

Assumptions for June 30, 2020 OPEB Actuarial Valuation

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Agenda



- Background
- Assumptions
 - Discount rate
 - Health care trend rates
 - Dependent coverage elections
 - Health/Dental plan elections
 - In-Lieu elections
 - Trust administrative expenses
 - Claims costs
- Board Decisions



- OPEB plan is mostly closed
 - Only Tier 1 members who did not elect VEBA can receive full benefits
 - Benefits for others who qualify for catastrophic disability
- Member contributions are fixed at 8.0% of pay
- City contributions are set by the Board
 - City can cap contributions at 11% of pay
- June 30, 2020 valuation
 - Develops City contribution for FYE 2022
 - Used as basis for GASB 74/75 valuation in September for FYE 2021

Two Types of Subsidies

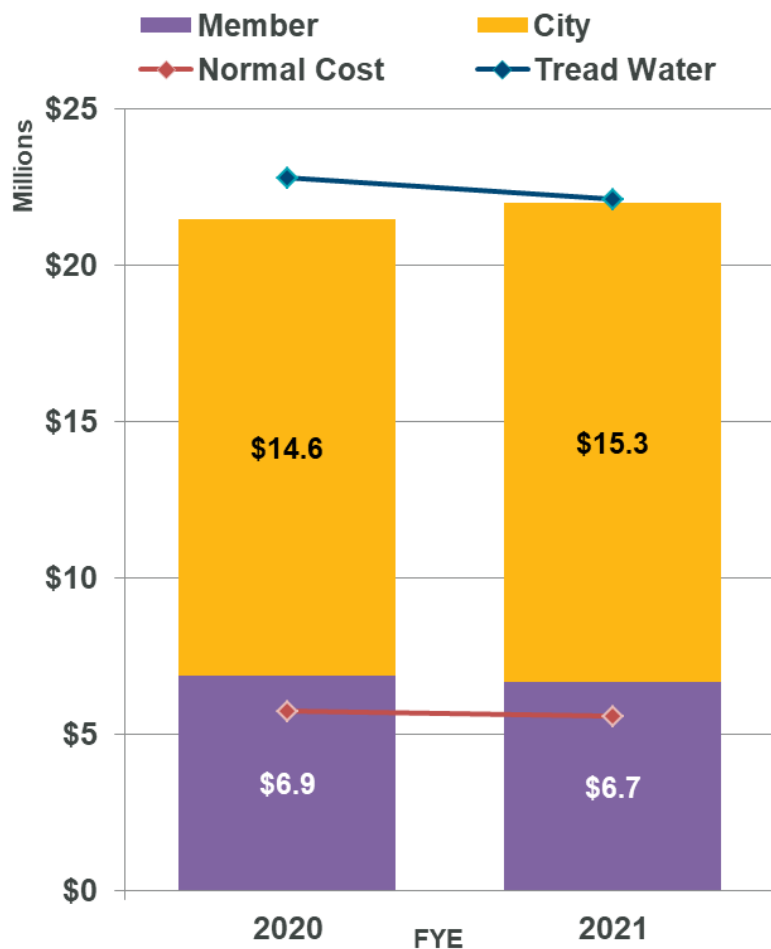


- Explicit subsidy – Pre-Funded
 - The plan pays the premium for health coverage selected by the retiree, up to 100% of the premium for the lowest cost plan offered to active employees
 - The explicit subsidy is the focus of our funding valuation
- Implicit subsidy – Pay-as-you-go
 - Difference between 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 retiree generally exceeds the premium
 - City pays for the implicit subsidy on a pay-as-you-go basis through its premiums for active employees
 - Value is disclosed in funding valuation and is a key part of required financial reporting

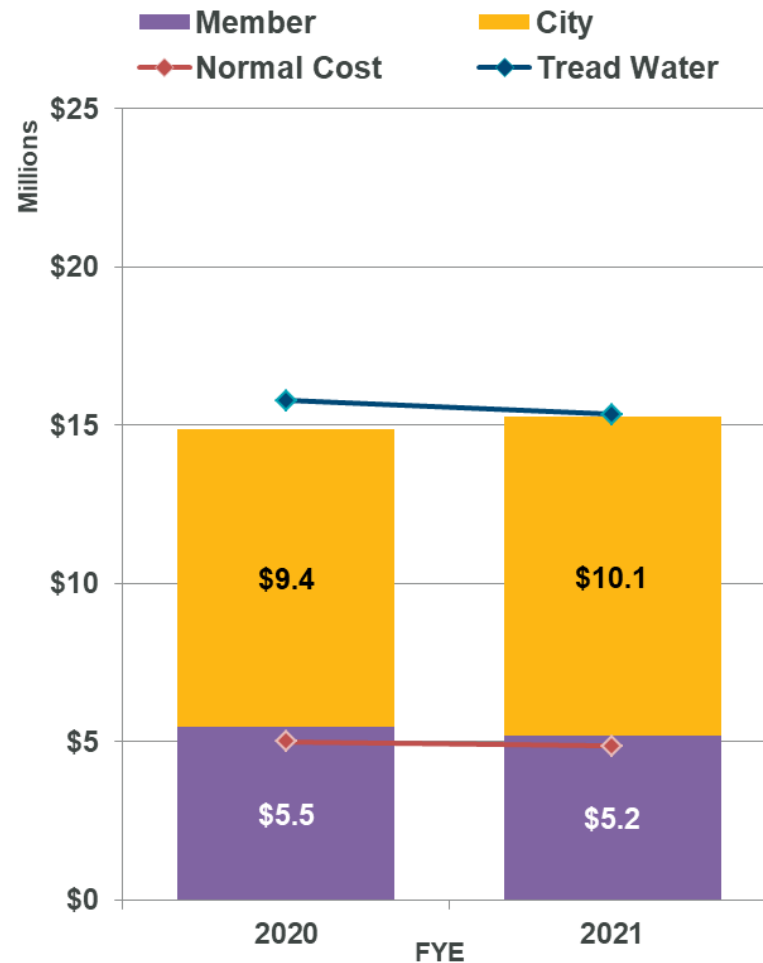
2019 Valuation Results



Contributions - Police



Contributions - Fire

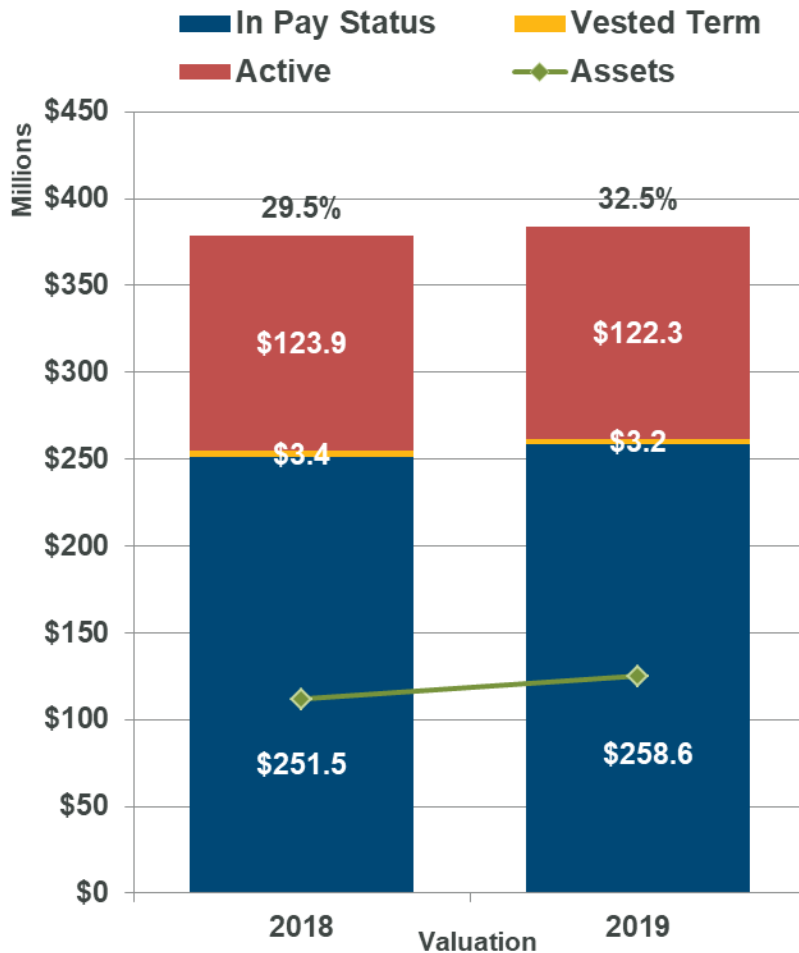


City's optional cap for FYE 2021 is approximately \$27 million

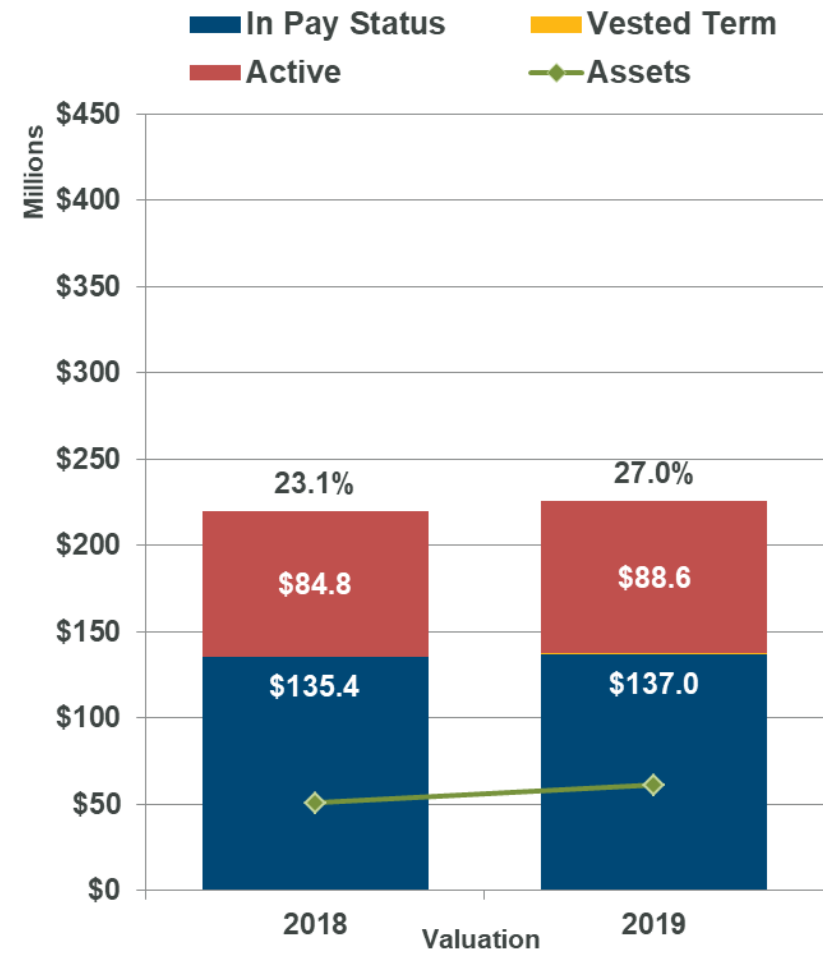
2019 Valuation Results



Funded Status - Police



Funded Status - Fire



Contribution Policy – Set by Board

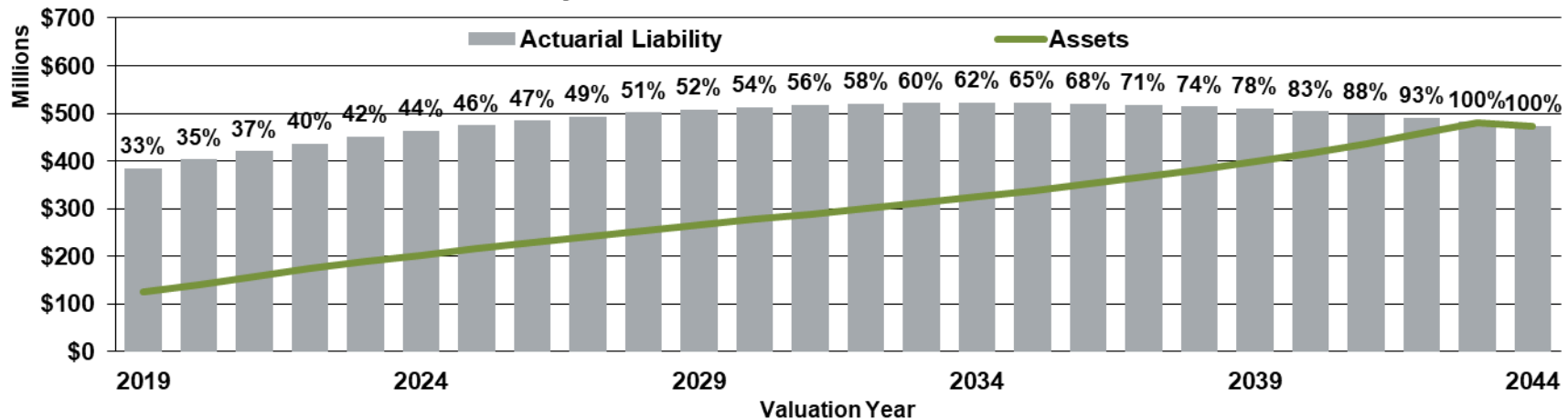


- City contributions =
 - Normal cost +
 - Administrative expenses +
 - UAL amortization –
 - Member contributions
- UAL Amortization
 - 25 years with a 3-year phase-in and out
 - Payments increase with wage inflation each year
 - 3.25% in 2019 valuation for FYE 2021
 - 3.00% in 2020 valuation for FYE 2022
- No asset smoothing

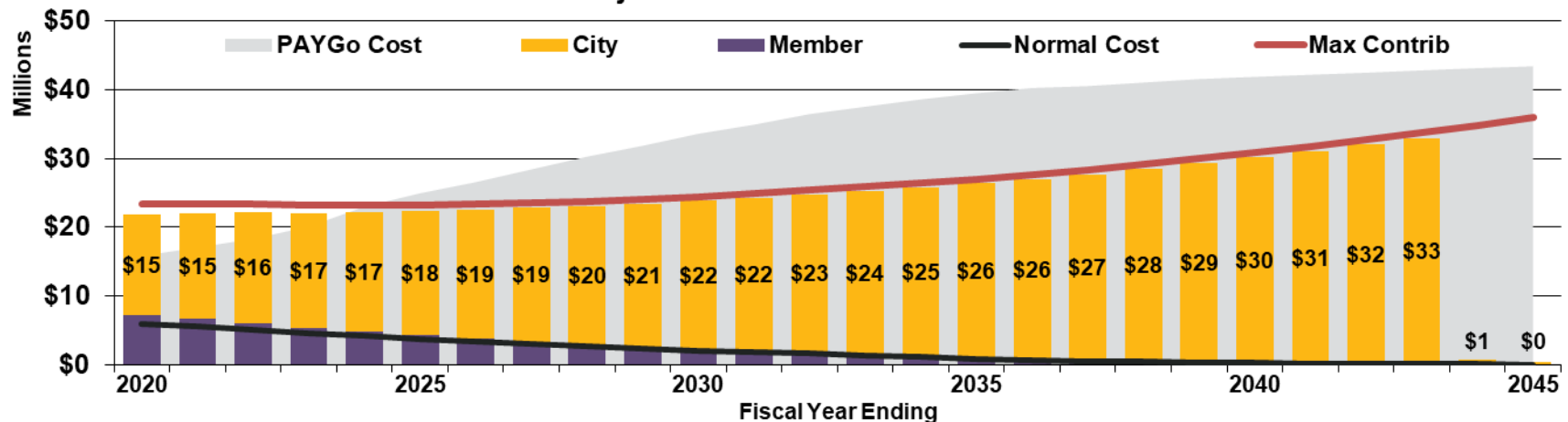
2019 Valuation Projections – Police



Projected Assets and Liabilities - Police



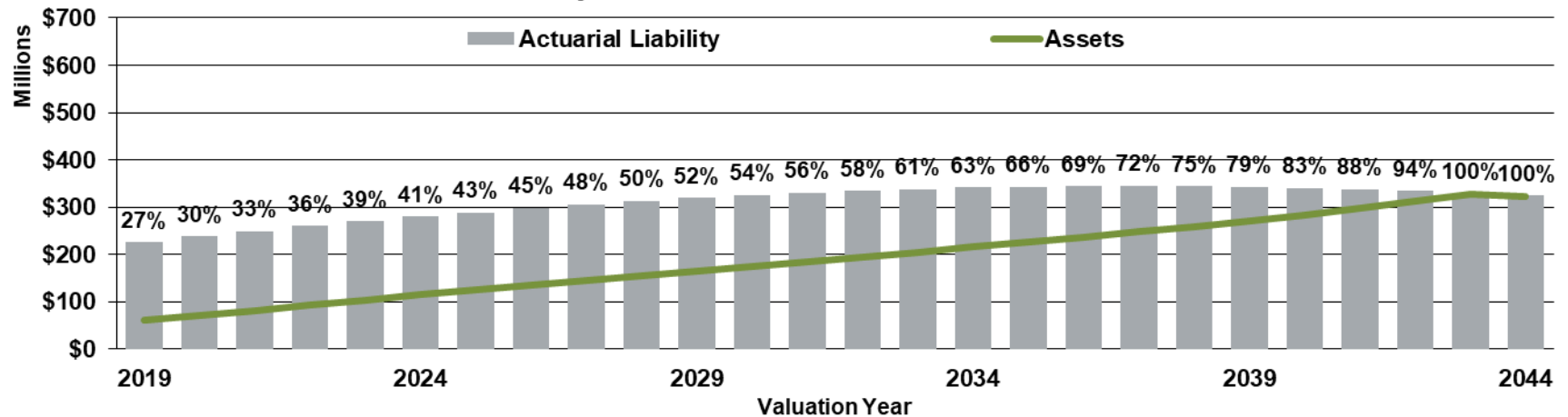
Projected Contributions - Police



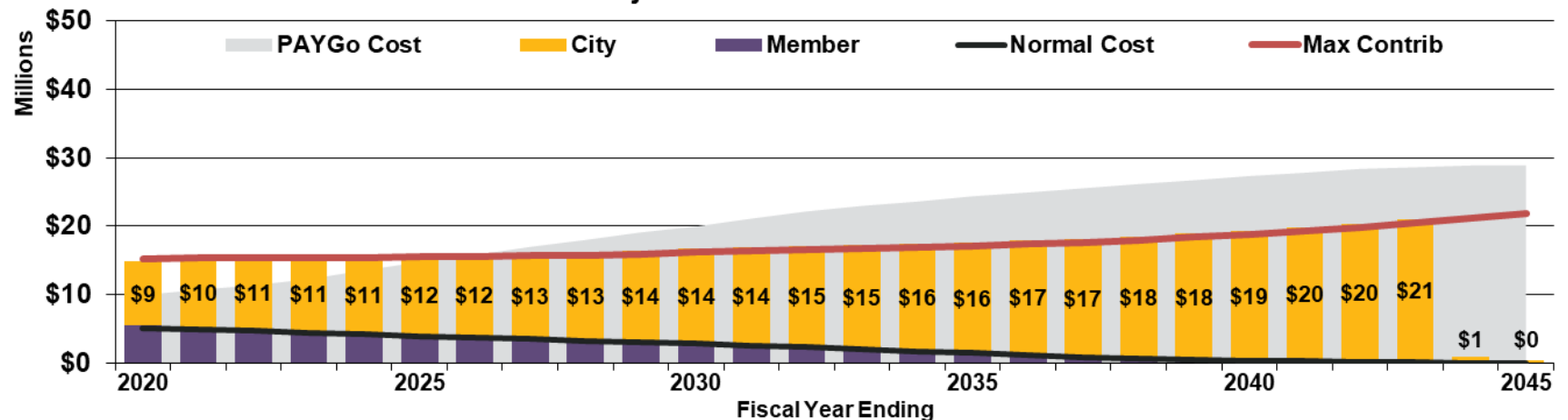
2019 Valuation Projections – Fire



Projected Assets and Liabilities - Fire



Projected Contributions - Fire





Assumptions

Assumptions for 2020 Valuation



- Where applicable, the same assumptions are used as in the pension valuation
- OPEB assumptions:
 - Discount rate
 - Health care trend rates
 - Dependent coverage elections
 - Health/Dental plan elections
 - In-Lieu elections
 - Administrative expenses
 - Claims costs (Implicit subsidy only)

Expected Return on Assets



- 115 Trust assets account for more than 85% of the assets
 - 115 Assets = \$179.1 million
 - 401(h) Assets = \$29.4 million
- Meketa provided forward-looking post-pandemic capital market assumptions
 - 10-Year Horizon
 - 20-Year Horizon
- Also compared to average pre-pandemic capital market assumptions from the investment consultants in the Horizon survey
- Appendix shows Meketa's assumptions by asset class and the assumed asset allocation

Expected Distribution of Average Annual Passive Returns			
Percentile	Meketa		Horizon Survey
	10 Years	20 Years	20 Years
95th	11.4%	10.5%	10.5%
75th	7.7%	8.0%	8.1%
60th	6.2%	6.9%	7.0%
55th	5.7%	6.6%	6.7%
50th	5.2%	6.2%	6.4%
45th	4.8%	5.9%	6.1%
40th	4.3%	5.6%	5.8%
25th	2.8%	4.5%	4.7%
5th	-0.5%	2.1%	2.4%

We did not exactly match Meketa's calculations. Meketa's median calculations are about 15-20 basis points higher

Expected Return on Assets



- Discount rate reduced from 6.875% to 6.50% in 2018
- Typically stay 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 assumption of 6.50% is no longer reasonable
- Consider reasonable alternatives
 - 6.25%
 - 6.00%
 - 5.75%

Changes in Explicit Subsidy



Maximum Annual Explicit Subsidy

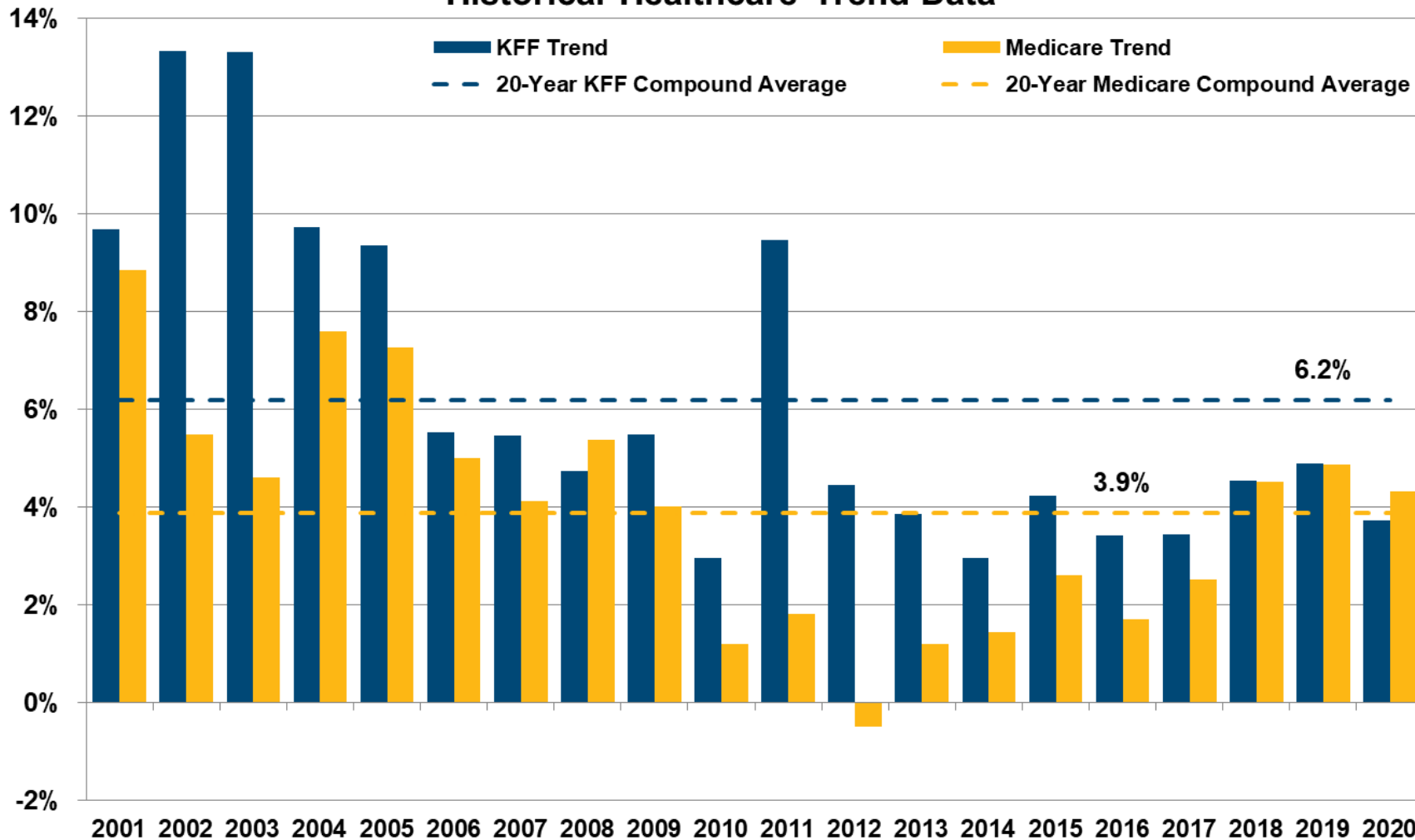
Year	Member Only	Member + Spouse	Member + Child(ren)	Member + Family	Approximate Increase
2016	\$5,603	\$11,206	\$9,805	\$16,809	
2017	\$5,882	\$11,765	\$10,294	\$17,647	5.0%
2018	\$4,916	\$9,833	\$8,604	\$14,749	-16.4%
2019	\$5,340	\$10,681	\$9,346	\$16,021	8.6%
2020	\$5,807	\$11,615	\$10,163	\$17,422	8.7%
2021	\$6,172	\$12,344	\$10,801	\$18,516	6.3%

- The maximum explicit subsidy is the premium for the lowest cost health plan offered to active employees
 - The lowest cost plan in 2021 remains the Kaiser \$3,000 deductible plan
- The maximum explicit subsidy paid by the City will increase from 2020 to 2021 by 6.3% for all coverage levels compared to the assumed increase of 8.0%
 - All pre-Medicare plans receive this level of subsidy
 - All Medicare eligible plans have premiums below the maximum subsidy
 - Medicare eligible plan premiums decreased by 5% to 9%

Healthcare Trend Rates



Historical Healthcare Trend Data



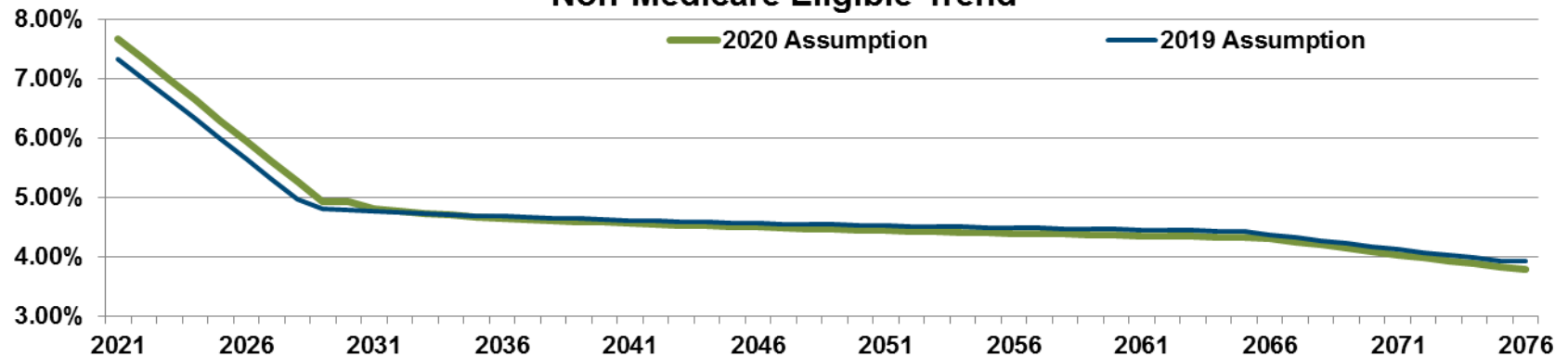


- Developed medical trend assumptions using 2020 Getzen model published by the Society of Actuaries
 - Initial trends for 2021 reflect short-term expectations
 - Non-Medicare Eligible = 7.66% (increased from 7.33%)
 - Medicare Eligible = 4.10% (reduced from 4.22%)
 - Adjusts linearly to long run trend of 4.93% in 2029
 - Price inflation = 2.25% (reduced from 2.50%)
 - Real per capita GDP = 1.50% (increased from 1.4%)
 - Excess medical cost growth = 1.10% (increased from 1.0%)
 - Grades down to nominal per capita GDP growth of 3.78% in 2076
- The trend for dental remains 3.5% for all years

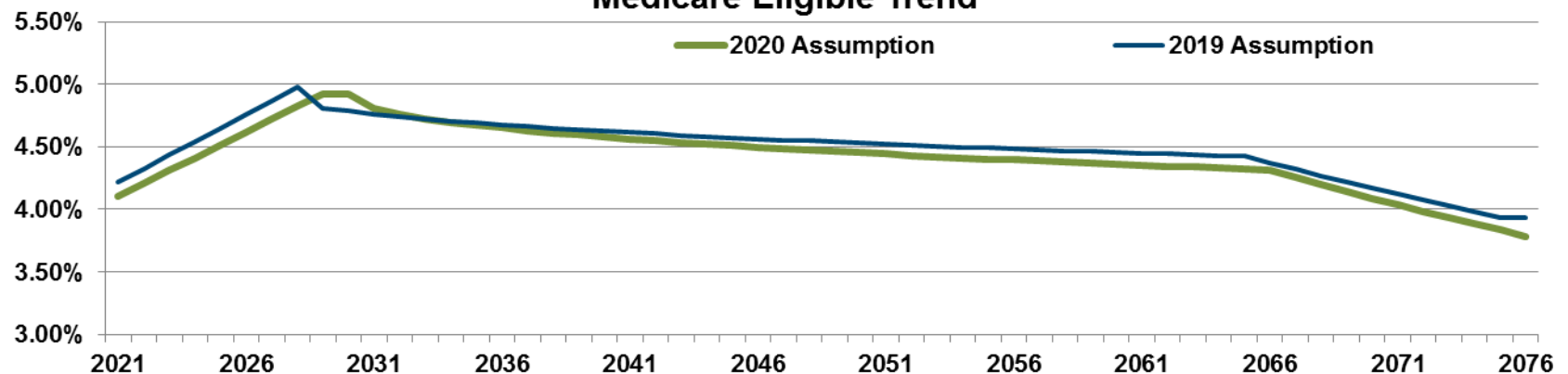
Comparison of Health Trend Rates



Non-Medicare Eligible Trend



Medicare Eligible Trend



Dependent Coverage Elections



Actual Pre-Medicare Dependent Coverage Elections



We recommend no changes to the assumptions

Coverage Tier	Assumed Future Retiree Tier Elections					
	Current		Proposed			
	Male	Female	Male	Female	Male	Female
Retiree Only	20%	52%	20%	52%	27%	74%
Retiree and Children	7%	22%	7%	22%	0%	0%
Retiree and Spouse	34%	13%	34%	13%	73%	26%
Retiree and Family	39%	13%	39%	13%	0%	0%

Health/Dental Plan Elections



Assumed Plan Elections for Future Retirees*			
	2020 Enrollment	2019 Valuation	2020 Valuation
Pre-Medicare Medical Plans			
Kaiser DHMO	4%	8%	4%
Kaiser \$25 Co-pay	62%	56%	62%
Kaiser HDHP	6%	5%	6%
Anthem DHMO	2%	1%	2%
Anthem \$20 Co-pay	9%	7%	9%
Anthem HDHP PPO	7%	0%	7%
Anthem Select PPO	8%	0%	8%
Anthem Classic PPO	2%	23%	2%
Medicare-Eligible Medical Plans			
Kaiser Senior Advantage	43%	41%	43%
Anthem Medicare HMO	1%	6%	1%
Anthem Medicare PPO	56%	53%	56%
Dental Plans (All Retirees)			
Delta Dental PPO	99%	99%	99%
DeltaCare HMO	1%	1%	1%

* Eligible for coverage and elect coverage

- Current enrollment for 2020 was compared to the 2019 plan election assumptions
 - Pre-Medicare – Movement away from Anthem Classic PPO
 - Medicare Eligible – Movement away from Anthem HMO
- We recommend changing the plan election assumptions to more closely match the current enrollment

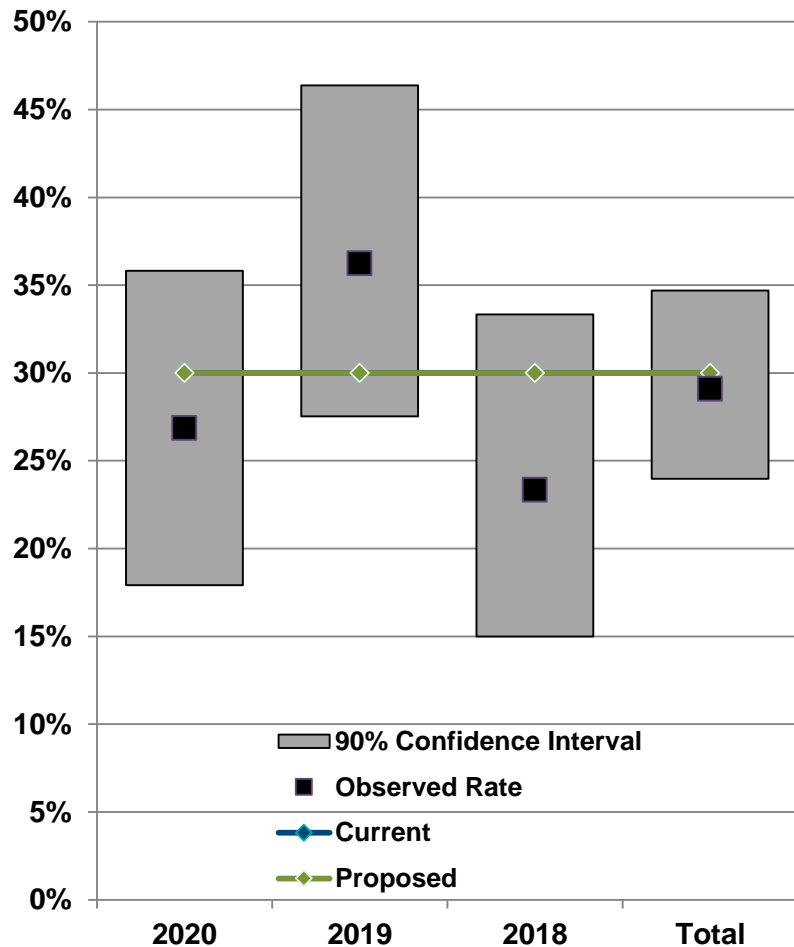


- Measure F added an “In-Lieu” option
 - Retirees can waive health coverage in exchange for a credit equal to 25% of the explicit subsidy for the tier of coverage for which they qualify
 - Credit can be applied to pay future premiums
- Experience is very limited
 - Assumptions set last year based on 2 years of experience
 - Re-assess this year based on another year of experience

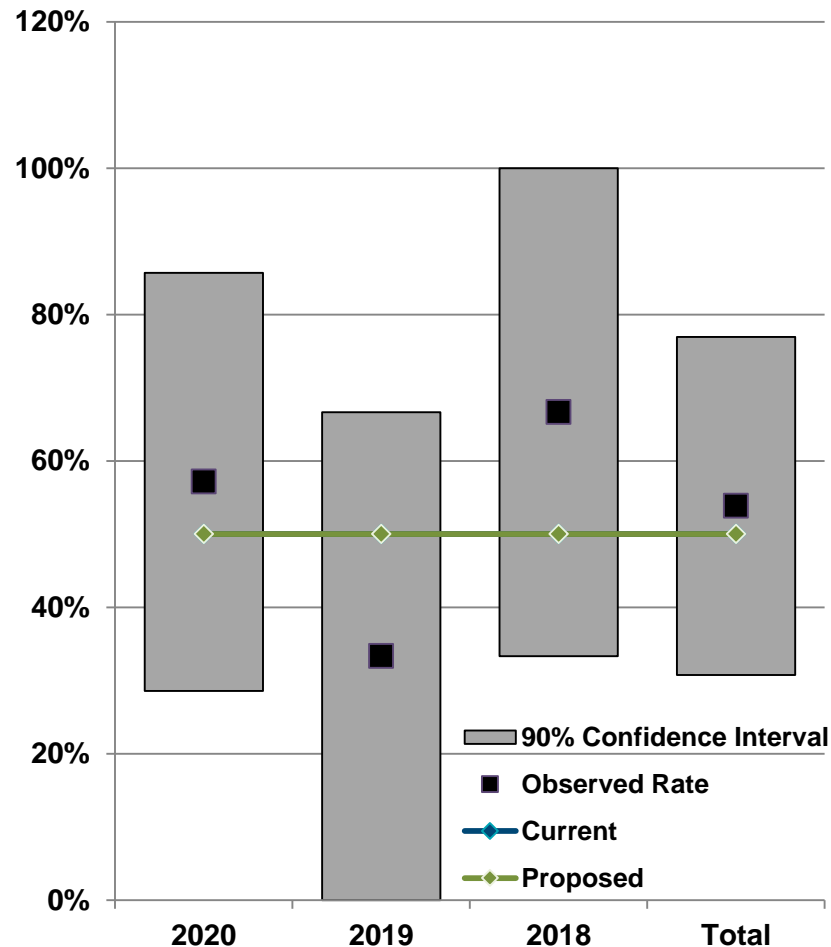
Probability Elect In-Lieu



**Probability Elect In-Lieu
Active Members**



**Probability Elect In-Lieu
Vested Terminated Members**



In Lieu Coverage Tier / Duration



- In-Lieu Coverage Credit
 - Very little data
 - Originally assumed same coverage tier as other retirees
 - Sufficiently different experience warrants minor adjustments this year
 - Continue to monitor
- Duration of In-Lieu Coverage
 - Very little data on duration so far
 - Recommend continuing with current assumption of 5 years
 - Continue to monitor as experience develops

Assumed In-Lieu Coverage Tier			
	2020 Enrollment	2019 Valuation	2020 Valuation
Pre-Medicare			
Retiree Only	25.3%	25%	25%
Retiree + Spouse	19.7%	25%	20%
Retiree + Family	55.1%	50%	55%
Medicare Eligible			
Retiree Only	38.1%	60%	50%
Retiree + Spouse	61.9%	40%	50%

Administrative Expenses



- Current assumption would be \$42.33 per member for FYE 2022
 - Increases each year with assumed wage inflation
- Analysis adjusts historical administrative expenses to the current year with assumed wage inflation of 3.25% per year
- Average adjusted expense per member is increased from 2020 to 2022 with future assumed wage inflation of 3.00% per year
- We recommend an assumption of \$41 per member for FYE 2022 increasing with future wage inflation
 - Partially reflects lower expenses of last two years

FYE	Adjusted Administrative Expenses	Members	Adjusted Expense / Member
2020	\$ 121,316	3,936	\$ 30.8
2019	128,527	3,871	33.2
2018	168,336	3,763	44.7
2017	200,300	3,613	55.4
2016	158,425	3,613	43.8
2015	143,826	3,578	40.2
2014	124,044	3,582	34.6
2013	97,572	3,608	27.0
2020 Average Adjusted Expense / Member			\$ 38.7
FYE 2022 Expense per Member			\$ 41.0

Aggregate Claims Costs



Age	<u>FYE 2021</u>		<u>FYE 2020</u>		<u>% change</u>	
	Male	Female	Male	Female	Male	Female
Medical						
50	\$11,403	\$12,946	\$11,824	\$13,432	-3.6%	-3.6%
55	12,703	13,792	13,197	14,331	-3.7%	-3.8%
60	14,929	14,554	15,533	15,142	-3.9%	-3.9%
64	17,634	14,350	18,365	14,944	-4.0%	-4.0%
65	4,343	3,831	4,676	4,125	-7.1%	-7.1%
70	4,612	3,906	4,965	4,205	-7.1%	-7.1%
75	5,301	4,393	5,707	4,729	-7.1%	-7.1%
80	6,019	4,981	6,480	5,363	-7.1%	-7.1%
85	6,500	5,444	6,998	5,861	-7.1%	-7.1%
Dental	\$699		\$723		-3.3%	

- 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 1/1/2020
- Aggregate claims costs for FYE 2020 are lower than expected

Board Decisions



- Discount rate
 - Consider 6.25% to 5.75%
- Health care trend rates
 - Proposed minor adjustments
- Dependent coverage elections
 - No changes
- Health/Dental plan elections
 - Update to reflect Anthem enrollments
- In-Lieu elections
 - Proposed minor adjustments to assumed coverage Tiers
- Administrative expenses
 - Proposed slight reduction
- Claims costs
 - Update to reflect recent experience



- The purpose of this presentation is to present recommended assumptions for the June 30, 2020 Valuation for the City of San José Police and Fire Department 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.
- 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 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.

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Consulting Actuary

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Principal Consulting Actuary

Appendix – Meketa's CMAs



Police & Fire Section 115 Trust Portfolio Meketa's Capital Market Assumptions

Asset Class	Allocation	Standard Deviation	Arithmetic Return	
			10-Year	20-Year
Cash Equivalents	0.0%	1.0%	0.5%	1.3%
Short-term Investment Grade Bonds	29.0%	1.0%	0.7%	1.7%
US Equity	28.0%	17.0%	6.5%	8.5%
Developed Market Equity (non-US)	13.0%	19.0%	9.0%	9.4%
Emerging Market Equity	15.0%	24.0%	10.9%	11.3%
Real Estate	10.0%	15.0%	7.4%	8.0%
Commodities (naive)	5.0%	17.0%	5.6%	5.2%
Total	100.0%	11.5%	5.9%	11.5%
Geometric Return			5.4%	6.4%

Getzen Health Trend Model Parameters

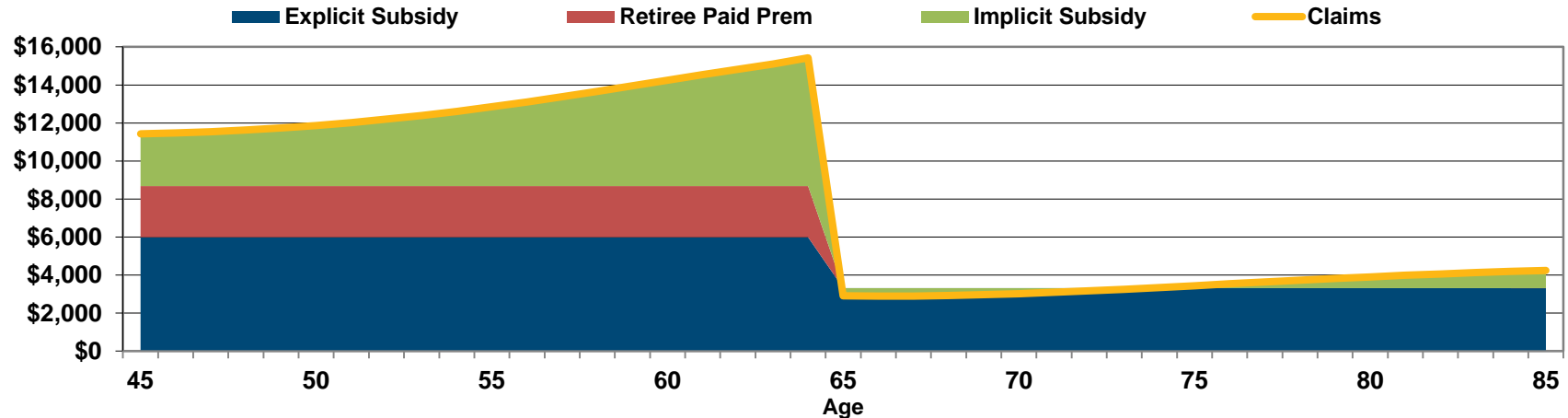


- Initial 2020 Trend Rate (Updated from prior valuation)
 - Non-Medicare Eligible = 8.00%
 - Medicare Eligible = 4.00% in 2020, 4.10% in 2021
- Linear decline to long run trend in 2029
- Long run trend = 4.93%
 - Inflation = 2.25%
 - Real GDP per capita = 1.5%
 - Excess medical cost growth = 1.1%
- Capacity constraints
 - Expected GDP Share in 2029 = 20.0%
 - Resistance point = 20.0%
 - Applies resistance to growth in health spending as a percentage of GDP starting in 2030
 - Some evidence resistance already applies – health spending has declined slightly from 18.0% of GDP in 2016 to 17.9% in 2017 and 17.8% projected for 2019
 - Year limited to GDP growth = 2076

Illustration of Subsidies



Illustration of Implicit Subsidy - Kaiser \$25 Co-pay Plan



Member Age 64 Illustration

	2020	2021	% Change
Explicit Subsidy	\$ 5,807	\$ 6,172	6.3%
Retiree Paid Premium	<u>2,611</u>	<u>2,774</u>	6.3%
Kaiser \$25 Co-Pay Plan Premium	\$ 8,418	\$ 8,946	6.3%
Implicit Subsidy	<u>6,752</u>	<u>6,569</u>	2.3%
Total Claims	\$ 15,170	\$ 15,515	-2.7%