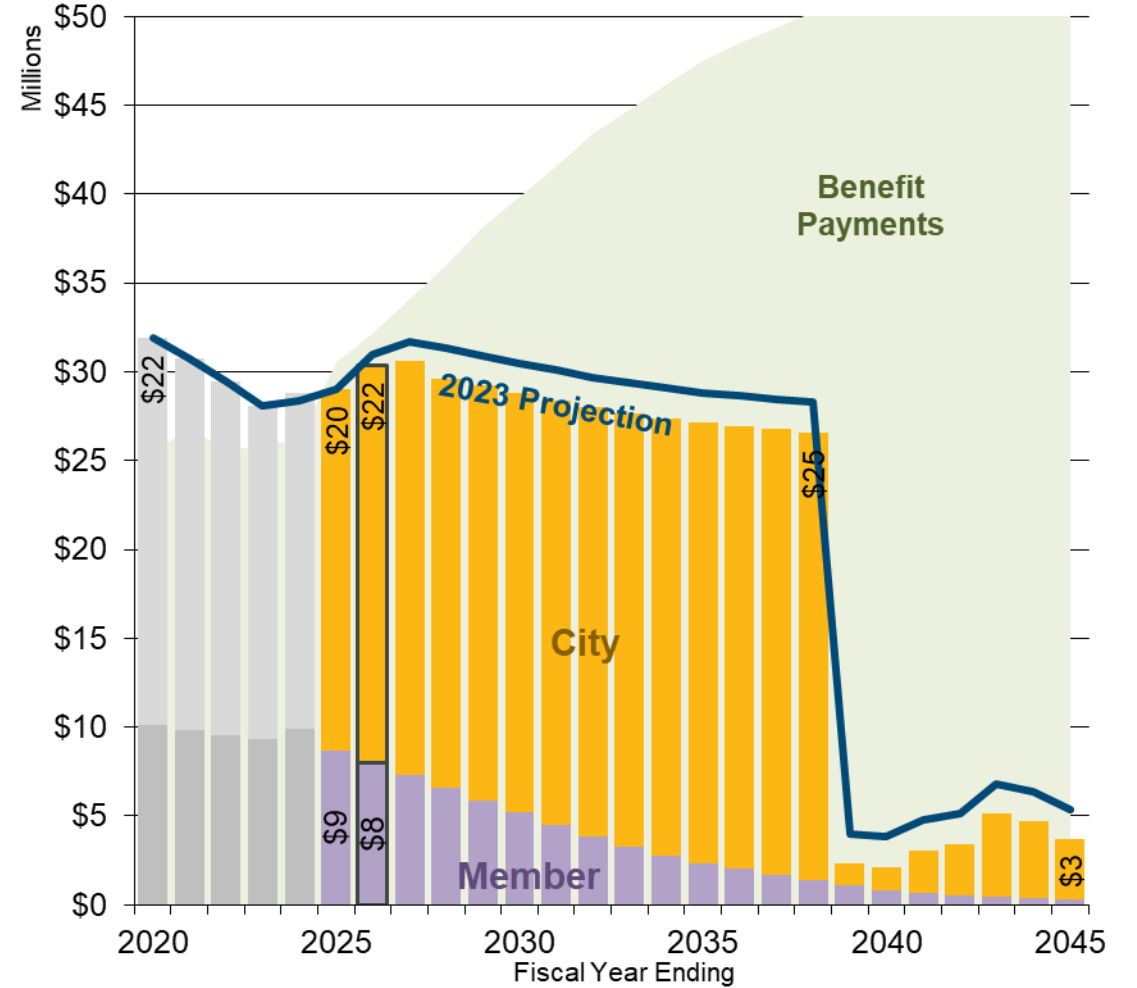
# Projections – Updated for Investment Returns



### 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"><li>Update Getzen model parameters (details in appendix)<ul style="list-style-type: none"><li>New short-term trends</li></ul></li></ul>
Health/Dental plan elections	<ul style="list-style-type: none"><li>No change</li></ul>
Future retiree tier elections	<ul style="list-style-type: none"><li>Increase retiree + spouse coverage elections for females</li></ul>
In-Lieu election and coverage duration	<ul style="list-style-type: none"><li>No change</li></ul>
In-Lieu credit tier	<ul style="list-style-type: none"><li>Increase retiree + spouse coverage for Medicare eligible</li></ul>
Administrative expenses	<ul style="list-style-type: none"><li>No change</li></ul>
Discount rate	<ul style="list-style-type: none"><li>No change</li></ul>

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

# Changes in Explicit Subsidy



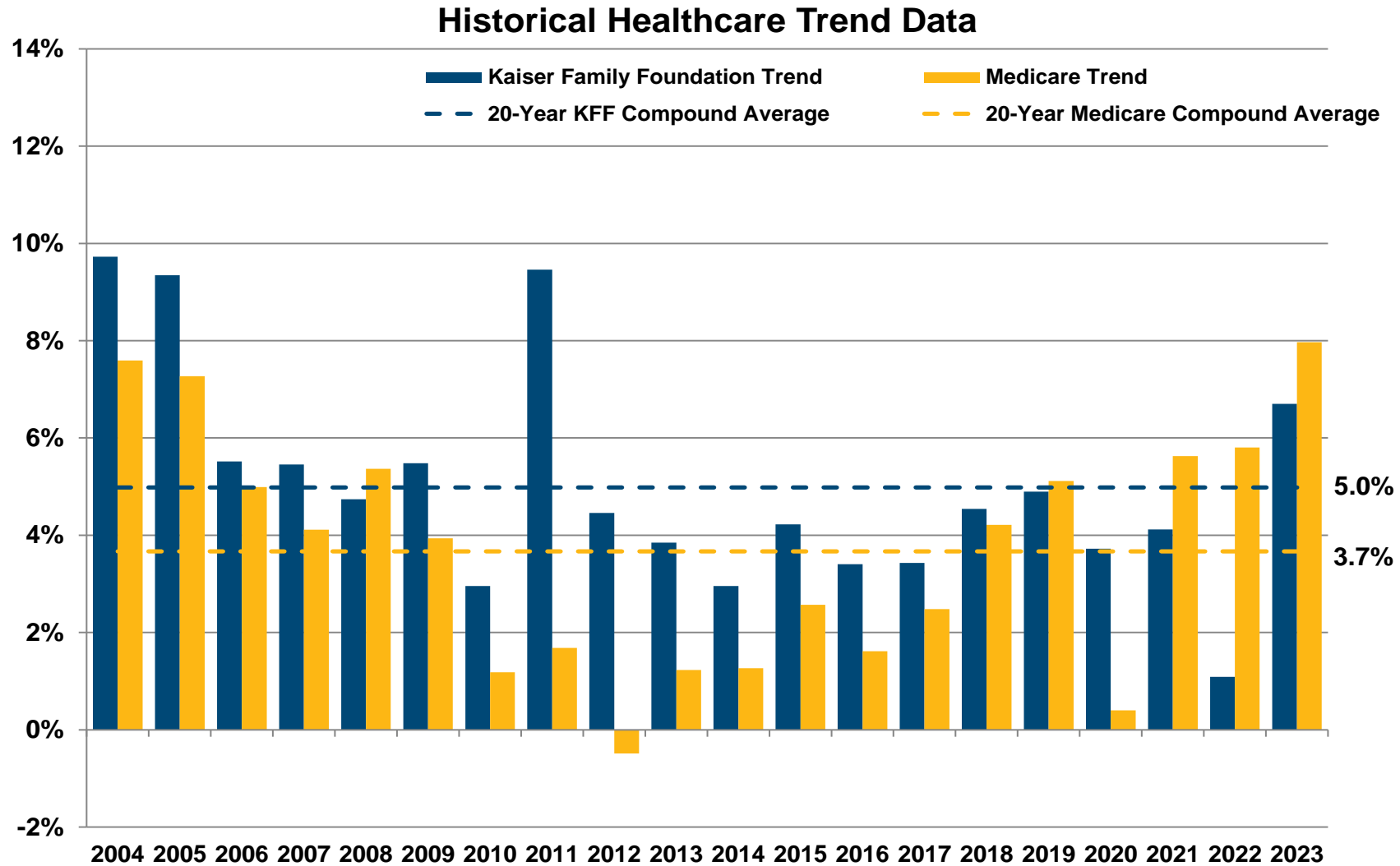
## Maximum Annual Explicit Subsidy Premium for Lowest Cost Health Plan Offered to Active Employees

Year	Member Only	Member + Spouse	Member + Child(ren)	Member + Family	Approximate Increase
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%
2025	\$7,653	\$15,306	\$13,393	\$22,959	6.9%

- Maximum explicit subsidy
  - Expected increase = 8.6%
  - Actual increase = 6.9%
  - All pre-Medicare plans receive maximum subsidy
- All Medicare-eligible plans have premiums below the maximum subsidy
  - Expected increase = 5.7%
  - Actual increase =
    - +8.9% for Kaiser (~43% of population)
    - +9.0% for Anthem PPO (~57% of population)



# Historical Healthcare Trend Rates



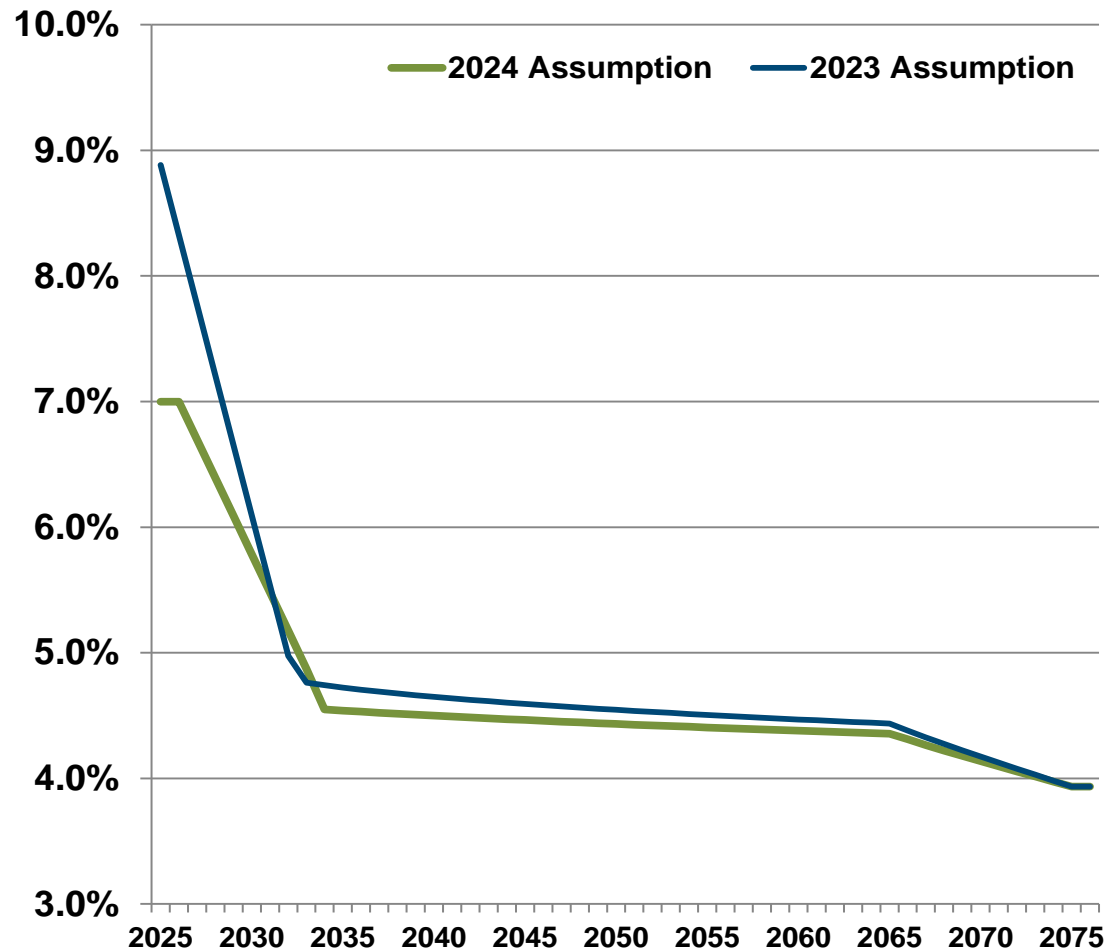


- Developed medical trend assumptions using 2024 Getzen model published by the Society of Actuaries
  - Initial 2025 trends reflect short-term expectations
    - Non-Medicare Eligible = 7.00%
    - Medicare Eligible = 7.50%
  - Adjusts linearly to the long-run trend of 4.87% in 2033
    - Nominal per capita GDP growth plus 0.9% 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

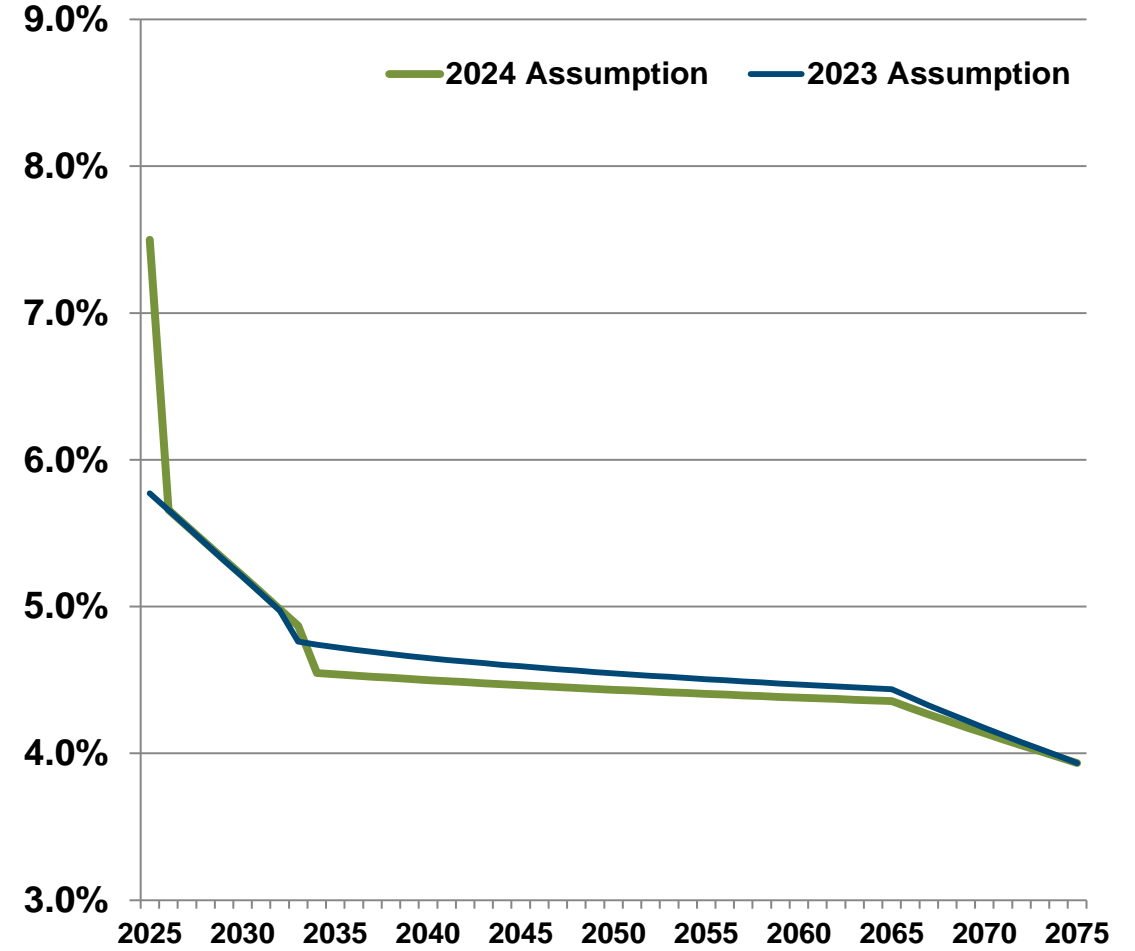
# Comparison of Health Trend Rates



### Non-Medicare Eligible Trend



### Medicare Eligible Trend



# Healthcare Trend Rates



- Premium rates change on a calendar year basis
- Converted to a fiscal year basis for valuation
- For the fiscal year beginning July 1, 2025, trend is developed using actual calendar year 2025 premiums and a trend assumption for calendar year 2026

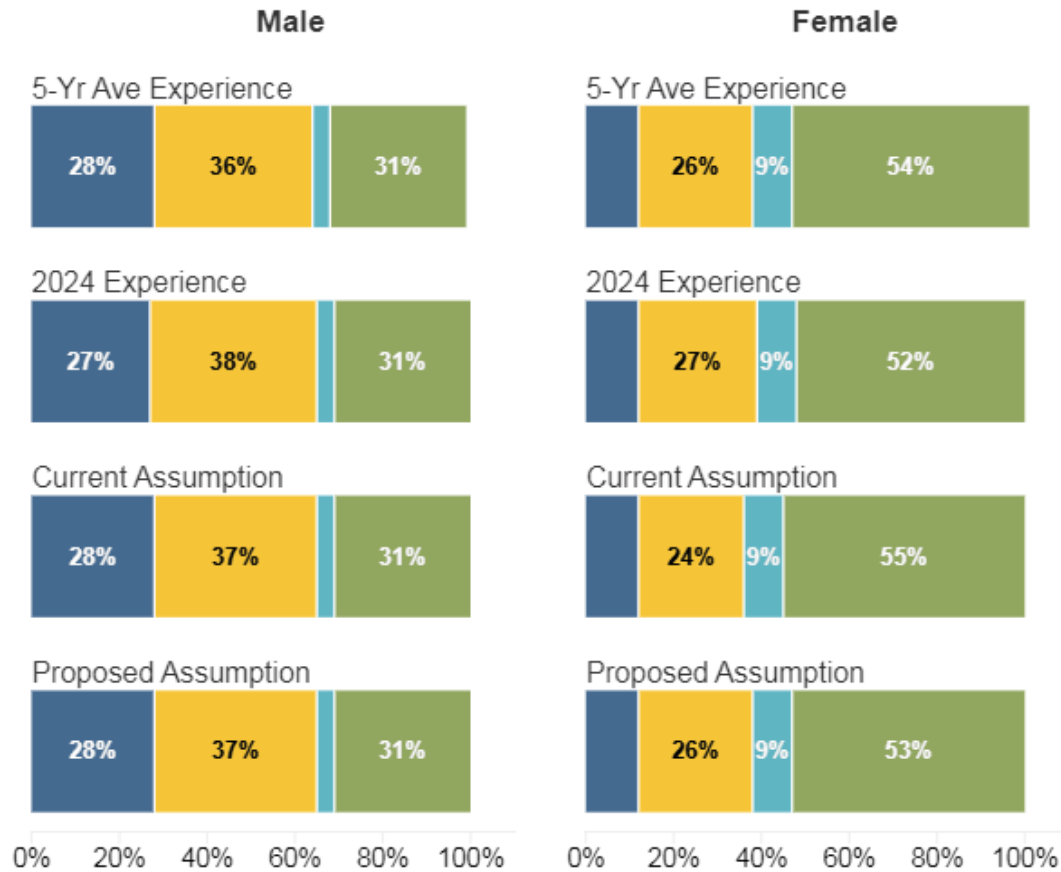
Plan	FY Beginning 2025 Trend
<b>Pre-Medicare</b>	
Kaiser Nationwide	6.93%
Anthem Plans	6.02%
<b>Medicare</b>	
Kaiser Nationwide	7.19%
Anthem PPO Plan	7.24%
<b>Dental</b>	
HMO Plan	1.76%
PPO Plan	1.75%

# Future Retiree Tier Elections



## Future Retiree Tier Elections Experience vs. Assumptions

■ Retiree + Family 
 ■ Retiree + Spouse 
 ■ Retiree + Children 
 ■ Retiree Only



## Assumed Future Retiree Tier Elections

Coverage Tier	Pre-Medicare		Medicare
	Current	Proposed	
<b>Males</b>			
Retiree Only	31%	31%	35%
Retiree and Children	4%	4%	0%
Retiree and Spouse	37%	37%	65%
Retiree and Family	28%	28%	0%
<b>Females</b>			
Retiree Only	55%	53%	62%
Retiree and Children	9%	9%	0%
Retiree and Spouse	24%	26%	38%
Retiree and Family	12%	12%	0%

# In Lieu Coverage Duration and 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
- Duration of In-Lieu Coverage
  - Very little data on duration so far
  - Recommend continuing with current assumption of 5 years

- In-Lieu Coverage Credit Tier
  - Six years of data
  - Experience has trended toward more expensive tiers for Medicare eligible
  - Adjustments proposed to reflect these trends

Assumed In-Lieu Coverage Tier				
	Experience		Assumption	
	2024	5-Yr Ave	2023	2024
<b>Pre-Medicare</b>				
Retiree Only	30%	32%	30%	<b>30%</b>
Retiree + Spouse	34%	28%	30%	<b>30%</b>
Retiree + Family	36%	40%	40%	<b>40%</b>
<b>Medicare Eligible</b>				
Retiree Only	41%	49%	50%	<b>45%</b>
Retiree + Spouse	59%	51%	50%	<b>55%</b>

# Expected Return on Assets

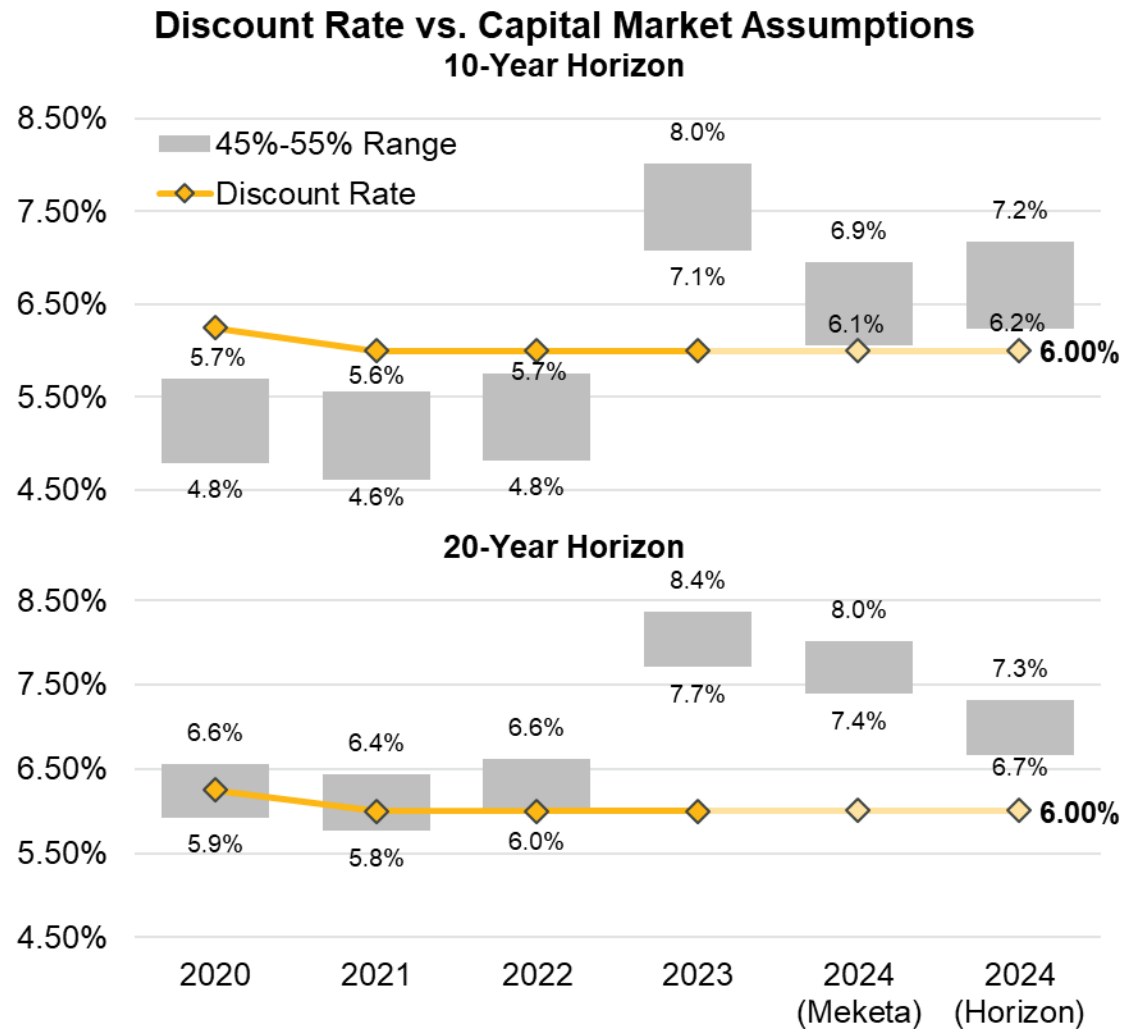


- Meketa provided forward-looking capital market assumptions for 2024
  - 10- and 20-year time horizons
- Horizon survey includes:
  - 10-year time horizon – 42 consultants
  - 20-year time horizon – 27 consultants
- Expectations remain higher than discount rate
  - Interest rates have been higher for last two years
  - Fed started reducing interest rates in September

Expected Distribution of Average Annual Passive Returns				
Percentile	10-Year Timeframe Horizon		20-Year Timeframe Horizon	
	Survey	Meketa	Survey	Meketa
95th	13.0%	12.5%	11.4%	11.9%
75th	9.2%	8.9%	8.8%	9.4%
60th	7.7%	7.4%	7.7%	8.3%
55th	7.2%	6.9%	7.3%	8.0%
<b>50th</b>	<b>6.7%</b>	<b>6.5%</b>	<b>7.0%</b>	<b>7.7%</b>
45th	6.2%	6.1%	6.7%	7.4%
40th	6.1%	5.6%	6.3%	7.1%
25th	4.2%	4.1%	6.1%	6.2%
5th	0.8%	0.8%	2.7%	3.7%

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

# Expected Return on Assets



- Capital market assumptions fluctuate
  - Interest rates
  - Valuations (P/E ratios)
- Time horizon considerations
  - 10 years ~ 40% of the present value of benefits
  - 20 years ~ 70% of the present value of benefits
- Current discount rate of 6.00%
  - Conservative compared to 2023 and 2024 capital market assumptions
  - Chance of return exceeding the discount rate
    - 10 years ~ 55% (Meketa), 57% (Horizon)
    - 20 years ~ 75% (Meketa), 65% (Horizon)



# Discount Rate Considerations



- Is the increase in capital market assumptions temporary?
  - The primary driver of increased capital market assumptions is the rise in interest rates due to actions of the Federal Reserve
  - The Federal Reserve just reduced rates by 50 basis points in September and 25 basis points in November
- Painful to reduce the discount rate
  - Be cautious about increasing the discount rate
  - Don't want to increase the discount rate and then have to reverse course and reduce the discount rate again
  - Change would only affect City contributions
- It is okay for the discount rate to be less than the 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



OPEB Assumption	Recommendation
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Discount rate	<ul style="list-style-type: none"><li>No change</li></ul>



- The purpose of this presentation is to present recommended assumptions for the June 30, 2024 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, MAAA, FCA  
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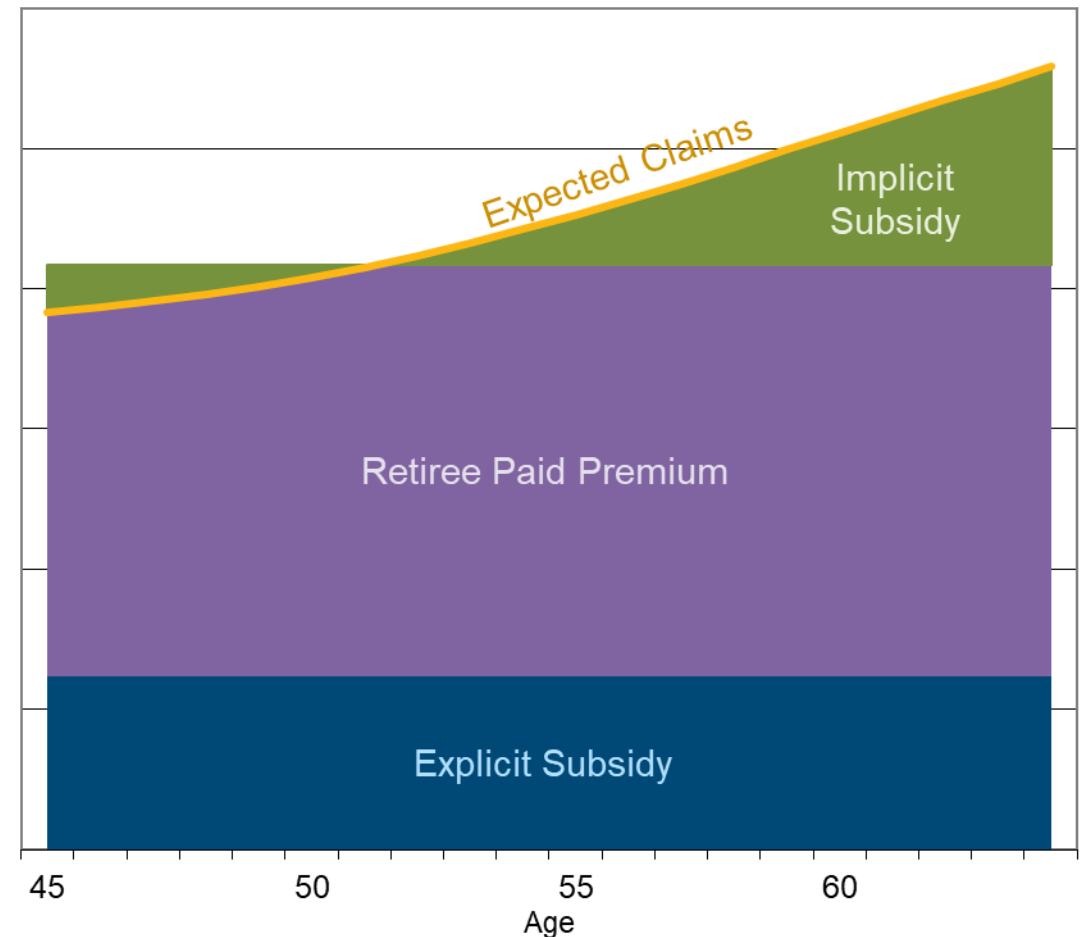
John L. Colberg, FSA, EA, MAAA  
Principal Consulting Actuary

# 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: Getzen Health Trend Model Parameters



- Initial 2024 Trend Rate (Updated from prior valuation)
  - Non-Medicare Eligible = 6.40% in 2024, 7.00% in 2025
  - Medicare Eligible = 8.91% in 2024, 7.50% in 2025
- Linear decline to long run trend in 2033
- Long run trend = 4.87%
  - Inflation = 2.50%
  - Real GDP per capita = 1.4%
  - Excess medical cost growth = 0.9%
- Capacity constraints
  - Expected GDP Share in 2033 = 19.8%
  - Resistance point = 17.7%
    - Applies resistance to growth in health spending as a percentage of GDP starting in 2033
  - Year limited to GDP growth = 2075

# Appendix: Health/Dental Plan Elections



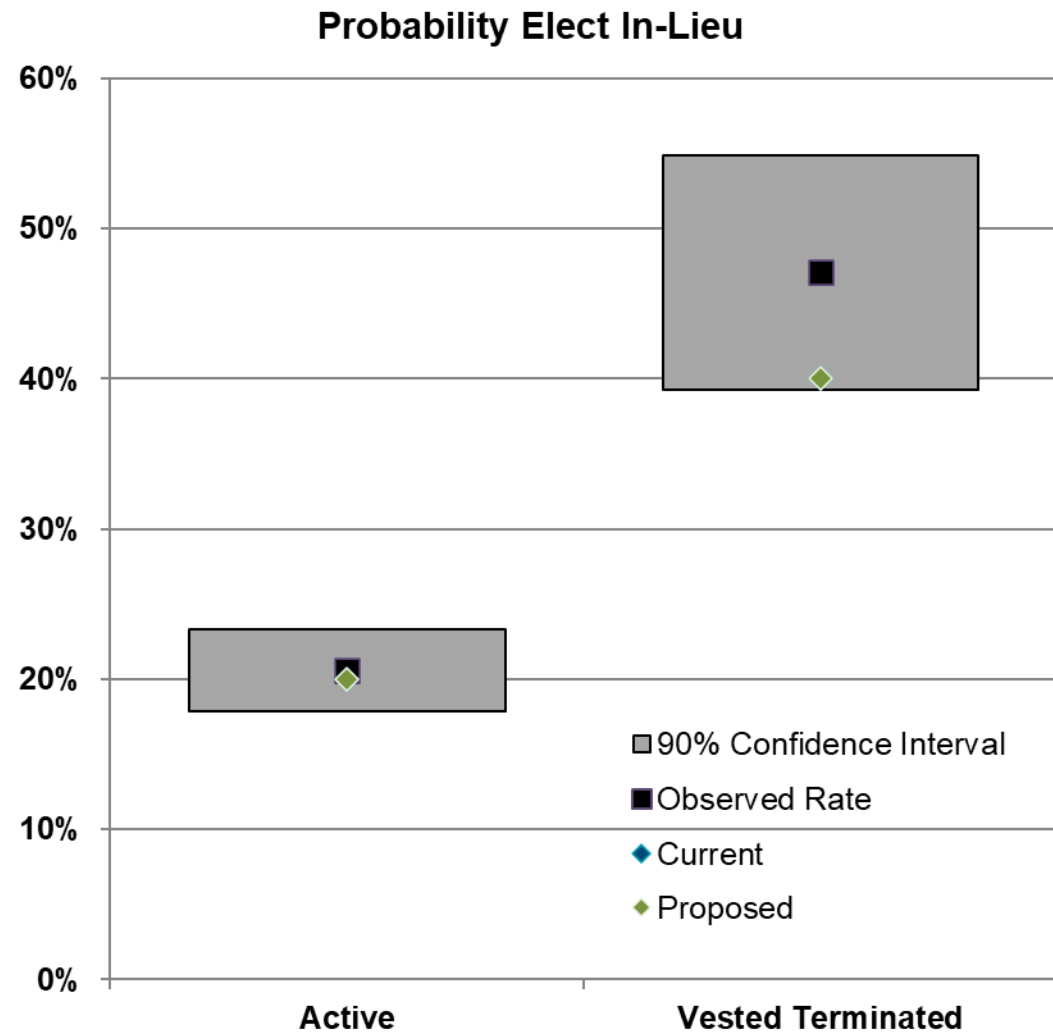
## Assumed Plan Elections for Future Retirees\*

	Enrollment Experience		Enrollment Assumption	
	2024	5-Yr Ave	2023	2024
<b>Pre-Medicare Medical Plans</b>				
Kaiser DHMO	7%	9%	8%	<b>8%</b>
Kaiser \$25 Co-pay	67%	66%	67%	<b>67%</b>
Kaiser HDHP	9%	8%	8%	<b>8%</b>
Anthem DHMO	1%	1%	1%	<b>1%</b>
Anthem Select \$20 Co-pay	5%	6%	5%	<b>5%</b>
Anthem Traditional \$20 Co-pay	4%	3%	2%	<b>2%</b>
Anthem HDHP PPO	4%	4%	5%	<b>5%</b>
Anthem Select PPO	2%	3%	3%	<b>3%</b>
Anthem Classic PPO	1%	1%	1%	<b>1%</b>
<b>Medicare-Eligible Medical Plans</b>				
Kaiser Senior Advantage	62%	60%	61%	<b>61%</b>
Anthem Medicare PPO	38%	37%	39%	<b>39%</b>
<b>Dental Plans (All Retirees)</b>				
Delta Dental PPO	98%	98%	98%	<b>98%</b>
DeltaCare HMO	2%	2%	2%	<b>2%</b>

\* Eligible for coverage and elect coverage

- Enrollment experience only differs slightly from assumptions
  - Will continue to monitor
  - No changes proposed this year

# Appendix: In-Lieu Coverage Option



- Probability Elect In-Lieu Coverage
  - Current Assumption
    - 20% of active members elect in-lieu coverage
    - 40% of vested terminated members elect in-lieu coverage
  - No changes 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: Administrative Expenses



- Current assumption would be \$109.27 per member for FYE 2026
  - 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 the last 5 years is \$102.64. Increasing the average for expected wage inflation produces an estimate of \$108.89 per member for FYE 2026
  - Very close to the current assumption
- No change proposed

FYE	Adjusted Administrative Expenses	Members	Adjusted Expense / Member
2024	\$ 831,537	7,999	\$ 103.96
2023	772,989	7,788	99.25
2022	811,218	7,542	107.56
2021	761,580	7,541	100.99
2020	772,111	7,613	101.42
2024 5-Year Average Adjusted Expense / Member			\$ 102.64
<b>FYE 2026 Expense per Member</b>			<b>\$ 108.89</b>

# Appendix: Capital Market Assumptions



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%	3.71%	US Corp Bonds - Core	20.0%	5.9%	5.10%	5.04%
Investment Grade Bonds	14.0%	4.0%	4.67%	4.87%					
Long-term Government Bonds	5.0%	12.0%	4.91%	5.64%	US Treasuries	5.0%	1.1%	3.69%	3.44%
US Equity	30.0%	17.0%	8.08%	9.73%	US Equity - Large Cap	30.0%	16.5%	7.74%	8.25%
Developed Market Equity (non-US)	16.0%	18.0%	9.01%	10.27%	Non-US Equity - Developed	16.0%	18.1%	8.61%	9.08%
Emerging Market Equity	12.0%	22.0%	9.53%	10.91%	Non-US Equity - Emerging	12.0%	23.6%	10.31%	11.00%
Core Private Real Estate	12.0%	12.0%	5.41%	7.53%	Real Estate	12.0%	16.6%	7.43%	7.38%
Commodities (naive)	5.0%	17.0%	6.10%	6.56%	Commodities	5.0%	17.8%	6.45%	6.56%
Inflation			2.40%	2.80%	Inflation			2.43%	2.44%

# Appendix: Aggregate Claims Costs



- 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 7/1/2024
- Claim costs will be developed using combined data for Federated and Police and Fire