

San José Federated
Postemployment Healthcare Plan



Assumptions for June 30, 2018 OPEB Actuarial Valuation

December 20, 2018

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Agenda



- Background
- Contribution Policy Overview
- Discount Rate
- OPEB Assumptions
- Board Decisions
 - Adopt Discount Rate
 - Adopt OPEB Assumptions

Background



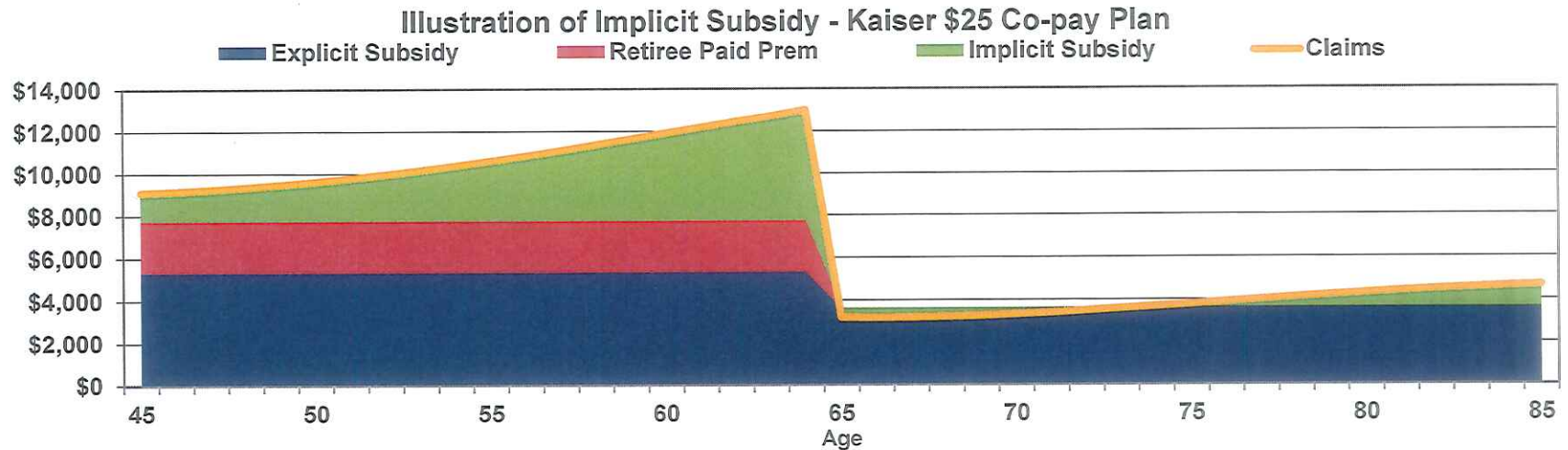
- June 30, 2018 valuation:
 - Develops City contribution for FYE 2020
 - Used as basis for GASB 74/75 valuation in September for FYE 2019
- Measure F made substantial changes to the retiree healthcare plan
 - Established VEBA for Tier 2 members and offered one-time election to Tier 1 members
 - VEBA Members on service-connected disability receive DB OPEB benefits for employee only coverage to age 65 once VEBA funds exhausted
 - Can use VEBA funds to pay self-supporting premiums for City retiree health plans
 - DB plan retired members may take a credit “in lieu” of current benefits that may be applied to future premiums
 - Active members contribute 7.5% of pay

Two Types of Subsidies



- Benefits in the plan are based on an **explicit** (premium) subsidy plus an **implicit** subsidy
- Explicit subsidy (i.e., premium subsidy)
 - The trust 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
- Implicit subsidy
 - Difference between the expected claims cost for a retiree or spouse and the total (retiree + city) premium
 - Applicable for non-Medicare retirees only

Illustration of Subsidies



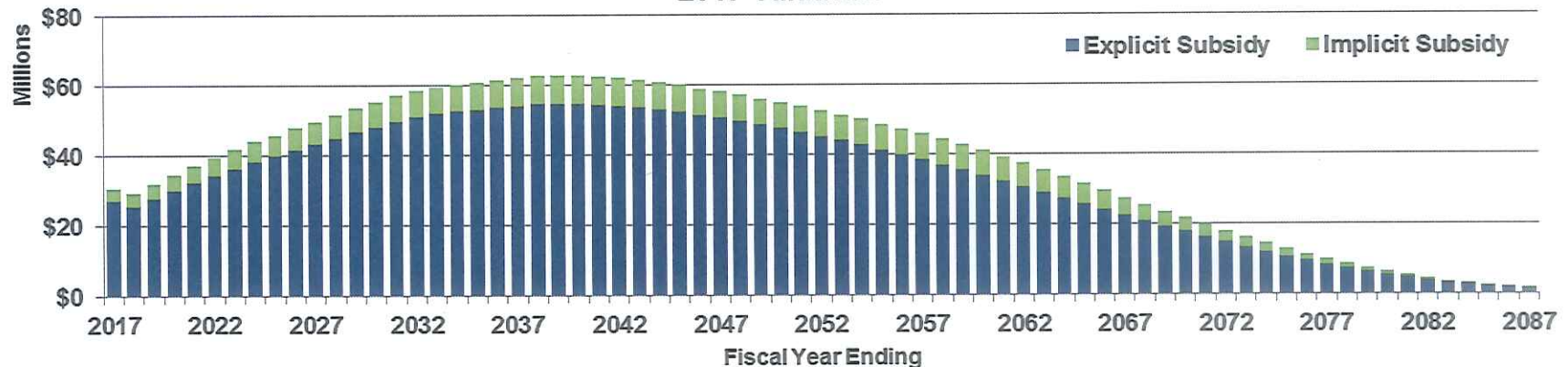
Member Age 64 Illustration

| | 2018 | 2019 | % Change |
|---------------------------------|------------------|------------------|-------------|
| Explicit Subsidy | \$ 4,916 | \$ 5,340 | 8.6% |
| Retiree Paid Premium | <u>2,210</u> | <u>2,401</u> | 8.6% |
| Kaiser \$25 Co-Pay Plan Premium | \$ 7,126 | \$ 7,741 | 8.6% |
| Implicit Subsidy | <u>5,341</u> | <u>5,261</u> | -1.5% |
| Total Claims | \$ 12,467 | \$ 13,002 | 4.3% |

Projected Benefit Payments



Projected Benefit Payments
2017 Valuation



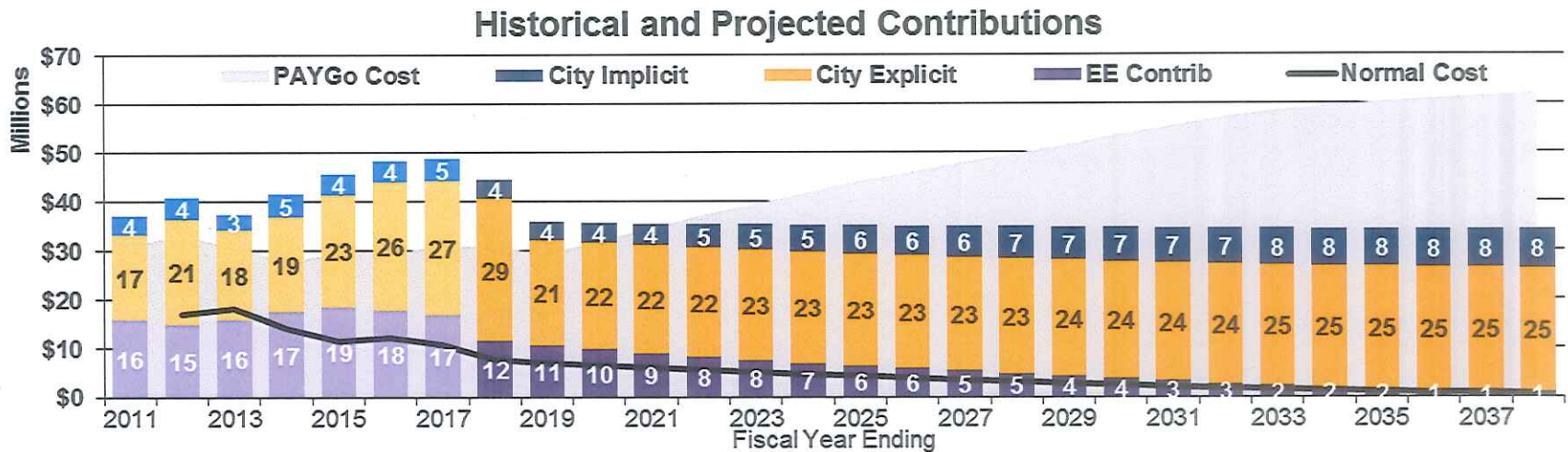
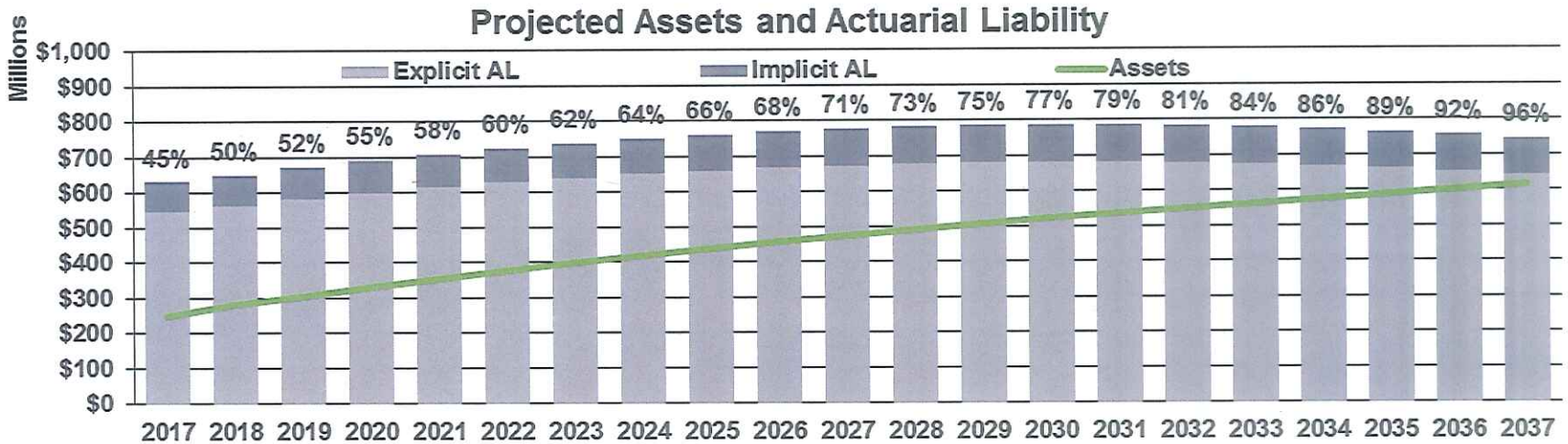
- Even though the plan is closed, projected benefit payments extend over a long period
- The implicit subsidy is a relatively minor portion of the total benefit projected to be paid

Contribution Policy – Set by Board



- Implicit Subsidy – Pay-as-you-go
 - Paid as a part of active member medical premiums
- Explicit Subsidy – Prefunded through 115 Trust
 - City contributions equal normal cost plus level dollar amortization of UAL less member contributions
 - UAL changes are amortized over 20 years with a 3-year phase-in and out
 - City can cap its contribution at 14% of payroll

2017 Valuation Results





Assumptions

Assumptions for 2018 Valuation



- Where applicable, the same assumptions are used as in the pension valuation
- While the assets are invested in two separate trusts, the 401(h) account will be exhausted soon
 - Discount rate is based on expected return for the 115 Trust
- In addition, the following specific OPEB assumptions are used:
 - Claims costs
 - Plan elections
 - Dependent coverage elections
 - Health care trend rates

Expected Return on Assets



- Meketa provided forward-looking capital market assumptions
 - 10-Year Horizon
 - 20-Year Horizon
- Expectations are 50-60 basis points lower than for the pension trust
- Appendix shows Meketa's assumptions by asset class and the assumed asset allocation
- We recommend a discount rate between 6.25% and 6.75%

| Expected Distribution of Average Annual Passive Returns | | |
|--|--------------|----------|
| Percentile | Time Horizon | |
| | 10 Years | 20 Years |
| 95th | 11.8% | 11.1% |
| 75th | 8.1% | 8.5% |
| 60th | 6.5% | 7.4% |
| 55th | 6.0% | 7.1% |
| 50th | 5.6% | 6.8% |
| 45th | 5.1% | 6.4% |
| 40th | 4.6% | 6.1% |
| 25th | 3.1% | 5.0% |
| 5th | -0.4% | 2.5% |

Changes in Explicit Subsidy



| Maximum Annual Explicit Subsidy | | | | |
|---------------------------------|-------------|-----------------|---------------------|-----------------|
| Year | Member Only | Member + Spouse | Member + Child(ren) | Member + Family |
| 2015 | \$5,397 | \$10,794 | \$9,444 | \$16,190 |
| 2016 | \$5,603 | \$11,206 | \$9,805 | \$16,809 |
| 2017 | \$5,882 | \$11,765 | \$10,294 | \$17,647 |
| 2018 | \$4,916 | \$9,833 | \$8,604 | \$14,749 |
| 2019 | \$5,340 | \$10,681 | \$9,346 | \$16,021 |

- The maximum explicit subsidy is the premium for the lowest cost health plan offered to active employees
 - The lowest cost plan in 2019 remains the Kaiser \$3,000 deductible plan
- The maximum explicit subsidy paid by the City will increase from 2018 to 2019 by 8.6% for all coverage levels
 - Assumed increase was 8.0%
 - All pre-Medicare plans receive this level of subsidy
 - Some Medicare-eligible plans have premiums below the maximum subsidy

Aggregate Claims Costs



| Age | FYE 2019 | | FYE 2018 | | % change | |
|----------------|----------|----------|----------|----------|----------|--------|
| | Male | Female | Male | Female | Male | Female |
| Medical | | | | | | |
| 50 | \$9,029 | \$10,301 | \$8,556 | \$9,758 | 5.5% | 5.6% |
| 55 | \$10,226 | \$11,123 | \$9,678 | \$10,525 | 5.7% | 5.7% |
| 60 | \$12,186 | \$11,877 | \$11,520 | \$11,227 | 5.8% | 5.8% |
| 64 | \$14,516 | \$11,809 | \$13,713 | \$11,156 | 5.9% | 5.9% |
| 65 | \$4,447 | \$3,923 | \$4,387 | \$3,870 | 1.4% | 1.4% |
| 70 | \$4,722 | \$4,000 | \$4,658 | \$3,945 | 1.4% | 1.4% |
| 75 | \$5,428 | \$4,498 | \$5,354 | \$4,437 | 1.4% | 1.4% |
| 80 | \$6,163 | \$5,101 | \$6,080 | \$5,032 | 1.4% | 1.4% |
| 85 | \$6,656 | \$5,574 | \$6,566 | \$5,499 | 1.4% | 1.4% |
| Dental | \$675 | | \$674 | | 0.1% | |

- 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 1/1/2018
- Aggregate claims costs for FYE 2018 are higher than expected prior to Medicare eligibility and lower than expected otherwise

In-Lieu Elections



- 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
- For 2017 valuation, we had no experience and assumed no one elected the “In-Lieu” option
- 2018 experience is very limited

2018 In-Lieu Experience



| | Non-Medicare Eligible | Medicare Eligible | Total |
|-------------------|-----------------------|-------------------|------------|
| No Coverage | 23 | 27 | 50 |
| Retiree Only | 12 | 5 | 17 |
| Retiree/ Spouse | 7 | 1 | 8 |
| Retiree/ Children | 2 | 0 | 2 |
| Family | 23 | 2 | 25 |
| Total | 67 | 35 | 102 |

- In-Lieu option
 - 76 (out of 2,898) current retirees
 - 7 (out of 16) new retirees from vested terminated
 - 19 (out of 111) new retirees from active status
- About 50% did not have San José health coverage last year

2018 In-Lieu Assumptions



- Percentage electing In-Lieu option
 - Current retirees = No additional retirees elect In-Lieu
 - Future retirees eligible for medical coverage
 - Vested terminated members = 50%
 - Active members = 15%
- In-Lieu coverage credit
 - Non-Medicare Eligible
 - 50% Retiree only
 - 10% Retiree / Spouse
 - 40% Family
 - Medicare Eligible
 - 60% Retiree only
 - 40% Retiree / Spouse
- Duration of In-Lieu coverage
 - We have no data for this assumption yet
 - Recommend an initial assumption of 5 years

Plan Elections



| Assumed Plan Elections for Future Retirees* | | | | | | | | |
|---|------------|-----------|-----------|--|------------|-----------|-----------|--|
| | 2018 | 2017 | 2018 | | 2018 | 2017 | 2018 | |
| | Enrollment | Valuation | Valuation | | Enrollment | Valuation | Valuation | |
| Pre-Medicare Medical Plans | | | | Medicare-Eligible Medical Plans | | | | |
| Kaiser DHMO | 12% | 14% | 11% | Kaiser Senior Advantage | 59% | 58% | 58% | |
| Kaiser \$25 Co-pay | 64% | 61% | 64% | BS Medicare HMO | 7% | 8% | 8% | |
| Kaiser HDHP | 8% | 6% | 8% | BS Medicare PPO | 34% | 34% | 34% | |
| Sutter Health DHMO | 1% | 1% | 1% | Dental Plans (All Retirees) | | | | |
| Sutter Health \$20 Co-pay | 5% | 3% | 4% | Delta Dental PPO | 98% | 97% | 97% | |
| Sutter Health Vista | N/A | N/A | 0% | DeltaCare HMO | 2% | 3% | 3% | |
| BS PPO \$25 Co-pay | 12% | N/A | 12% | | | | | |

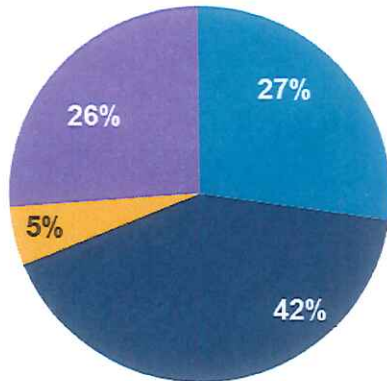
* Eligible for coverage and elect coverage

- Current enrollment for 2018 was compared to the plan election assumptions developed for the June 30, 2017 valuation
- Plan changes introduced for 2018 will impact future enrollment:
 - The Sutter Health Vista \$2,500 deductible plans were not offered in 2018
- We recommend the above minor adjustments for the June 30, 2018 valuation due to these changes

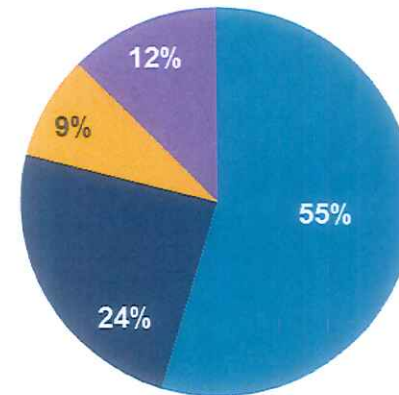
Dependent Coverage Elections



Pre-Medicare - Male



Pre-Medicare - Female



- Ret Only
- Ret/Spouse
- Ret/Children
- Ret/Family

Future Retiree Tier Elections

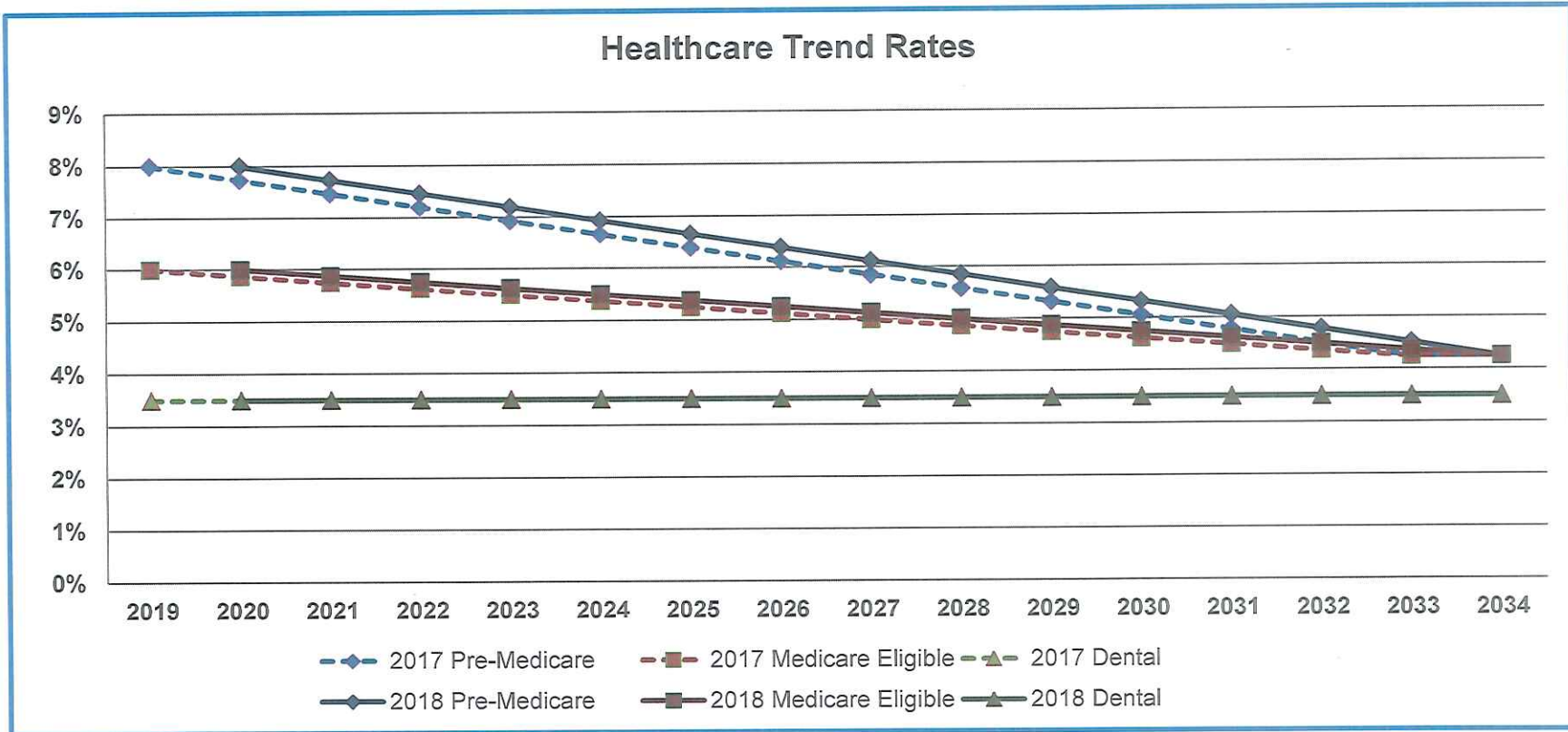
| Coverage Tier | Pre-Medicare | | Medicare | |
|----------------------|--------------|--------|----------|--------|
| | Male | Female | Male | Female |
| Retiree Only | 27% | 55% | 32% | 63% |
| Retiree and Spouse | 42% | 24% | 68% | 37% |
| Retiree and Children | 5% | 9% | 0% | 0% |
| Retiree and Family | 26% | 12% | 0% | 0% |

Healthcare Trend Rates



- Healthcare trend rates generally start at current trend experience and grade down to a projected GDP rate
 - Implication is that health care is a growing percentage of GDP until the ultimate rate is achieved
- We recommend re-starting the trends at the same rate as in the prior valuation
 - No change to the ultimate trend rate for medical

Healthcare Trend Rates



| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 2017 Pre-Medicare | 8.00% | 7.73% | 7.46% | 7.20% | 6.93% | 6.66% | 6.39% | 6.13% | 5.86% | 5.59% | 5.32% | 5.05% | 4.79% | 4.52% | 4.25% | 4.25% |
| 2017 Medicare Eligible | 6.00% | 5.88% | 5.75% | 5.63% | 5.50% | 5.38% | 5.25% | 5.13% | 5.00% | 4.88% | 4.75% | 4.63% | 4.50% | 4.38% | 4.25% | 4.25% |
| 2017 Dental | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% |
| 2018 Pre-Medicare | | 8.00% | 7.73% | 7.46% | 7.20% | 6.93% | 6.66% | 6.39% | 6.13% | 5.86% | 5.59% | 5.32% | 5.05% | 4.79% | 4.52% | 4.25% |
| 2018 Medicare Eligible | | 6.00% | 5.88% | 5.75% | 5.63% | 5.50% | 5.38% | 5.25% | 5.13% | 5.00% | 4.88% | 4.75% | 4.63% | 4.50% | 4.38% | 4.25% |
| 2018 Dental | | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% |

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Classic Values, Innovative Advice

Board Decisions



- Adopt discount rate
- Adopt OPEB assumptions

Certification



- The purpose of this presentation is to present recommended assumptions for the June 30, 2018 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.
- 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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Classic Values, Innovative Advice

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Non-Medicare Plan Claims Costs



Age 64 Claims Costs

| | FYE 2019 | | FYE 2018 | | % change | |
|---------------------|----------|----------|----------|----------|----------|--------|
| | Male | Female | Male | Female | Male | Female |
| Medical | | | | | | |
| Kaiser \$25 Co-Pay | \$14,359 | \$11,682 | \$13,774 | \$11,207 | 4.2% | 4.2% |
| Kaiser DHMO | 11,884 | 9,666 | 10,379 | 8,448 | 14.5% | 14.4% |
| Kaiser HDHP | 8,320 | 6,771 | 9,750 | 7,935 | -14.7% | -14.7% |
| BS PPO \$100 Co-Pay | 21,838 | 17,763 | 18,020 | 14,652 | 21.2% | 21.2% |
| Sutter \$20 Co-Pay | 14,660 | 11,923 | 14,575 | 11,855 | 0.6% | 0.6% |
| Sutter DHMO | 14,700 | 11,968 | 13,233 | 10,778 | 11.1% | 11.0% |
| Dental | | | | | | |
| Delta PPO | | \$686 | | \$685 | | 0% |
| DeltaCare HMO | | \$312 | | \$311 | | 0% |

- Claims costs had been expected to increase
 - 8.00% for non-Medicare medical costs
 - 3.50% for dental costs
- Renewal increases were
 - Higher than expected for Blue Shield PPO plans and California Kaiser plans and
 - Lower than expected for all other Plans
- Sutter \$2,500 Claim Curves go into effect 1/1/2019. For the current valuation, it is assumed that no one will elect this plan

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Medicare Eligible Plan Claim Costs



Age 65 Claims Costs

| | <u>FYE 2019</u> | | <u>FYE 2018</u> | | <u>% change</u> | |
|-------------------------|-----------------|---------|-----------------|---------|-----------------|--------|
| | Male | Female | Male | Female | Male | Female |
| Medical | | | | | | |
| Kaiser Senior Advantage | \$3,409 | \$3,007 | \$3,341 | \$2,948 | 2.0% | 2.0% |
| BS PPO | 5,670 | 5,001 | 5,598 | 4,938 | 1.3% | 1.3% |
| BS HMO | 6,779 | 5,980 | 6,819 | 6,015 | -0.6% | -0.6% |
| Dental | | | | | | |
| Delta PPO | | \$686 | | \$685 | | 0% |
| DeltaCare HMO | | \$312 | | \$311 | | 0% |

- Claims costs had been expected to increase
 - 6.00% for Medicare medical costs
 - 3.50% for dental costs
- Renewal increases were
 - Lower than expected for all plans

Appendix – Meketa's CMAs



Federated 115 Trust Portfolio Meketa's Capital Market Assumptions

| Asset Class | Allocation | Standard Deviation | Arithmetic Return | |
|-----------------------------------|---------------|-------------------------|-------------------|-------------|
| | | | 10-Year | 20-Year |
| Short-term Investment Grade Bonds | 29.0% | 1.5% | 1.8% | 3.1% |
| Investment Grade Bonds | 0.0% | 4.0% | 2.8% | 3.7% |
| TIPS | 0.0% | 7.5% | 3.1% | 3.6% |
| US Equity | 28.0% | 18.0% | 7.0% | 8.9% |
| Developed Market Equity (non-US) | 13.0% | 20.0% | 8.1% | 9.1% |
| Emerging Market Equity | 15.0% | 25.0% | 12.1% | 12.5% |
| Core Private Real Estate | 10.0% | 12.0% | 4.8% | 6.2% |
| Natural Resources (Public) | 0.0% | 23.0% | 9.5% | 9.8% |
| Commodities (naive) | 5.0% | 18.0% | 7.0% | 6.2% |
| Infrastructure (Public) | 0.0% | 18.0% | 8.7% | 8.8% |
| Total | 100.0% | 11.8% | 6.2% | 7.4% |
| | | Geometric Return | 5.6% | 6.8% |