CHEIRON

Classic Values, Innovative Advice

Emerging Risk/Reward Changes and a Split Valuation Approach

San José Police & Fire Department Retirement Plan

Bill Hallmark

June 17, 2026

Agenda

- Introduction
- 2025 Valuation Review
- Changes to Risk / Return Tradeoffs as the Plan Becomes Better Funded
- Consequences of Reducing Risk
- Split Valuation Approach
- Questions

Introduction

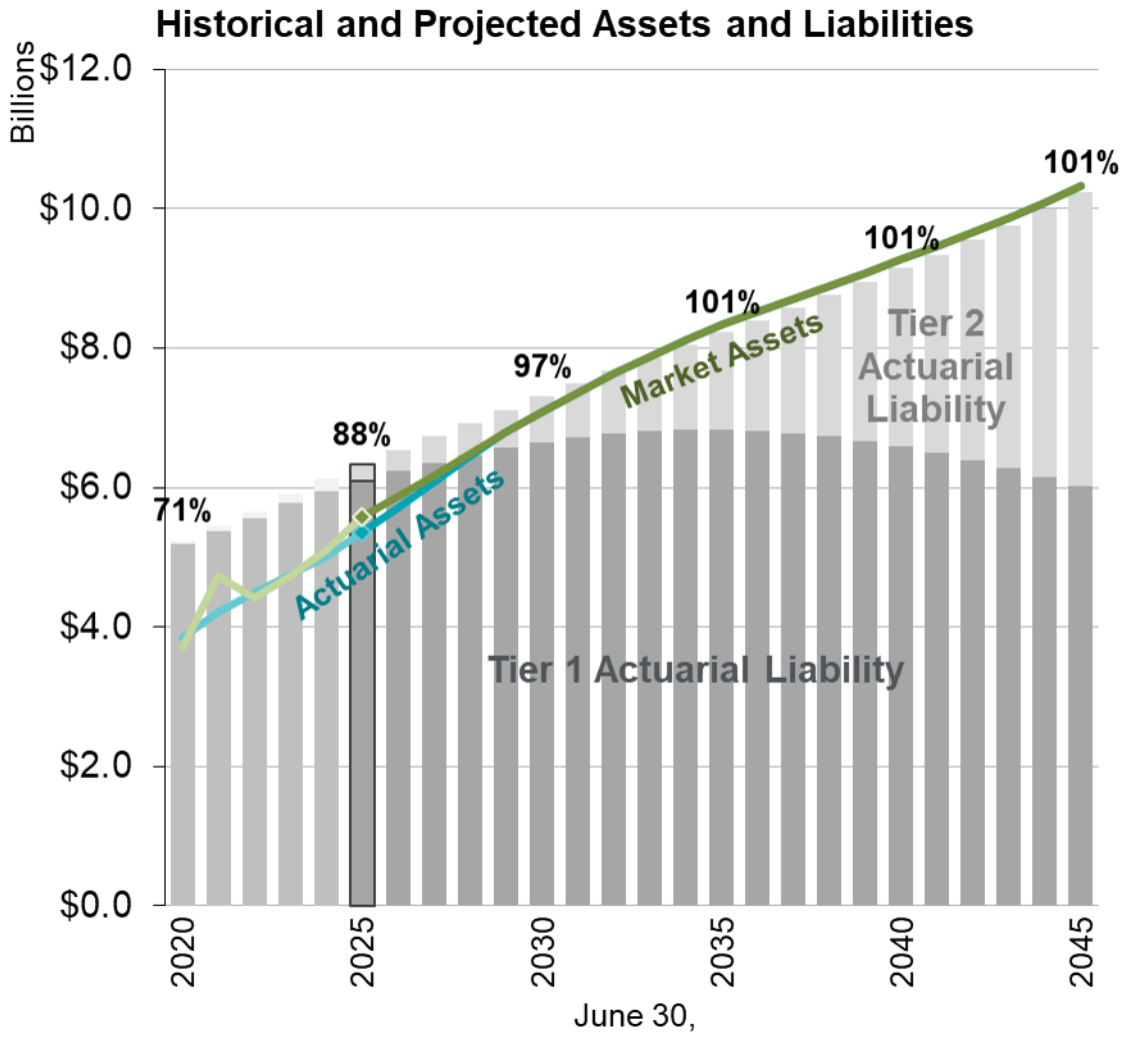
- The focus has been on recovering from the Great Recession
  - 113% funded in 2007 ➔ 68% funded in 2009 ➔ 88% funded in 2025
- Key strategies
  - City-driven cost controls
  - More realistic/conservative assumptions
  - Increase contributions
  - Improve investment strategies
- As the Plan approaches a 100% funded ratio and contribution rates decline, the focus will likely shift to preserving the funded status

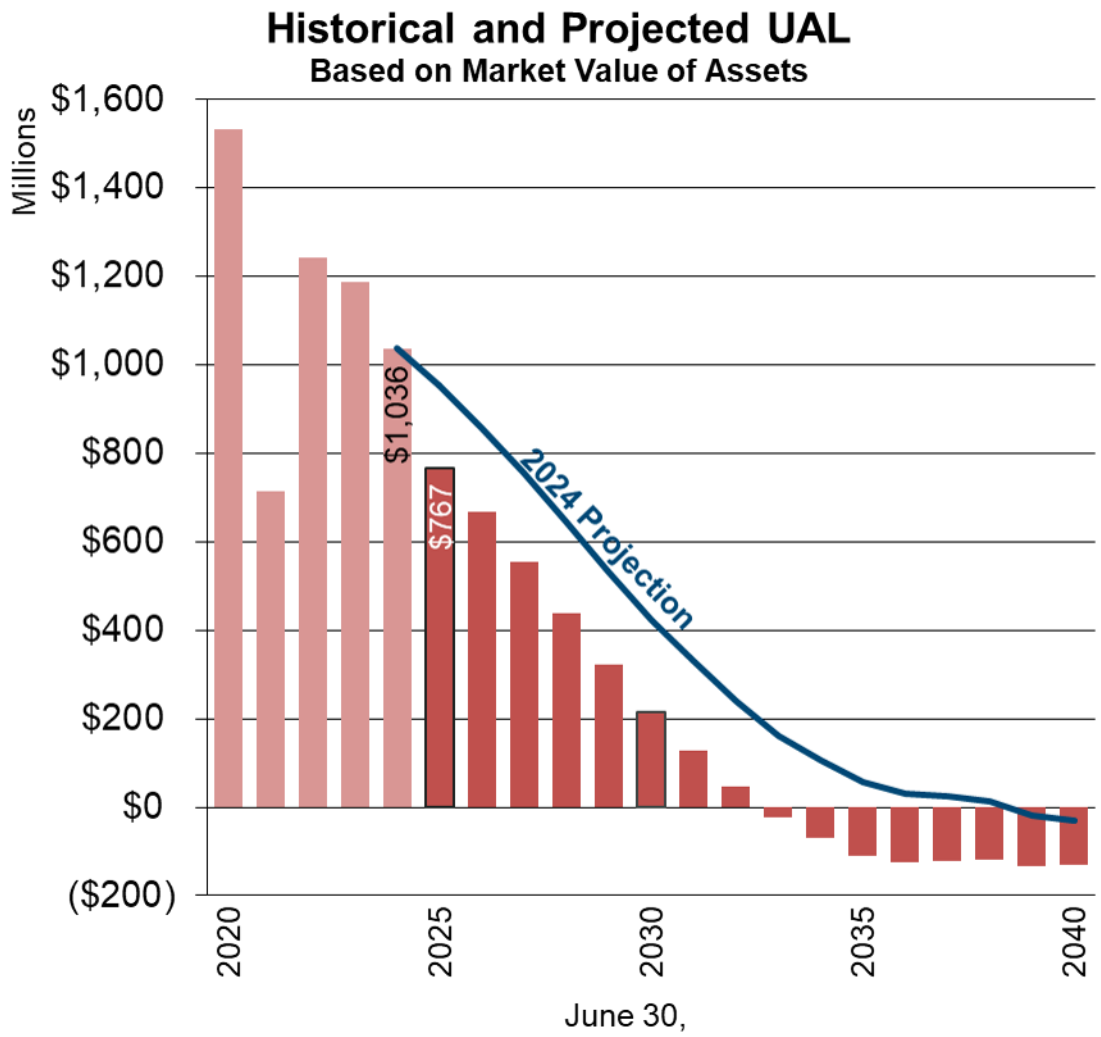
Asset-Liability Management (ALM) Study

- Beginning ALM study process
- Coordinated approach
  - Meketa will run the ALM study and propose asset allocations
  - Cheiron will coordinate with Meketa's actuary to:
    - Provide the information needed for the study
    - Verify that Meketa's projections are reasonably similar to our projections
    - Ensure risks to contributions and funded status are adequately analyzed and communicated
- Changes to risks versus rewards and focus on preserving funded status indicate a different and more complex analysis

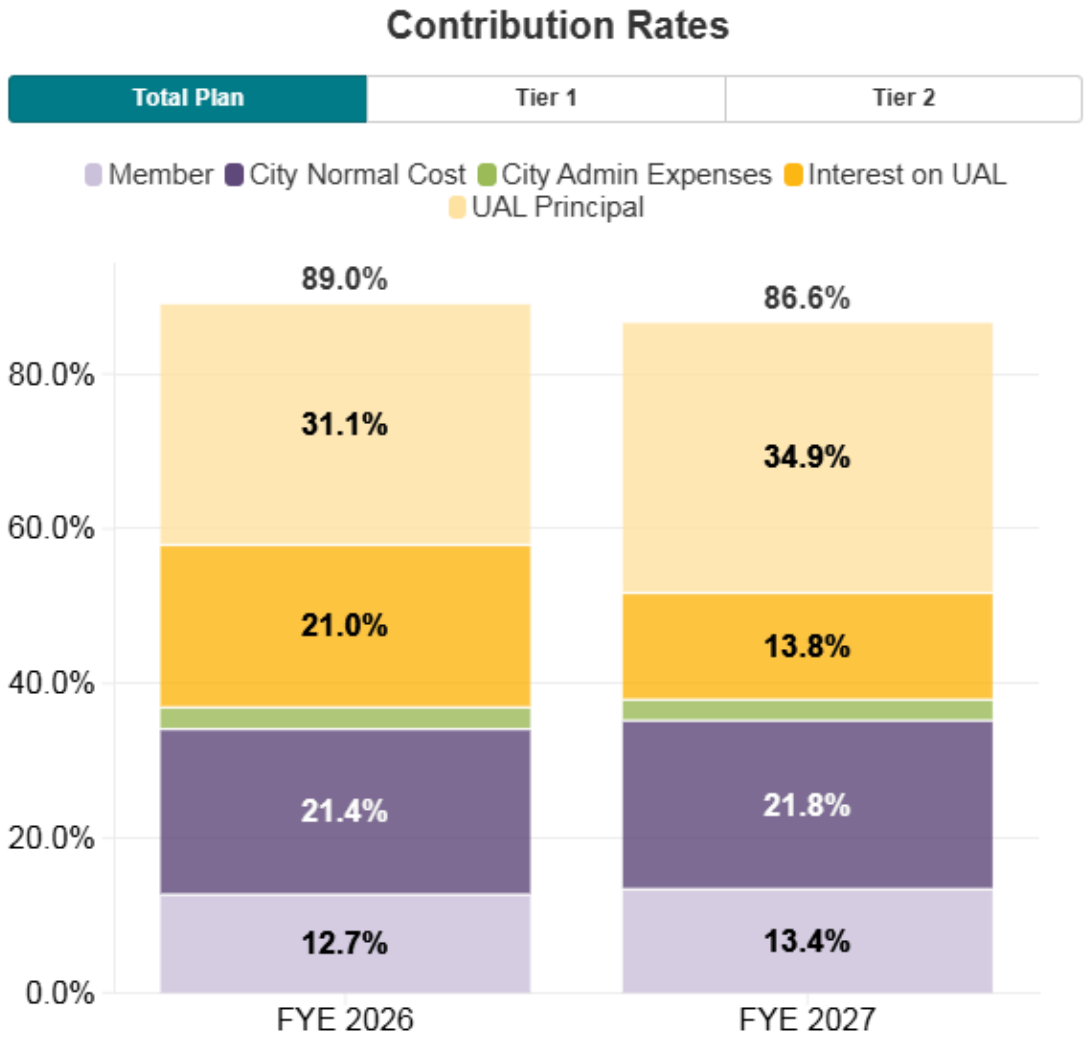
2025 Valuation Review

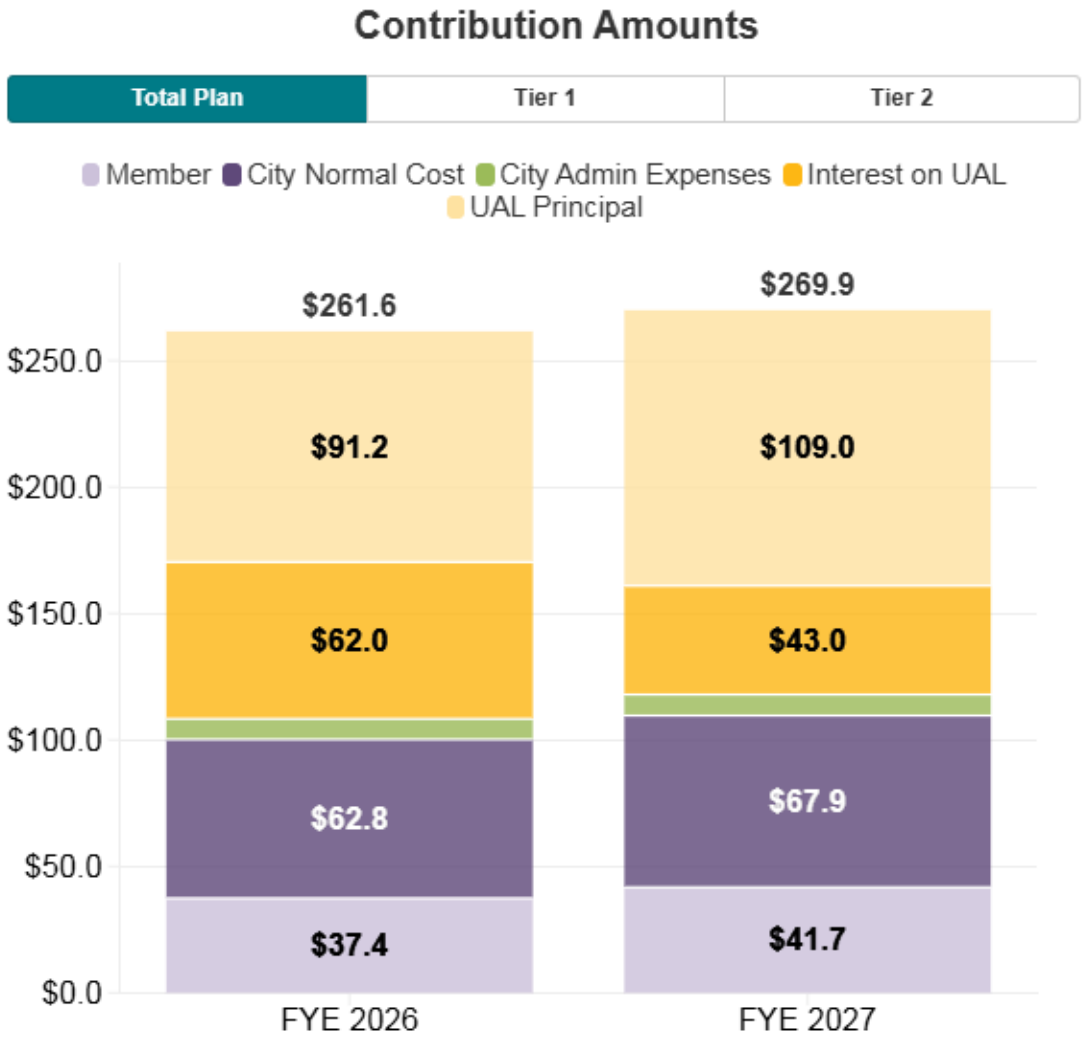
Baseline Projections – Funded Status and UAL





Final FYE 2027 Contributions



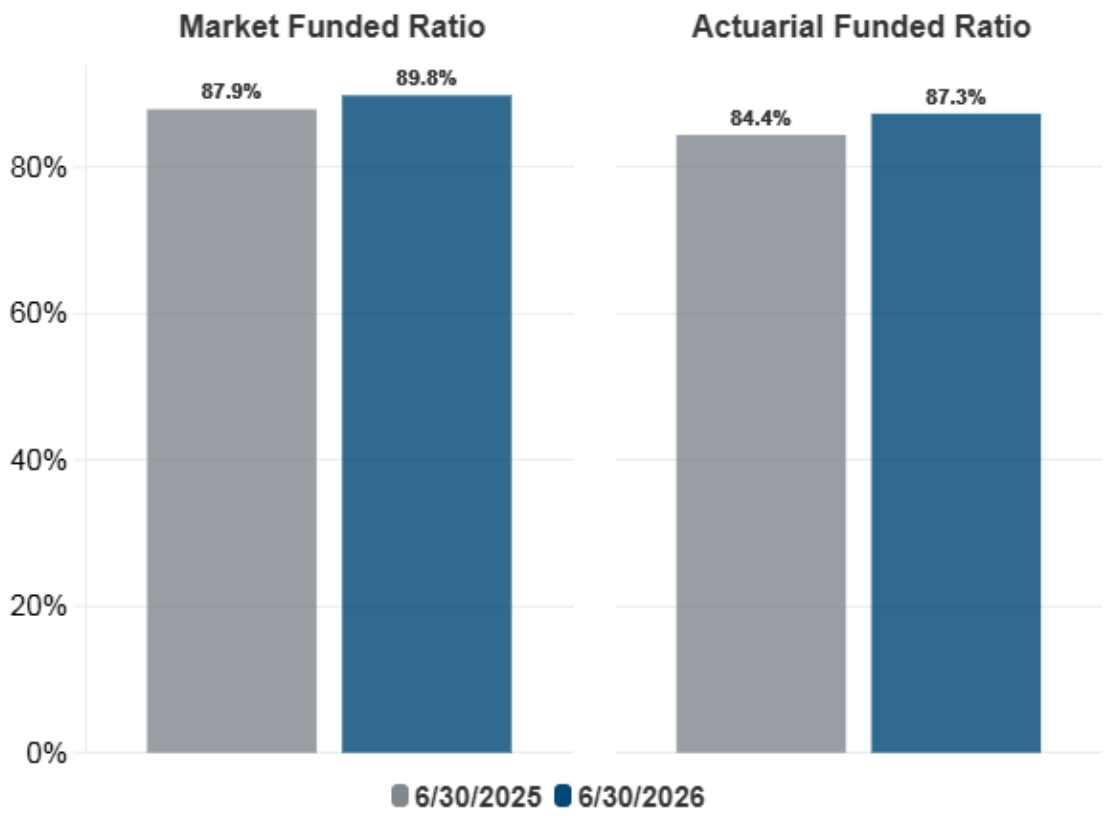


Estimated Impact – FYE 2026 Returns

Projected Funded Ratio

Select the investment return by moving the slider to estimate next year's funded ratios

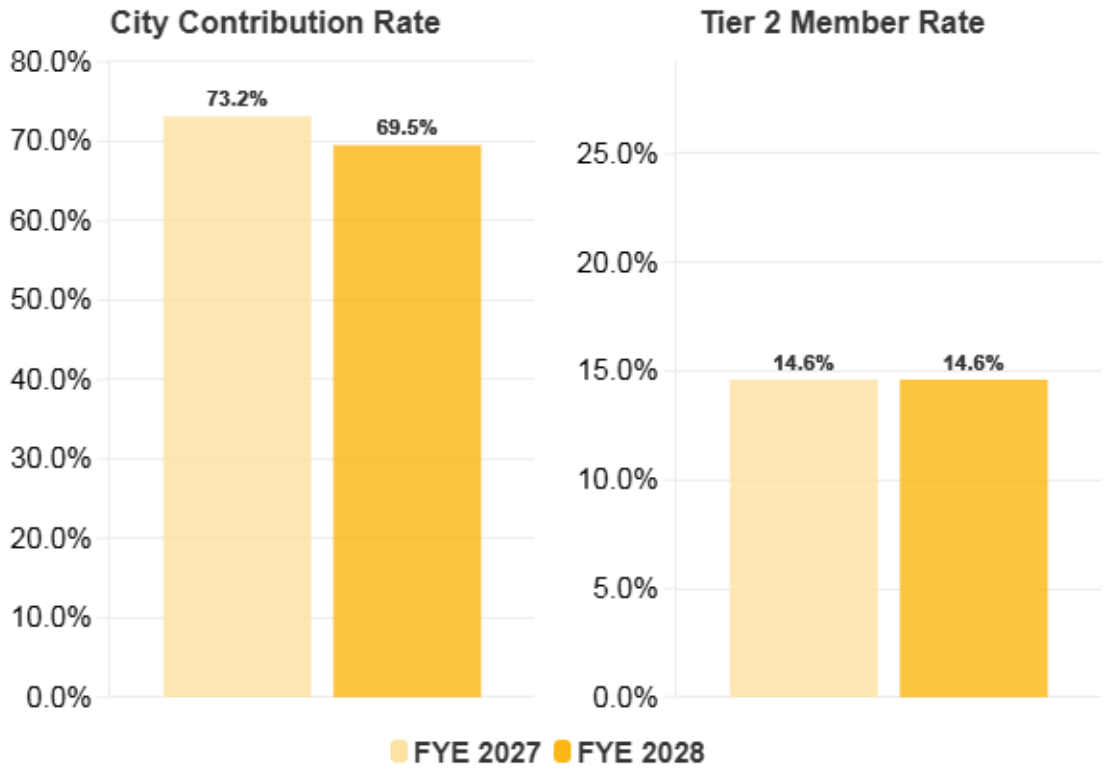
FYE 2026 Investment Return ▶ 6.625%



Projected Contribution Rates

Select the investment return by moving the slider to estimate next year's contribution rate

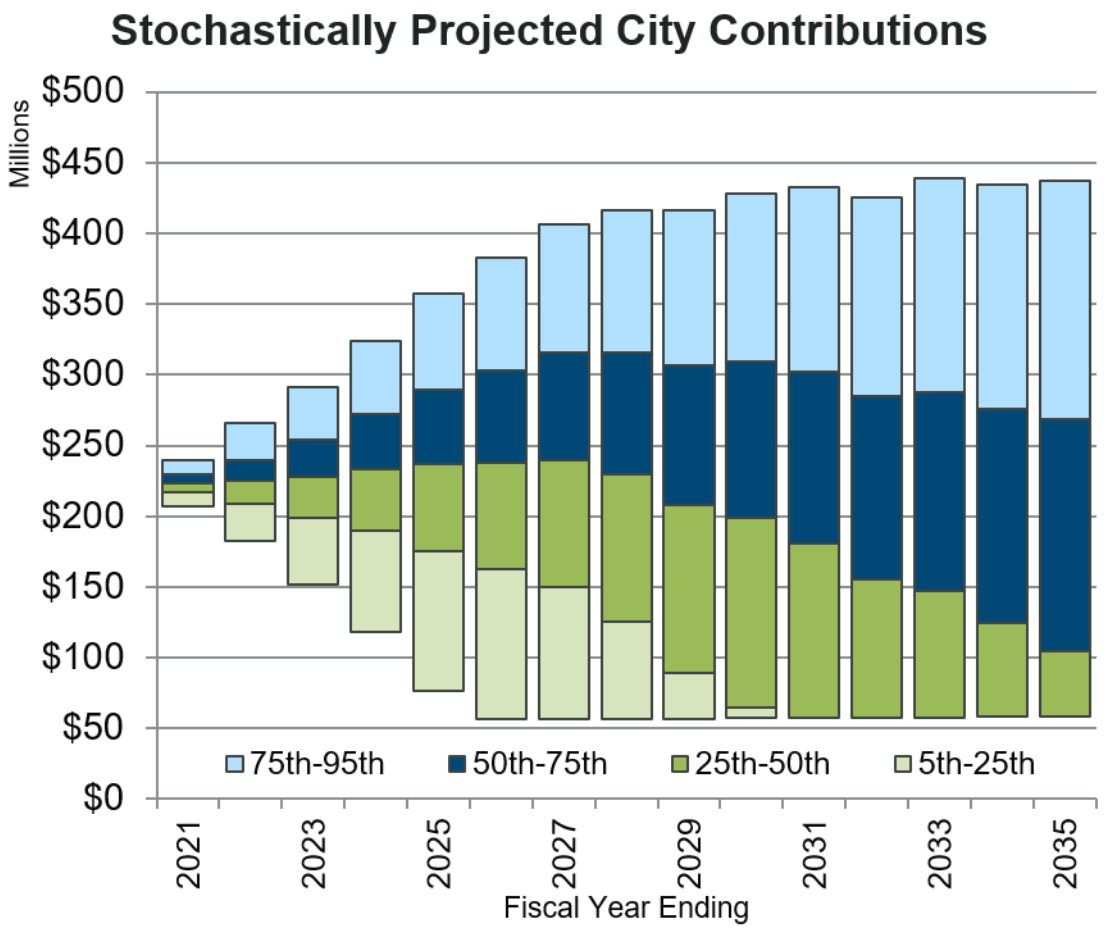
FYE 2026 Investment Return ▶ 6.625%



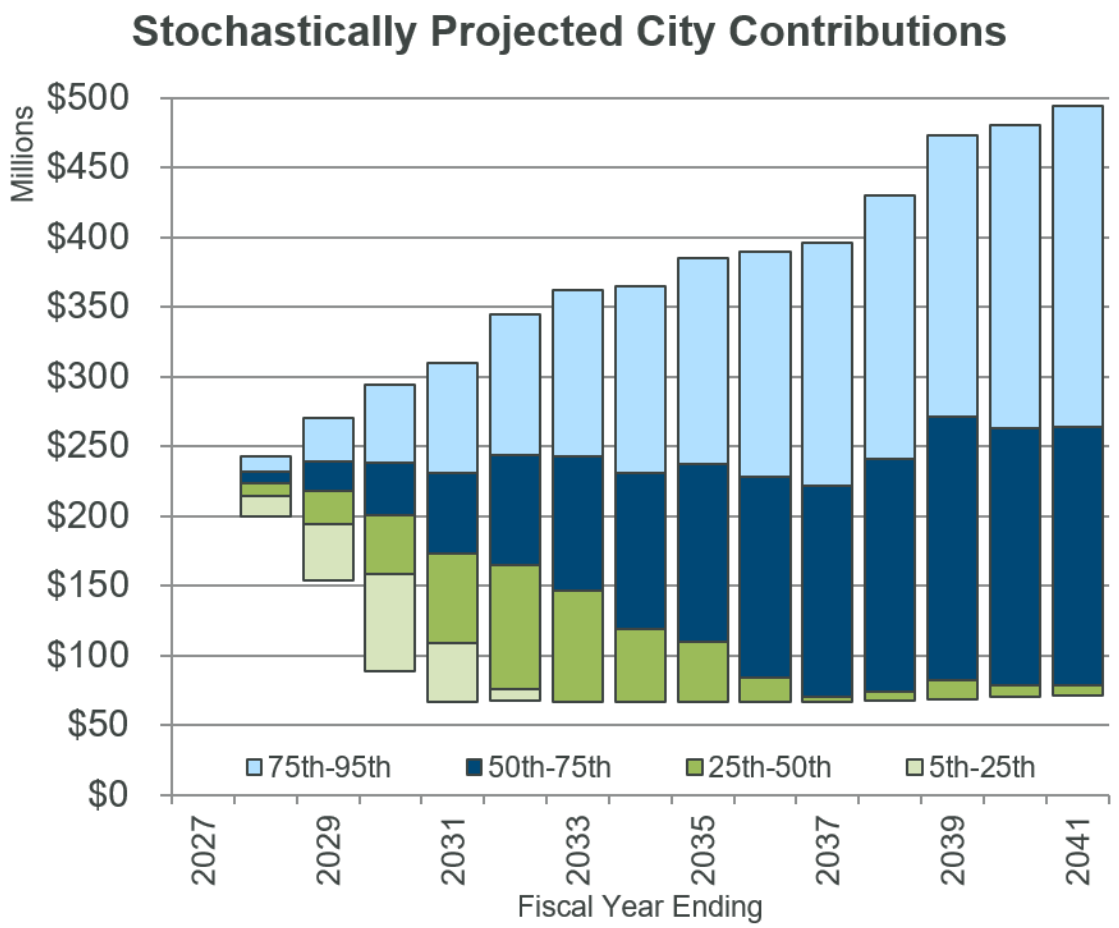
Changes to Risk / Return Tradeoffs as the Plan Becomes Better Funded

Potential Rewards Decline When Near 100%

2020 Valuation = 74% Funded

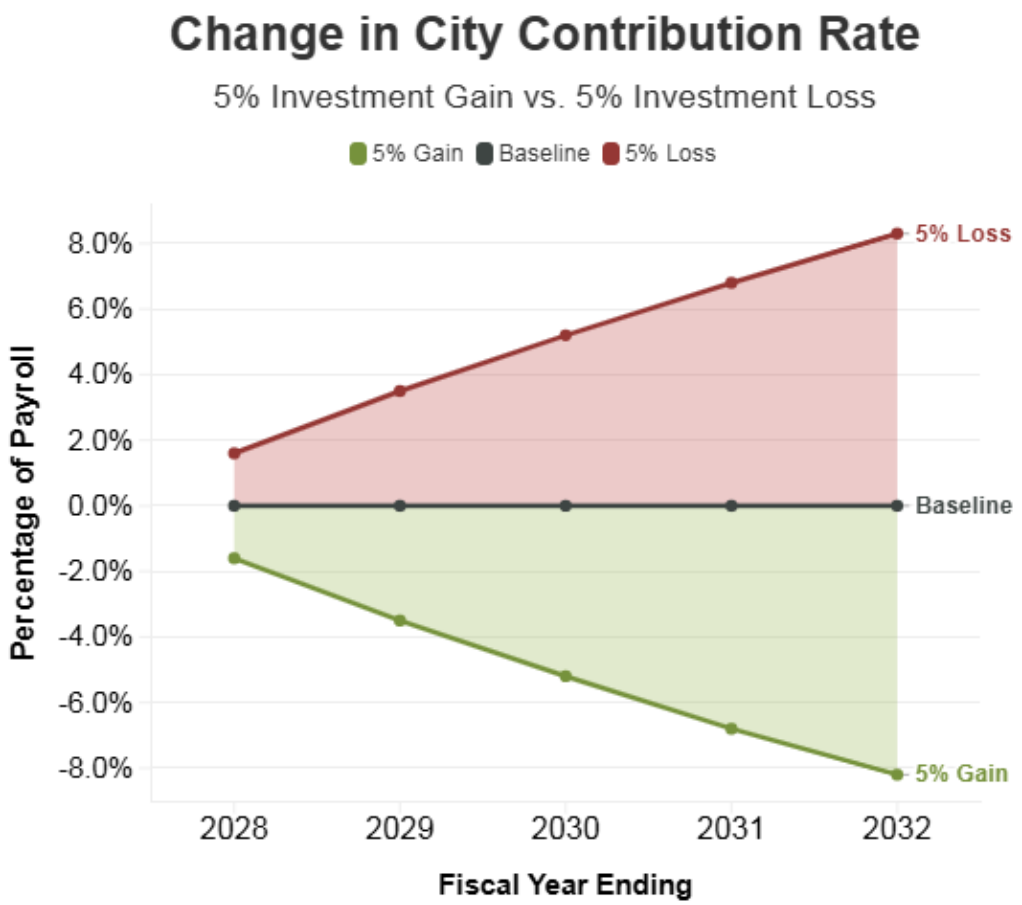


2025 Valuation = 88% Funded

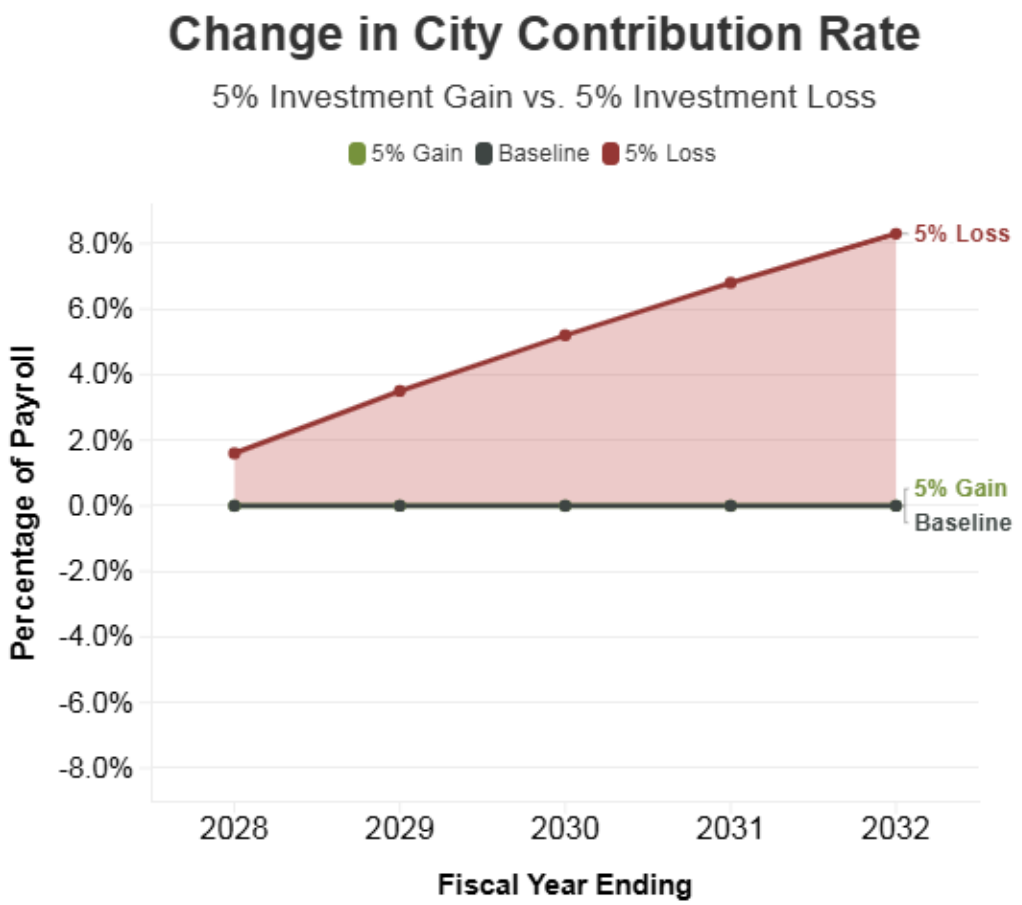


Impact of 5% Investment Gain vs. Loss

Below 100% Funded

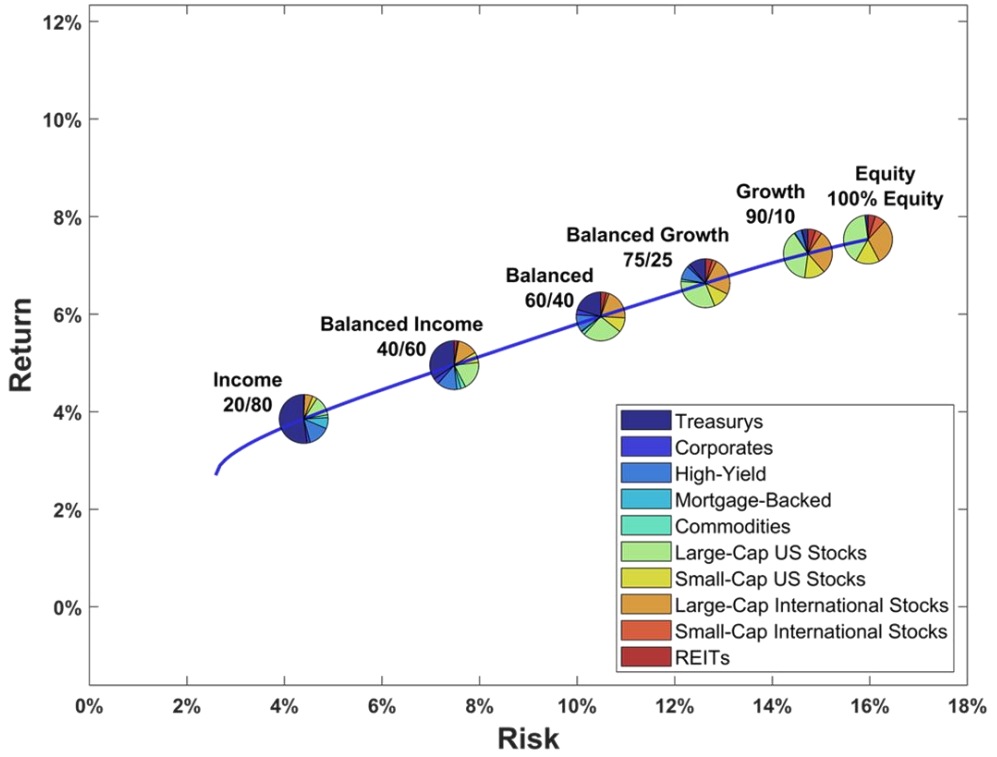


At 100% Funded



Reduce Investment Risk – Traditional Approach

- Reduce the standard deviation of the portfolio
  - Reduces risk of poor returns
  - Lowers expected return
  - Increases normal cost
    - Higher member/City contributions
- Trade-offs may not be attractive
  - The increase in contributions may be viewed as counterproductive
  - The risk reduction may not warrant the lower expected return



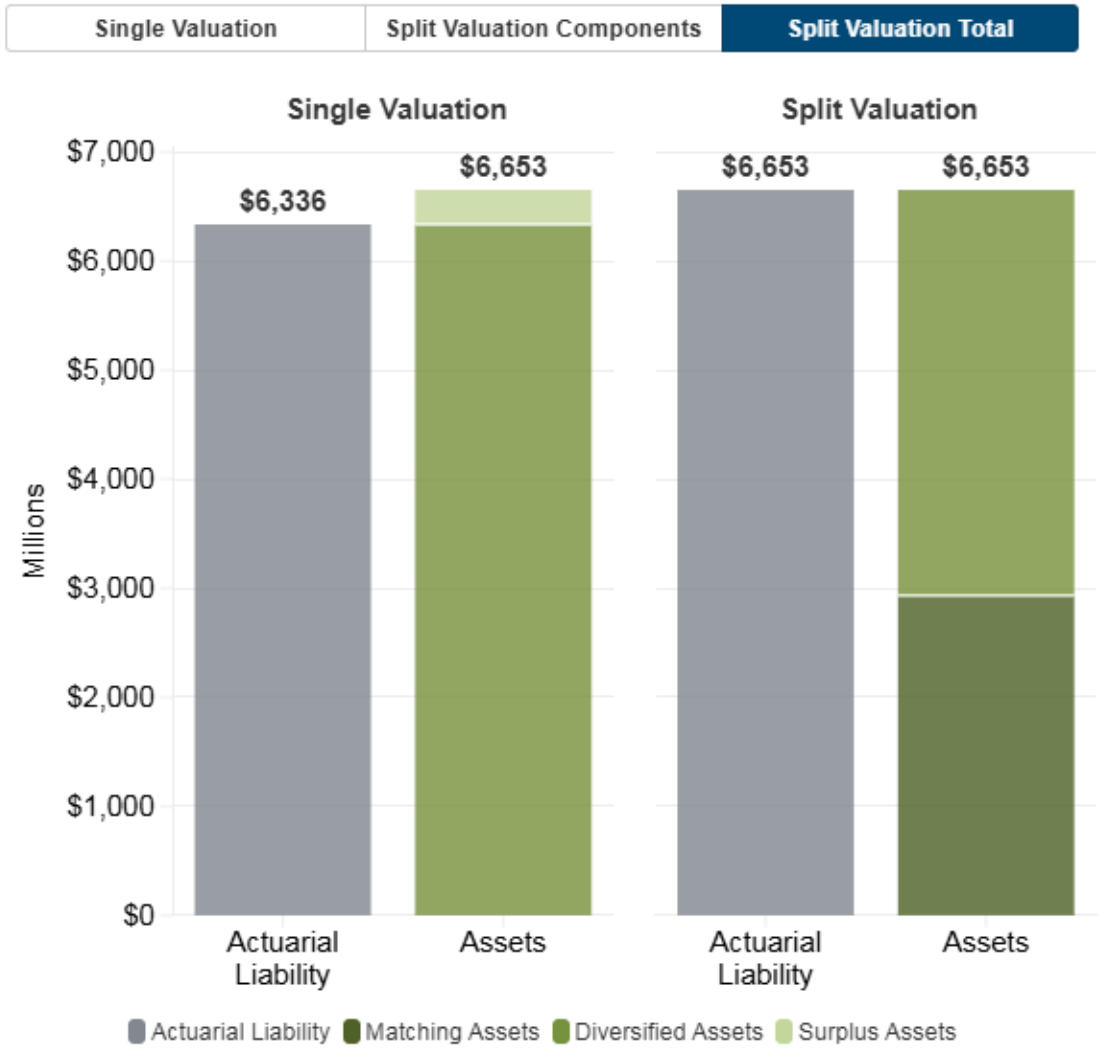
The Split Valuation Approach

Split Valuation Objectives

- Primary objective
  - Allow the use of a more conservative asset allocation to stabilize funding, without increasing the normal cost or member contribution rates
- Secondary objectives
  - Avoid the investment complexity of matching specific cash flows
  - Make it simple to implement and to unwind, particularly if funding levels fall below a specified target

Split Valuation Illustration – 105% Funded

- Set a target funded ratio for the split valuation (e.g., 100%)
- Assets above the target are used to pay for lower returns on high-quality fixed-income securities
  - Investment consultant provides projected cash flows from these investments
  - Annual cash flows are limited to retiree benefit payments
- For valuation purposes
  - Retiree benefit payments that match the cash flows are valued separately
  - Remaining liability, including all active member liability, is valued as it is now

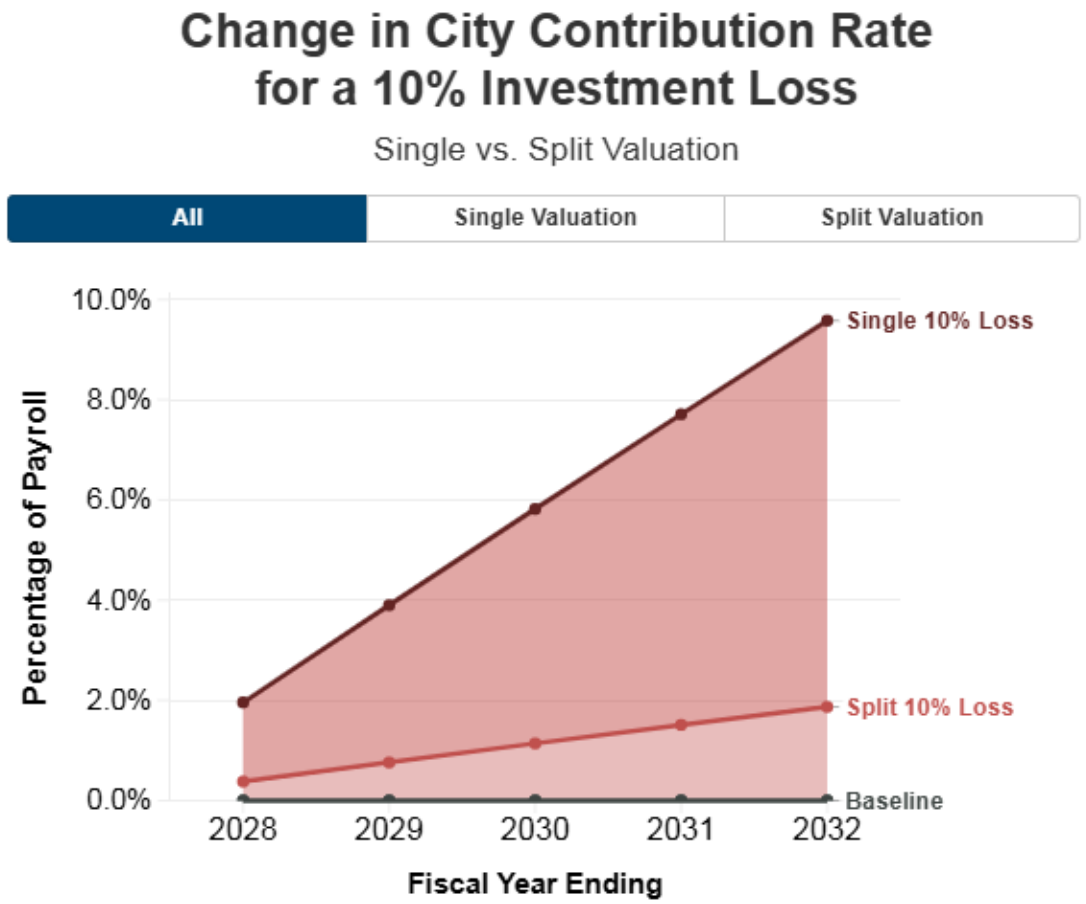


Split Valuation Example – 105% Funded

	Single Valuation		Split Valuation		
	Diversified Portfolio	De-Risked Portfolio	Matching Portfolio	Diversified Portfolio	Total
Discount Rate	6.625%	6.26%	5.60%	6.625%	
Actuarial Liability	$6,336	$6,653	$2,933	$3,720	$6,653
Assets	$6,653	$6,653	$2,933	$3,720	$6,653
UAL	($317)	$0	$0	$0	$0
Funded Ratio	105%	100%	100%	100%	100%
Normal Cost Rate	35.80%	39.38%	N/A	35.80%	35.80%

Split Valuation – Impact on Investment Risk

- Diversified Portfolio
  - Impact of returns of the diversified portion is muted by its smaller size
  - Lower asset leverage ratio
- Matching Portfolio
  - Actual return on the matching portion is not relevant, except for defaults
  - Produces income to satisfy liquidity needs



Based on the example from the prior slide
(105% funded on single valuation basis before 10% investment loss)
Matching assets earn 5.6% return

Potential Variations

- The example assumed 100% of assets in excess of 100% funded were used to buy down the interest rate for the matching portfolio
- These parameters can be varied
  - Funded ratio trigger could be 90% or 110%, for example
  - Policy could use 25% or 50% of assets over the funded ratio trigger, for example
- When the diversified portfolio suffers a loss, the example assumes the matching portfolio reverts to the diversified portfolio
  - Alternatively, the matching portfolio could remain intact, and a larger amortization payment set up for the diversified portfolio
- Cheiron can work with Meketa to develop policy options to ensure orderly transitions between the matching and diversified portfolios

Complications

- Coordination with Investment Staff/Consultant
  - The matching portfolio should be in place on the valuation date
  - Requires estimating the funding target as of the next valuation date
  - Additional cost for a high-quality fixed-income portfolio at the valuation date
  - Decisions to expand the matching portfolio are built into the policy, but contracting the matching portfolio is an investment decision
- Impact on diversified portfolio
  - What if high investment returns are due to illiquid assets?
- Other actuarial complications
  - The discount rate for the matching portfolio will change every year
  - GASB 67/68
  - Verify that actuarial equivalence can continue to be based on the assumptions for the diversified portfolio

Questions

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