

City of San José Police and Fire  
Department Postemployment  
Healthcare Plan



# June 30, 2016 OPEB Actuarial Valuation Results

February 2, 2017

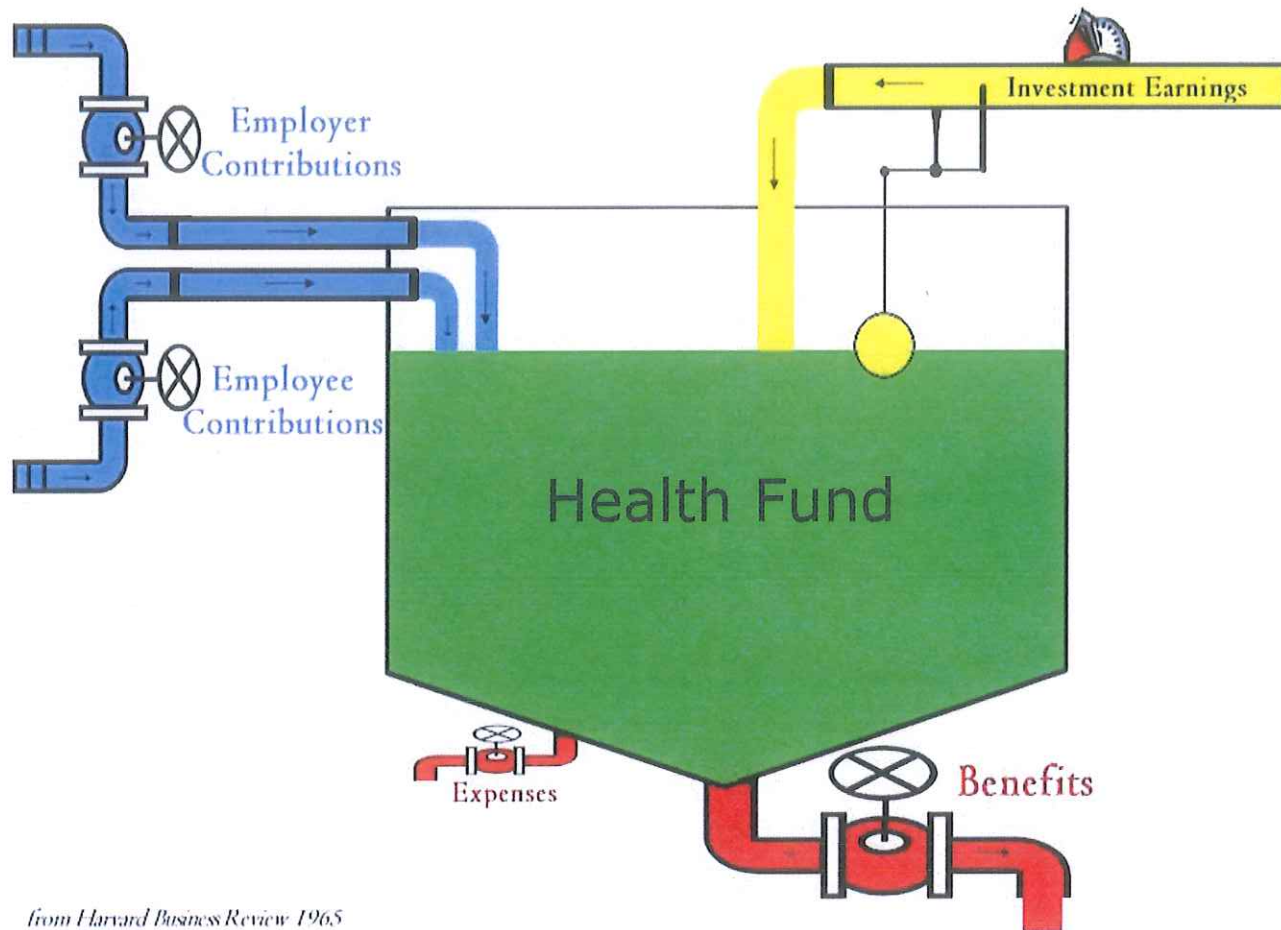
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# Agenda



- Introduction
- Funding Valuation Results
- GASB Valuation Results

# Introduction



*from Harvard Business Review 1965*

# Introduction



- June 30, 2016 valuation results determine:
  - GASB reporting for FYE 2017
- Measure F changes are not reflected
- Key drivers of changes since the last valuation include:
  - Investment losses
  - Demographic losses
  - Discount rate changes
  - Health assumption changes

# Funding Valuation Results



- Contributions are assumed to remain constant for the remainder of FYE 2017
  - Measure F changes are assumed to be phased in as ordinances are adopted, IRS approvals received, and member elections are implemented
  - No impacts to contributions are assumed prior to 6/30/2017
- FYE 2017 contribution rates are:
  - Police: 9.51% for members and 10.31% for the City
  - Fire: 9.74% for members and 10.62% for the City
- Ultimately, when Measure F is fully implemented, member contributions will be fixed and the Board will set City contributions up to a cap

# Funding Valuation Results



## Summary of Key Valuation Results

### Funding Valuation Basis<sup>1</sup>

Valuation Date	6/30/2016	6/30/2015
Discount Rate	6.875%	7.00%
Actuarial Liability (AL)	624,228	591,996
Actuarial Value of Assets (AVA)	135,207	114,565
Unfunded Actuarial Liability (UAL)	489,021	477,430
AVA Funding Ratio	21.7%	19.4%
Market Value of Assets (MVA)	123,425	109,627
Unfunded Liability (MVA basis)	500,803	482,369
MVA Funded Ratio	19.8%	18.5%

<sup>1</sup> Excludes implicit subsidy

Dollar amounts in thousands

# GASB Valuation Results



- The results of this valuation determine the City's accounting and financial reporting for FYE 2017
- The Unfunded Actuarial Liability (UAL) measured on a GASB basis decreased by about \$19 million since the prior valuation

Summary of Key Valuation Results			
GASB Valuation Basis			
Valuation Date	6/30/2016	6/30/2015	
Discount Rate	5.90%	6.00%	
Actuarial Liability (AL)	\$ 778,871	\$ 739,753	
Actuarial Value of Assets (AVA)	135,207	114,565	
Unfunded Actuarial Liability (UAL)	\$ 643,664	\$ 625,188	
AVA Funding Ratio	17.4%	15.5%	
Market Value of Assets (MVA)	\$ 123,425	\$ 109,627	
Unfunded Liability (MVA basis)	655,446	630,126	
MVA Funded Ratio	15.8%	14.8%	
Fiscal Year Ending	6/30/2017	6/30/2016	
City ARC			
-- if paid as percent of pay	17.20%	17.70%	
-- if paid as dollar amount (MOY)	\$ 33,381	\$ 32,694	
Expected/Actual City Contribution <sup>1</sup>	\$ 21,865	\$ 21,064	
Expected/Actual Net Benefit Payments <sup>1</sup>	\$ 24,588	\$ 23,449	

<sup>1</sup> Includes implicit subsidy

Dollar amounts in thousands

# GASB Valuation Results



\* Funding valuation information not available before 2009

Funding Valuation Basis										
	2006	2007	2009	2010	2011	2012	2013	2014	2015	2016
<b>Funded Ratio</b>			9.9%	8.5%	9.2%	11.1%	14.7%	16.8%	19.4%	21.7%
<b>UAL/(Surplus)</b>			\$507.2	\$627.8	\$596.8	\$529.8	\$437.0	\$462.1	\$477.4	\$489.0
<i>(in millions)</i>										
<b>Discount Rate</b>			8.00%	7.75%	7.50%	7.25%	7.13%	7.00%	7.00%	6.875%
GASB Valuation Basis										
	2006	2007	2009	2010	2011	2012	2013	2014	2015	2016
<b>Funded Ratio</b>	4.5%	6.8%	7.3%	6.2%	6.0%	6.7%	10.7%	13.2%	15.5%	17.4%
<b>UAL/(Surplus)</b>	\$812.8	\$620.8	\$706.0	\$887.7	\$943.1	\$930.9	\$625.5	\$613.1	\$625.2	\$643.7
<i>(in millions)</i>										
<b>Discount Rate</b>	5.30%	6.40%	6.70%	6.30%	5.70%	4.40%	6.00%	6.00%	6.00%	5.90%

\* Funding valuation information performed by prior actuary not available before 2009



# Assets



	Market Value of Assets				FYE 2015
	Fiscal Year Ending 2016				
	401(h)	Police 115	Fire 115	Total	
Market Value, Beginning of Year	\$ 51,343	\$ 38,864	\$ 19,420	\$ 109,627	\$ 97,645
Contributions					
Member	18,007	0	0	18,007	17,017
City	0	11,576	8,100	19,675	20,909
Implicit Subsidy	1,389	0	0	1,389	2,050
Total	\$ 19,395	\$ 11,576	\$ 8,100	\$ 39,071	\$ 39,976
Net Investment Earnings	(540)	(843)	(441)	(1,824)	(1,738)
Benefit Payments					
Premium Payments	22,060	0	0	22,060	24,205
Implicit Subsidy	1,389	0	0	1,389	2,050
Total	\$ 23,449	\$ 0	\$ 0	\$ 23,449	\$ 26,256
Market Value, End of Year	\$ 46,750	\$ 49,597	\$ 27,078	\$ 123,425	\$ 109,627
Estimated Rate of Return	-1.1%	-1.7%	-1.6%	-1.4%	-1.5%

*Dollar amounts in thousands*

- Assets are maintained in two trusts: the 401(h) account in the pension plan and a 115 trust with separate sub-trusts for Police and Fire
- Assets within the 401(h) account are also tracked separately between Police and Fire

# Assets



Development of Actuarial Value of Assets					
	FYE 2013	FYE 2014	FYE 2015	FYE 2016	June 30, 2016
Market Value of Assets					\$ 123,425
Actual Earnings	\$ 6,367	\$ 12,497	\$ (1,738)	\$ (1,824)	
Expected Earnings	5,334	6,314	8,051	8,912	
Gain or (Loss)	1,033	6,183	(9,789)	(10,735)	
Deferred %	20%	40%	60%	80%	
Deferred Amount	\$ 207	\$ 2,473	\$ (5,873)	\$ (8,588)	\$ (11,782)
Preliminary Actuarial Value of Assets					\$ 135,207
Minimum (80% of Market Value)					98,740
Maximum (120% of Market Value)					148,110
Actuarial Value of Assets					\$ 135,207
Ratio of Actuarial to Market Value					109.5%
Estimated Rate of Return on Actuarial Value					3.8%
Actuarial Gain or (Loss)					\$ (4,237)

*Dollar amounts in thousands*

- The return on the Actuarial Value of Assets is lower than the assumed return of 7.0%, resulting in an actuarial loss

# GASB Valuation Results



## Development of Blended Discount Rate

### Expected FYE 2017 Contributions

Member Contribution	\$	18,647,256
City Contribution		20,266,267
Implicit Subsidy		1,598,907
<b>Total Contribution</b>	<b>\$</b>	<b>40,512,430</b>

### FYE 2017 Full ARC

Normal Cost (Middle of Year)	\$	16,111,857
Amortization of UAL		29,430,057
<b>Total ARC</b>	<b>\$</b>	<b>45,541,914</b>

### Pay-as-you-go Costs

Pay-as-you-go Cost	\$	24,587,752
Contribution in Excess of Pay-Go	\$	15,924,678
Full ARC in Excess of Pay-Go	\$	20,954,162
Weight to System Return		75.998%

### Expected Returns

Expected Return on Plan Assets		6.88%
Expected Return on City Assets		3.00%
<b>Blended Discount Rate</b>		<b>5.90%</b>

- When the Full ARC isn't contributed, the discount rate is a blend between:
  - Expected return on Plan assets
  - Expected return on City assets
- This year, the blended discount rate went from 6.0% to 5.9%

# GASB Valuation Results



Unfunded Actuarial Liability (UAL) – GASB Basis				
	Medical		Dental	Total
	Implicit	Explicit		
Present Value of Future Benefits				
Retirees and Beneficiaries	\$ 34,904	\$ 389,728	\$ 43,599	\$ 468,231
Term Vested Members	352	3,115	306	3,772
Active Employees	35,873	405,961	38,585	480,419
Total	\$ 71,129	\$ 798,804	\$ 82,489	\$ 952,422
Present Value of Future Normal Costs	10,638	148,979	13,933	173,551
<b>Actuarial Liability</b>	<b>\$ 60,491</b>	<b>\$ 649,824</b>	<b>\$ 68,556</b>	<b>\$ 778,871</b>
Actuarial Value of Assets	0	125,683	9,524	135,207
<b>Unfunded Actuarial Liability</b>	<b>\$ 60,491</b>	<b>\$ 524,141</b>	<b>\$ 59,032</b>	<b>\$ 643,664</b>

*Dollar amounts in thousands*

- The funding valuation does not include the implicit subsidy, but the GASB valuation does

# GASB Valuation Results



GASB ARC		
Fiscal Year Ending	6/30/2017	6/30/2016
Discount Rate	5.90%	6.00%
Total Normal Cost	\$ 20,898	\$ 19,822
UAL Amortization	31,130	30,612
Total Cost	\$ 52,028	\$ 50,434
Employee Contributions	18,647	17,740
<b>Total ARC</b>	<b>\$ 33,381</b>	<b>\$ 32,694</b>

*Dollar amounts in thousands*

- The total normal cost plus UAL amortization payment increased about \$1.6 million
- Employee contributions are expected to increase about \$0.9 million, resulting in an increase in the ARC of \$0.7 million
- As total contributions increase, the blended discount rate will approach the expected return on assets, reducing the ARC
- As employee contributions increase, the portion of the total cost attributable to the City decreases, reducing the ARC

# GASB Valuation Results



Development of Net OPEB Obligation			
		Projected 6/30/2017	6/30/2016
1. Net OPEB Obligation, beginning of year	\$	284,423,908	\$ 269,423,883
2. Annual Required Contribution	\$	33,380,844	\$ 32,693,530
3. Interest on Net OPEB Obligation		16,781,011	16,165,433
4. Adjustment to Annual Required Contribution		(13,755,638)	(13,192,114)
5. Annual OPEB Cost (2.) + (3.) – (4.)	\$	36,406,217	\$ 35,666,849
6. Employer Contributions		20,266,267	19,278,323
7. Implicit Rate Subsidy		1,598,907	1,388,501
8. Net OPEB Obligation, end of year (1.) + (5.) - (6.) - (7.)	\$	298,964,951	\$ 284,423,908

- The Net OPEB Obligation is expected to increase in FYE 2017 as City contributions are less than the Annual OPEB Cost

# GASB Valuation Results



- GASB adopted significant changes for OPEB accounting effective for FYE 2017 and FYE 2018 for the Plan and City, respectively
  - Changes are similar to pension changes we have just implemented
  - No ARC or Net OPEB Obligation
  - Discount rate is determined by a new methodology that is driven by expected future contributions instead of current contributions
  - Entire unfunded liability is disclosed on the City's statement of net position
  - Annual expense is very volatile
  - Doesn't necessarily change contribution strategy

# Questions





# Required Disclosures



- The purpose of this presentation is to present selected results of the June 30, 2016 Actuarial Valuation Report 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. This presentation is not intended to benefit any third party and Cheiron assumes no duty or liability to any such party.
- In preparing the valuation, we relied on information (some oral and some written) supplied by the City of San José. 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. Please refer to the full June 30, 2016 Actuarial Valuation Report for a complete description of the plan provisions, assumptions, methods, and a summary of the data used in the actuarial valuation.
- This valuation does not reflect future changes in benefits, penalties, taxes, or administrative costs that may be required as a result of the Patient Protection and Affordable Care Act of 2010, related legislation, or regulations.
- Recently adopted GASB Statements for OPEB accounting and financial reporting will significantly change the projection of accounting results. The new statements will be effective for the fiscal year ending June 30, 2017 for the Plan and fiscal year ending June 30, 2018 for the City. The provisions of these statements are not reflected in this presentation.
- To the best of our knowledge, this presentation has been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. 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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*February 2, 2017*



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